Revenue Options Review – Questions and Answers

Q1. Why look at Revenue Options?

A1. The Government of the Northwest Territories reviews its tax (and other revenues) regime on a regular basis. These reviews are completed to ensure the GNWT is raising as much revenue as possible to pay for government programs and services without compromising other objectives such as a strong NWT economy.

The current fiscal outlook shows revenues declining amidst growing expenditures. In fact, unless action is taken, operating deficits are anticipated by as soon as 2018-19.

- **Read more about the NWT Economic Outlook**

The GNWT is aiming for a stable and predictable tax structure that adheres to established tax policy principles, is competitive with other jurisdictions and, to the extent possible, does not negatively affect the NWT economy.

With this in mind, the territorial government is working closely with the 18th Legislative Assembly to review available options and consider whether revenues could possibly help address the fiscal challenges faced by the territory.

It is important to note that while increasing revenues may be part of the solution, we will have to be realistic about what we can and cannot do. Due to a number of factors, it is evident that we cannot solve our fiscal problems solely on the revenue side.

Q2. What are the current main revenue generators for the GNWT?

A2. Over 75 per cent of GNWT revenues come from federal transfers. The largest single source of revenue is the Territorial Formula Financing Grant, which accounts for about two-thirds (68 per cent) of total revenues. Other transfers from Canada, such as the Canada Health Transfer (CHT) and the Canada Social Transfer (CST), account for another 9 per cent. These formula-based transfers are outside the GNWT's ability to influence.

The remaining one-quarter of total revenues comes from own-sources: taxes, fees, charges, resource royalties, investment income, and recoveries. The GNWT has influence over how much revenue it raises from own sources, subject to constraints such as concerns about the cost of living, the need to maintain a competitive tax structure, or the impact that tax increases can have on economic activity.

- **Learn more about where the GNWT's money comes from**

Q3. Why is Revenue Growth slow?

A3. Revenue growth has slowed in recent years; this is primarily because of slower growth in Territorial Formula Financing.

The Territorial Formula Financing Grant is determined by the growth in the NWT population relative to the Canadian population and the growth in provincial/local government expenditures.

The slowdown in the Canadian (including the NWT) economy means provinces are facing slower revenue growth while addressing debt levels, providing them with few options other than to reduce spending. Reduced provincial/local government expenditure growth and flat NWT population growth are the main reasons for the slower Territorial Formula Financing growth.

Weakness in the mining sector has also led to slower growth in own-source revenues than in the past.

Q4. What is the outlook for revenue growth? Can we expect it to improve in the next few years?

A4. Total revenue is expected to decline 1.4 per cent over the five year period to 2019-20 because of a slower NWT economy. This is mainly due to the impact of low commodity prices on the mining sector.

Looking to the longer term, current economic projections show an extended decline in resource production. Potential mining operations will not replace the economic activity of current operations in terms of output or employment, and resource exploration – which is essential for further development – is also declining.

The growth in Territorial Formula Financing Grant, which makes up the majority of GNWT revenues, is also expected to be slow over the medium term. As provinces struggle to return to balanced budgets and also start to pay down large debts, the expectation is that they will continue to restrain their spending. Flat NWT population growth also continues to drag the growth in the Territorial Formula Financing Grant.

Own-source revenue growth has been modest in recent years due to flat population growth and slower economic activity in the NWT. The slower economic activity in the territory is directly linked to low commodity prices and the inability of resource companies to obtain financing for exploration and development. Growth in own-source revenues is likely to remain subdued given the current state of the NWT economy and some own-revenue sources are projected to decline over the next few years.

Q5. What factors does the GNWT look at when assessing revenue options?

A5. As it considers and evaluates options for new revenues, the GNWT uses the following criteria:

- revenue-raising potential: small tax bases limit the amount that can be raised through increased taxation;

- principles of sound tax policy to ensure that the tax system is as predictable, fair, efficient, and simple as possible; and

- impact on the NWT economy, including the need to be competitive with other jurisdictions.

Q6. What revenue options are being considered?

A6. The revenue options considered in this review include opportunities to increase tax rates or introduce new taxes.

Q7. Do the options in this review cover ways to increase the population or stimulate economic growth?

A7. No. The revenue options currently under consideration do not include growing the NWT economy. The GNWT has various economic strategies to encourage economic growth such as the Economic Opportunities Strategy http://www.iti.gov.nt.ca/content/economic-opportunities-strategy and the Mineral Development Strategy http://www.iti.gov.nt.ca/content/mineral-development-strategy.

Q8. Do tax revenues cause Territorial Formula Financing to decrease?

A8. Under Territorial Formula Financing arrangements, the GNWT keeps 100 per cent of tax rate increases and new taxes.

However, if the economy grows, which results in increased tax bases, on average, the GNWT keeps 30 cents for every $1 in extra own source revenue. This is because Territorial Formula Financing arrangements are designed to cover the fiscal gap between GNWT own-source revenues and expenditure needs so as GNWT own source revenues increase, the Territorial Formula Financing Grant declines. However, to provide an incentive to grow our economy, the Grant includes a 30 per cent Economic Development Incentive. In other words, economic activity does increase own-source revenues, but on average 70 per cent of those revenues are offset against Territorial Formula Financing.

The increase in population that results from a strong economy has the greatest effect on increasing total revenues. For every additional person who lives in the NWT, $35,000 is added to the Territorial Formula Financing.

Q9. Would tax increases result in significant revenue increases?

A9. No, the NWT tax base is too small to make increasing taxes the most significant way of aligning our expenditures to our revenues. The small size of the territorial tax base removes the GNWT's ability to generate enough new revenues to solve the fiscal sustainability problem.

Further, increasing the tax burden on businesses and individuals poses its own risks. The NWT's harsh climate, limited infrastructure, and high transportation costs all contribute to the high cost of living, which is reflected in the current NWT tax structure.

Increasing taxes would take money out of the local economy, which affects the cost of living, family pocketbooks, and the bottom line of local businesses. It also reduces the attractiveness of the NWT as a place to do business, live and work. Already, tax revenues are in decline as global events affect the NWT resource-based economy.

The most recent revenue reviews did not result in increased taxes due to concerns surrounding the effect on the economy. The economic considerations are the same, if not more of a consideration, today. The GNWT has very little ability to raise significant new revenues without raising the cost of living and impacting economic growth. The revenue options that are possible in the NWT generate small amounts of own source revenue in comparison to the level of operating expenditures.

Q10. Can the generation of new revenues eliminate the operating deficits that are in the current economic forecast?

A10. The territorial government has limited flexibility on the revenue side of the budget. While the GNWT's fiscal strategy will include looking at tax options, the solution to the fiscal situation will not be realized solely by increasing taxes on NWT residents and businesses.

The few revenue options that could generate significant revenues would discourage business investment and economic growth, and would leave individuals and families with less disposable income at a time when the costs of living are rising.

The negative impact on consumers and businesses must be weighed against the positive effect of increased government spending, especially given the size of the NWT tax base and its small contribution to total revenue.

Q11. Weren't revenues supposed to increase with devolution?

A11. Total revenues did increase with devolution as the GNWT now collects all resource revenues and after the 50 per cent offset under Territorial Formula Financing and the sharing with Aboriginal organization signatories to the Devolution Agreement, the GNWT keeps 37.5 per cent. As well, in 2014-15, $67.5 million was permanently added to the Gross Expenditure Base in the Territorial Formula Financing Grant to pay for the costs to manage NWT lands, waters and non-renewable resources.

However, the primary purpose of devolution was to gain northern control over the management of lands, waters and non-renewable resources; the ability to retain additional resource revenues was part of the agreement, but not a primary consideration.

Resource revenues are very volatile and the GNWT does not use these revenues in the operating budget. For example, since Devolution two years ago, commodity prices have declined and oil exploration and development in the Sahtu region has waned.