







# A Fair Price: Taxation, Services and Programs in the Northwest Territories

by David Thompson

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## Introduction

The Government of the Northwest Territories (Government, GNWT) has undertaken a public consultation on the subject of increasing its revenues.

The Government has stated that it requires additional revenues in order to address a projected budget shortfall, announcing its “commitment to putting its fiscal house in order, including raising new revenue, starting in the 2009-10 fiscal year.”<sup>1</sup>

What the Government is proposing is to increase its “own source revenues” (OSR), the money it raises from its own taxes, fees, etc. This OSR stream accounts for roughly a quarter of the total revenues of the Government, with the balance coming from federal transfer payments.

This report first discusses the Government’s two consultation documents – the Revenue Options Paper and the Revenue Options Summary – which provide the informational foundation for the consultation process. It briefly discusses the capacity of the tax system in furthering social, environmental, and economic goals. The report then examines whether the consultation documents are balanced, and the implications for the consultation process. It then discusses the general structure of the consultation options – raising tax rates vs. growing the tax base – and specifically the viability of the latter option.

The report then examines a number of potential tax adjustments raised in the consultation documents. It makes recommendations for tax adjustments that would serve social, environmental and economic goals, while raising revenues. It then briefly discusses a few taxes adjustments that do not need to be made.

The report concludes with a review of some of the key recommendations for tax adjustments, and for the consultation process itself.

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**1** GNWT, “Finance Document – Press Release September 5th 2008” <http://www.fin.gov.nt.ca/ViewPageData.aspx?PageDataId=52> accessed October 8, 2008.

## The Revenue Options consultation documents

The GNWT has released two principal consultation documents: a Revenue Options Paper of 39 pages and a Revenue Options Summary of 12 pages.<sup>2</sup> This section briefly reviews these two documents.

### Non-fiscal policy goals: tax bads, not goods

Tax systems are used to raise revenues for important public services and programs. In addition, they can, should be, and are used to achieve a range of public policy goals beyond mere revenue-raising.

The Revenue Options Paper acknowledges this, and lists (p. 1) a few traditional policy goals of tax systems:

- promoting economic activity and growth
- redistributing income from higher to lower income individuals
- redistributing income from one region to another
- promoting activities, such as saving for retirement or post-secondary education
- discouraging activities, such as tobacco or alcohol use.

Other policy goals are now also being addressed by tax systems, including environmental sustainability goals, as also noted by the Revenue Options Paper.

The general principle behind using the tax system to support public policy goals is that it is preferable to tax bads, not goods. Instituting or raising taxes on something raises its price, which means less of it will be generated. Conversely, reducing taxes on something means more of it will be generated. So if we want less of something (e.g. pollution) we should tax it and if we want more of something (e.g. income), we should reduce taxes on it.

Furthermore, economists note that some transactions create “externalities.”<sup>3</sup> In theory, the costs and benefits associated with something are reflected in its market price, and thus experienced by the parties to a transaction. However, some transactions have associated costs (e.g. pollution) or benefits (e.g. education) that are not included in prices; those costs and benefits are “externalized,” or experienced by people who are not parties to the transaction. This market failure creates economic inefficiency, as well as creating

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2 Both are available at <http://www.fin.gov.nt.ca/RevenueOptions.aspx> accessed September 30, 2008.

3 See a definition and brief discussion at <http://www.economist.com/research/Economics/alphabetic.cfm?letter=E> accessed September 30, 2008.

inequity by unjustly imposing costs and benefits. However, these costs and benefits can be internalized by fiscal reform – subsidizing positive externalities, and taxing negative externalities. Thus, economic efficiency and fairness provide further reasons to employ the tax system for more than simply raising revenue.

While the Revenue Options Paper rightly lists a relatively wide range of non-fiscal policy goals, other Government communications downplay or ignore goals other than promoting economic activity, growth and savings.<sup>4</sup>

Finally, although the Revenue Options Paper mentions the goals and priorities of the 16th Legislative Assembly (p. 1), it fails to discuss how the revenue options presented would serve those goals and priorities.

### **An anti-tax bias?**

“Taxes are the price we pay for civilization”

– Oliver Wendell Holmes, Jr.

The famous quote by US Supreme Court Justice Holmes is literally true – civilization itself depends on taxes. Imagine a Canada with no police force, no water or sewer systems, and few (if any) roads or hospitals.

Taxes pay for vital services and programs. They represent the pooling of citizens’ wealth so that we can collectively buy things more economically than if we had to buy them as individuals. A vast array of public goods would be undersupplied or non-existent if governments were unable to purchase them with tax revenues.

It is therefore important to regard taxes in a balanced way. While no individual would want to unilaterally increase their own tax payments, collectively we realize that we do need to pay them, and that the payments need to be fair. Thus an anti-tax bias should have no place in tax consultation documents.

Unfortunately, just such an anti-tax bias seems to have made its way into some areas of the two consultation documents.

Of the two, the Revenue Options Paper is much more balanced and shows a greater understanding of the material. From its content, it appears that the Revenue Options Summary was either written or edited by another hand – and one seemingly opposed to taxes. Unfortunately, as is the case with most such pairs of documents, far more people will read the 12-page Summary than the 39-page Paper.

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<sup>4</sup> For example, the Government’s main web page on Resource Options <http://www.fin.gov.nt.ca/RevenueOptions.aspx>. The Revenue Options Summary is also selective about which policy goals it mentions, especially in the context of proposed tax changes, e.g. p. 12 under “Questions to Consider.”

### *Revenue options summary*

- The Foreword of the Summary asserts that raising taxes could have “significant consequences,” that it could “hurt the economy, discourage investment, or even push people into leaving the territory.” It does not say that failure to raise taxes, and the resulting fiscal deficit or inability to invest in infrastructure, programs or services, could have similar effects.
- By framing the choice as being between growing the tax base and increasing tax rates, the Summary implies they are mutually exclusive, and that tax rate increases would drive people away from the NWT. However, there is no evidence presented to support that assumption. Perhaps improved programs and services made possible by higher taxes would expand the tax base. Or perhaps there would be no net influence in either direction.
- The Summary suggests (p. 3) that higher taxes could “reduce economic and population growth as businesses shrink to cut costs, and people make decisions about where and how to live and work.” It goes on for another paragraph in this vein, but fails to mention that higher taxes enable excellent public services and programs. At an international level, higher-tax jurisdictions seem to be correlated with, amongst other things, higher GDP per capita, higher savings rates, and higher growth competitiveness as ranked by the World Economic Forum.<sup>5</sup>
- The Summary asserts (p. 5, top box) certain benefits from lowering personal and corporate income taxes without discussing any of the costs, such as having either a fiscal deficit or a decline in programs or services as a result. Logically, reducing all taxes to zero would result in the dismantling of society as we know it, so lowering taxes cannot be invariably a good thing.
- The Summary asserts that higher income taxes would encourage people to maintain a residence in Alberta and pay tax there (p. 6). However, it provides no numbers or analysis to back up that assertion, quantify the effect, or compare the influence of other factors such as warmer temperatures, proximity to major cities, access to markets, friends and family. It also provides no analysis of whether any potential reduction in the tax base would be outweighed by increased revenues from higher tax rates.
- The Summary also suggests (p. 6) that because the corporate tax rate has been increased once and lowered twice in six years, an

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5 Brooks and Hwong, “The Social Benefits and Economic Costs of Taxation: A Comparison of High- and Low-Tax Countries” (CCPA, 2006) <http://www.policyalternatives.ca/Reports/2006/12/ReportsStudies1507/index.cfm?pa=A2286B2A> accessed October 1, 2008.

increase would create the impression that the NWT is not a “stable and predictable” place to invest. Does this same consideration apply to tax decreases, or only to increases? Has the Government ever used this stability and predictability argument to oppose tax cuts for corporations?

- 6 While this is in the context of downplaying the idea, it does allow for it as a possibility.
- 7 See, for example: Richard Kogan and Aviva Aron-Dine, “Claim That Tax Cuts ‘Pay For Themselves’ Is Too Good To Be True” (Center on Budget and Policy Priorities, July 27, 2006) <http://www.cbpp.org/3-8-06tax.htm> accessed September 30, 2008; Mark Thoma, “Do Tax Cuts Ever Raise Revenues” (Dept of Economics, University of Oregon, Dec 10, 2007) <http://economistsview.typepad.com/economistsview/2007/12/do-tax-cuts-eve.html> accessed September 30, 2008; and sources cited therein.
- 8 The CBO study estimates a recovery of 1% - 32%, at most. Congressional Budget Office, “Economic and Budget Issue Brief: Analyzing the Economic and Budgetary Effects of a 10 Percent Cut in Income Tax Rates” (December 1, 2005) <http://www.cbo.gov/ftpdocs/69xx/doc6908/12-01-10PercentTaxCut.pdf> accessed September 30, 2008.

\* Other Government communications share an anti-tax bias. For instance, the phrase “tax relief” (popularized by a US pollster as part of a campaign to demonize taxation, government and public services) is now used by the GNWT. On “tax relief,” Frank Luntz, and his influence in Canada, see: Gardner, “Spin doctor phrases sprout like mushrooms from tax announcement” (Edmonton Journal, Nov. 4, 2007) <http://www.dangardner.ca/Colnov0207.html>; Berkowitz, “Spurned by Washington Republicans, Frank Luntz turns to Canada” (Media Transparency, May 2006) <http://www.mediatransparency.org/story.php?storyID=129>; and Lakoff, Don’t Think of an Elephant (Chelsea Green, 2005) ch.1 [http://www.chelseagreen.com/bookstore/item/dont\\_think\\_of\\_an\\_elephant:paperback/chapter\\_1](http://www.chelseagreen.com/bookstore/item/dont_think_of_an_elephant:paperback/chapter_1). For a Google advanced search of “tax relief” at gov.nt.ca, see [http://www.google.ca/search?hl=en&as\\_q=&as\\_epq=tax+relief&as\\_oq=&as\\_eq=&num=10&lr=&as\\_filetype=&ft=i&as\\_sitesearch=gov.nt.ca&as\\_qdr=all&as\\_rights=&as\\_occt=any&cr=&as\\_nlo=&as\\_nhi=&safe=images](http://www.google.ca/search?hl=en&as_q=&as_epq=tax+relief&as_oq=&as_eq=&num=10&lr=&as_filetype=&ft=i&as_sitesearch=gov.nt.ca&as_qdr=all&as_rights=&as_occt=any&cr=&as_nlo=&as_nhi=&safe=images)

- Overall, the Summary provides a strictly negative picture of capital taxes (p.9):
  - ◊ Apart from the two sentences explaining what a capital tax is and how much money it could raise, every other sentence provides arguments against them.
  - ◊ It fails to mention the fact that capital taxes allow revenues to be raised when corporations employ accounting practices to avoid paying income taxes.
  - ◊ It asserts that a capital tax would “undermine” the Government’s objective of attracting investment and “fostering greater opportunities for Northerners,” without providing any evidence to support or even explain what is meant by this ominous-sounding but vague expression.
  - ◊ In terms of fairness, it also fails to mention the fact that individuals and families are already taxed on their major capital asset (their home).

### *Revenue options paper*

As noted earlier, the Revenue Options Paper is the more balanced of the two, and it contains fewer instances of an apparent anti-tax bias. However, it does suggest (p. 9) that reduced tax rates can result in higher revenues.<sup>6</sup> The notion that lower tax rates stimulate economic activity enough to result in higher revenues has been de-bunked.<sup>7</sup> While some politicians (a shrinking number) still make this claim, professional economists do not, and a 2006 study by the Congressional Budget Office of the United States confirmed that tax cuts do not result in revenue increases.<sup>8</sup> This discredited idea should not have been raised in a serious consultation paper.

### *Conclusion*

It is unfortunate that an anti-tax bias appears to have been injected into the consultation documents, as they are the primary sources of information that members of the public will rely upon to understand the options and provide their input to the Government.\*

Whether this anti-tax bias was intentional or not, it will likely affect the input that the Government receives from the public. The input will likely lean further away from taxes than it would have if the consultation documents had been balanced.<sup>9</sup>

As such, it would be appropriate to withdraw these documents, end this round of consultations, and start over. In a subsequent round of consultations, a balanced set of consultation documents needs to be released – documents that identify all the realistic options and the costs and benefits of each, and attempt to assess them where possible. A set of organizations representing the full range of views about taxes and the public services that they support should be appointed to a balanced steering committee that approves the text of all communications with the public. Such a committee should receive independent input and advice from academic advisors with a wide range of views.

### **Recommendations**

The current round of consultations should be scrapped. A small consultation steering committee should be struck to prepare new consultation documents and communications materials. The committee should be comprised of a balanced set of representatives from organizations bearing a full range of views on taxes. This committee should receive the independent advice and input of academics knowledgeable about both public finance and communications, who likewise reflect a balanced set of views. The committee's work should be carried out within three to four weeks.

### **Growing the base vs. raising taxes**

The Revenue Options Paper frames (e.g. at p. 3) the discussion as being a choice between two options for increasing revenues: growing the tax base or increasing tax rates.

However, the Paper fails to present any calculations on how much the tax base would need to grow per revenue dollar generated. Considering that growing the tax base is presented as one of only two options, presenting such calculations should be regarded as a vital part of the discussion. The Paper also should have indicated how much growth is actually projected by the Government.

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<sup>9</sup> International Communications Association, "Study Explains Role of Bias in Policy Discussions: Education About Policy Issues May Also Increase Deference to Decision Makers" (January 2008) <http://www.icahdq.org/aboutica/press/policybias.asp> accessed September 22, 2008.

There are two ways to grow the tax base: growing the economy and growing the population. However, the Resource Options Paper acknowledges that the normal link between growing the tax base and increases in revenues is “relatively weak” (p.7). This applies to both growing the economy and growing the population.

### *Growing the tax base: the economy*

In the NWT, there are two factors that pose challenges to growing revenues through growing the economy.

First, the economy is highly dependent upon resource extraction, and transactions relating to that industry are not always taxed within the NWT. According to the Revenue Options Paper, “most” of the goods, equipment, and machinery for resource development projects are purchased in the south (p. 7). Furthermore, many workers employed in those industries claim a residence in the south; the “share of NWT labour income earned by non-residents was about 18 per cent in 2007.”<sup>10</sup> Thus when the NWT economy grows, much of the tax base growth actually takes place in the south, not in the NWT.

Second, to whatever extent the tax base does grow within the NWT, the overall government revenues will grow much less because 70% of increases in own-source revenues will be clawed back by reductions in federal transfers.<sup>11</sup> In contrast, increases in own-source revenues as a result of tax rate increases or new taxes are not clawed back.<sup>12</sup>

Finally, it should be noted that economic growth is not without costs to the public purse. Increased economic activity requires government spending on infrastructure and services. What is needed in order to fill a potential budget gap is not increases in revenue, but increases in net revenue.

### *Growing the tax base: the population*

The Revenue Options Paper suggests (p. 9) that each additional resident will bring \$22,000 in revenues received from the federal government, plus tax revenue paid locally.

It fails to provide the costs associated with each additional resident, even though it is clear that there will be costs. It states that costs will “likely” be less than additional revenue, due to economies of scale. In other words, it is unclear what the net revenue of additional residents would be.

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**10** Revenue Options Paper at p. 10.

**11** Revenue Options Paper at pp. 8, 11.

**12** Revenue Options Paper at pp. 3, 12.

Without stating even approximate costs, the Paper draws undue attention to the \$22,000 gross revenue figure. This could encourage some to argue that population growth is a simple solution to the need for higher net revenues.<sup>13</sup>

### *Tax base vs. tax rates: a false choice*

Framing the choice as being between growing the tax base and increasing tax rates implies that the two are mutually exclusive in the NWT. However, there is no evidence presented to support that assumption.

Perhaps improved fiscal stability and attractive programs and services (enabled by higher taxes) would bring new taxpayers to the NWT. Perhaps strategic tax shifts between different sources would grow both revenues and the tax base, as they address externalities and shrink economic distortions. There could also be no net influence in either direction. In any event, the assumption made has not been justified with any evidence.

In sum, it appears that raising revenues by growing the tax base – either through economic growth or population growth – is not a simple matter. The Government has provided no figures on expected net revenue growth for either strategy, nor has it clearly explained how it would actually go about growing the tax base through fiscal policy.<sup>14</sup> Finally, it must be borne in mind that any revenue increases from growing the tax base would be largely clawed back from federal transfer payments.

With no analysis of how much revenue would be generated by growing the tax base, and no clear explanation of how fiscal changes would grow the base, it is difficult to treat this as a serious option.

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**13** For example, perhaps, Yellowknife Chamber of Commerce "Draft response to the GNWT revenue "options response" paper (at p.1)."

**14** As explained earlier, tax cuts would not grow the base sufficiently to offset their own revenue losses.

## Taxation changes needed

Below is a brief discussion of several taxation options, and recommendations for adjustments to the tax system. These recommendations include decreases in some tax rates, increases in others, and no change in others.

The recommendations include:

- For individuals, reductions in income and payroll tax for the large majority of people (not the highest income earners), and a payroll tax increase for high income earners so as to capture revenue “leakage.”
- For corporations, no income tax increases, except a new Resource Income Tax to capture some resource rents. These rents would be placed in a Territorial Trust Fund, which could finance future investments in human capital and energy efficiency.
- On consumption, no new sales tax, but rather targeted taxes on things that cause harm, like tobacco and pollution.

Overall, the changes proposed below would make income taxation more progressive, and would help to accomplish important public policy goals such as health promotion, resource conservation, and environmental protection. For some proposed changes, this report recommends phasing in the changes over time to make future changes gradual and predictable, enabling firms and individuals to arrange their affairs to as to minimize their costs over time.

The changes proposed below are part of an integral package. For instance, the ability to recommend income tax cuts for the majority hinges on increases in other taxes. It is a favourite game of some politicians to accept recommendations selectively, cherry picking the ones that are immediately popular while leaving behind others that may be equally or more necessary. This report should not be seen as supporting such a strategy.

### **Corporate and resource income taxes, and savings**

Unlike provincial governments, the GNWT has no authority to collect royalties on mining and fossil fuel extraction, and it appears unlikely to obtain that authority soon. If it did, federal transfer payments would then be reduced. Despite the attention that the GNWT draws to the ongoing royalty discussions, there is little point in hoping for royalties as a means of significantly raising overall revenues. Simply put, the GNWT will need to make other arrangements.

This said, royalties are only one mechanism for collecting the “rents” (a.k.a. supernormal,<sup>15</sup> windfall, or excess profits) from natural resource developments. A resource income tax is another mechanism.

At the rates and with the structure discussed in the Revenue Options paper (p. 23), a resource income tax could yield approximately \$34 million per year per diamond mine. Multiplied by the number of diamond mines, and adding significant resource income tax revenues from other mines and from oil and gas extraction, would yield total revenues on the order of hundreds of millions of dollars per year.

*It is within the power of the GNWT to establish a resource income tax that could capture substantial resource rents. So far it has failed to do so. The consequent loss of rents is the sole responsibility of the GNWT – not the federal government.*

Such numbers, while large,<sup>16</sup> should not be regarded as a potential bonanza for the current generation. Minerals and fossil fuels are non-renewable resources and will decline over time. Rents from their extraction should not be used to finance ordinary government operations; ordinary taxes should be used for that purpose. Because rents are derived from natural capital stocks, they should be converted to other forms of capital that will provide benefits for future years when the party is over and the natural capital is depleted.

It is important to reiterate and vital to bear in mind that the party will indeed, some day, be over; mining and fossil fuel extraction will not always fuel enormous economic activity. When that day comes, if the NWT has not made the right investments it will face large budget shortfalls, not to mention economic shrinkage, increased poverty and out-migration.

A Territorial Trust Fund, akin to those of Alaska or Norway, could be established to receive all the resource income tax revenues. It would then assist in financing public services and programs in the future, when the resource economy dwindles. It should be inflation-proofed, and its financial capital should be protected from premature withdrawal. A portion of its earnings (above that required for inflation proofing) could be used for appropriate investments. Such investments could include those in education (human capital) and renewable energy infrastructure (built capital) that will help sustain an economy and population in the North when resource income dwindles.<sup>17</sup>

**15** “Normal” profit rates (a.k.a. normal returns on investment) are those available elsewhere on competitive capital markets with commensurate risks.

**16** By way of comparison, the Government estimates own-source revenues of about \$300 million per year (Revenue Options p.13), or about a quarter of overall revenues.

**17** For further discussions of trust funds, see Austvik, “Reflections on permanent funds: The Norwegian pension fund experience” (Gordon Foundation, May 4, 2007) [http://www.gordonfn.org/resfiles/Forum\\_Permanent\\_Funds\\_indd.pdf](http://www.gordonfn.org/resfiles/Forum_Permanent_Funds_indd.pdf); “Saving for the Future: Fiscal Responsibility and Budget Discipline in Alberta” (Parkland Institute, April 2008) <http://www.ualberta.ca/PARKLAND/research/studies/index.html> accessed October 7, 2008 and sources cited therein.

There are types of spending that would not be good investments because they would not pay off when the resource boom goes bust. Road spending is one example: a road system that is overbuilt for the future economy would saddle the public purse with significant – possibly unaffordable – legacy maintenance costs.

The Revenue Options Paper suggests that a resource income tax “would require further analysis to fully understand the implications for the resource industry.” This is no doubt true, and one of the chief considerations in that analysis should be to anticipate the inevitable decline of that industry, and how the Government will – in the meantime – collect the savings that will be needed to finance future services and programs. Nevertheless, many other jurisdictions already levy such taxes, and an appropriate study could be completed in a few months. The need for further analysis is no excuse for failure to act.

The economy of the NWT is dominated by resource extraction industries. Given the need to diversify the economy away from those industries and into other areas, this report proposes that a resource income tax be established, and that income tax rates on other corporations not be raised.

However, the GNWT should work with other jurisdictions to stop corporate income tax competition.<sup>18</sup> Also known as the “race to the bottom,” tax competition means that provinces and territories (and countries) reduce corporate taxes in order to draw businesses away from each other. In the long run, such competition means that all jurisdictions end up with lower tax revenues, and the competitiveness “gains” of all the tax cuts made along the way have disappeared. At the same time, taxes have been shifted off of corporations and onto individuals.

### Recommendation

A resource income tax should be instituted at the rates discussed in the Revenue Options Paper, with the proceeds flowing into an arms-length Territorial Trust Fund. The Trust Fund would save and inflation-proof the capital in order to satisfy public spending needs when resource revenues dwindle. It could spend a portion of its earnings on investments in human capital (education) and built capital (renewable energy infrastructure).

### Recommendation

The GNWT should pursue agreements with other jurisdictions in Canada, and beyond, to halt the destructive “race to the bottom” of corporate income tax competition. Current corporate income tax rates should be stabilized, and negotiations should begin to steadily restore corporate income tax rates.

**18** See Organization for Economic Cooperation and Development, “Harmful Tax Competition: An Emerging Global Issue” <http://www.oecd.org/dataoecd/33/1/1904184.pdf>; European Commission, Taxation and Customs Union, “Harmful Tax Competition” [http://ec.europa.eu/taxation\\_customs/taxation/company\\_tax/harmful\\_tax\\_practices/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/company_tax/harmful_tax_practices/index_en.htm); and Kristian Weise, “Corporate Tax Warning” (OECD Observer, May 2007) [http://www.oecdobserver.org/news/printpage.php/aid/2229/Corporate\\_tax\\_warning.html](http://www.oecdobserver.org/news/printpage.php/aid/2229/Corporate_tax_warning.html) all accessed October 1, 2008.

## Capital tax

Corporations are able to avoid income taxes using a number of means, including transfer pricing to reduce profits, claiming large capital costs allowances, inflating other expenses, or claiming to be in the resource “development” stage instead of the production stage. A capital tax would allow at least some revenues to be raised from all corporations with capital. Most provinces and territories have capital taxes,<sup>19</sup> while the NWT does not. The federal government removed its capital tax in 2006, thus creating tax room for a capital tax in the NWT.

### Recommendation

Institute a capital tax of 0.3% on the paid-up capital of large corporations and 1% on the paid-up capital of financial institutions (mainly chartered banks), phased in over two years. This would generate approximately \$12.6 million per year by year two.<sup>20</sup>

- 19** Revenue Options Paper at p.38.
- 20** Revenue Options Paper at p.22.
- 21** Statistics Canada, “2006 Census; Table 1: Median earnings, in 2005 constant dollars, of full-time full-year earners by quintile, Canada, 1980 to 2005” <http://www12.statcan.ca/english/census06/analysis/income/tables/table1.htm>; Earnings and Incomes of Canadians Over the Past Quarter Century, 2006 Census: Family earnings – Greater inequality in family earnings <http://www12.statcan.ca/english/census06/analysis/income/eicopqc18.cfm> all accessed September 20, 2008
- 22** Statistics Canada “2006 Census: Table 3 Median earnings, 2005 constant dollars, of full-time full-year earners, provinces and territories, 1980 to 2005 <http://www12.statcan.ca/english/census06/analysis/income/tables/table3.htm> accessed September 20, 2008.
- 23** Statistics Canada, “2006 Census Highlights: Earnings and Incomes of Canadians Over the Past Quarter Century” <http://www12.statcan.ca/english/census06/analysis/income/highlights.cfm> accessed September 20, 2008.
- 24** GNWT, “Income Security – Breaking Down the Barriers of Poverty Promoting Self Reliance” July 2007) at p.5 [http://www.ece.gov.nt.ca/NEW\\_Items/Income%20Security%20-%20Breaking%20Down%20the%20Barriers%20of%20Poverty%20Promoting%20Self%20Reliance.pdf](http://www.ece.gov.nt.ca/NEW_Items/Income%20Security%20-%20Breaking%20Down%20the%20Barriers%20of%20Poverty%20Promoting%20Self%20Reliance.pdf) accessed October 7, 2008.

## Personal income taxes

Combined, the income tax and payroll tax on individuals constitutes the biggest source of revenues of the GNWT. Yet income is a good, not a bad; we want people to earn more income, boost economic activity, and be able to save for retirement.

At the same time, there is a growing gap between high income earners and low income earners in Canada.<sup>21</sup> NWT median income is the highest in Canada,<sup>22</sup> and it rose by over 19% in real terms between 1980 and 2005.<sup>23</sup> However, there is still a serious problem with poverty. While the cost of living in the Territories is acknowledged to be high, over 15% of households have incomes below \$30,000 per year.<sup>24</sup> The fiscal system can and should address inequality through progressive redistribution of income.

For the above reasons, this report proposes a reduction of income tax rates for lower and middle income earners. At the same time, it must be recognized that some lower income people don’t file income tax returns, and so fairness suggests that income tax reductions be complemented by income assistance increases.

### Recommendation

The tax rates for all but the highest tax bracket should be reduced. Specifically, the tax rate for lowest bracket should be reduced by 3%, the next lowest by 2%, and the next by 1%. For the subsequent three years, the rates for each of those brackets should

be reduced by a further 1% per year. This would mean income tax reductions for the large majority of income earners in the NWT, and no taxes on the first \$35,986 earned by all taxpayers. This would result in a reduction in revenues on the order of \$18.5 million in the first year,<sup>25</sup> and a further \$24 million by the third subsequent year.<sup>26</sup>

### Recommendation

Income support for lower income people, many of whom don't file income tax returns, should be increased.

### Payroll taxes

The GNWT loses millions of dollars per year as a result of people who earn incomes in the NWT but who claim a residence and pay income taxes elsewhere. The Government estimates that the "share of NWT labour income earned by non-residents was about 18 per cent in 2007."<sup>27</sup> This would constitute a loss on the order of \$12 million per year.<sup>28</sup>

Restructuring taxes can help reduce this leakage. Income taxes are paid where the income-earner resides, while payroll taxes are paid in the NWT. Payroll taxes, which are levied on employees but collected by employers, could be increased in order to reduce the revenue leakage.

Which employees work in the NWT but reside in the south? As noted in the Revenue Options Paper (pp. 6, 17), those with higher incomes tend to be more mobile. The problem of some people working in the NWT and paying taxes elsewhere is likely far more important toward the high end of the income scale.

The NWT's top combined marginal personal income tax rate is the fourth-lowest in Canada, and 6% below the national average.<sup>29</sup> So there is room to increase the payroll tax for high income earners. Because lower income people are less likely to work in the NWT and pay taxes elsewhere, the rate on lower income brackets could be reduced.

### Recommendation

The payroll tax rate should be increased from 2% to 2.5% on wages and salaries above the 75th percentile of today's income distribution.<sup>31</sup> For wages and salaries below this level, the payroll tax rate should be decreased by an amount that would roughly maintain the total payroll tax collected. This would provide for a revenue-neutral<sup>32</sup> adjustment of the payroll tax to make it more

**25** Based on revenues estimated for 2% increases in each bracket in Revenue Options Paper at p. 16.

**26** It is important to bear in mind the discussion above, in which it was pointed out that such a significant tax reduction would hinge on other tax increases occurring. This report does not support "cherry picking" of immediately politically popular ideas while necessary changes are ignored.

**27** Revenue Options Paper at p. 10.

**28** Assumes 18% of \$68 million in personal income taxes (Revenue Options Paper, p.13).

**29** Thompson, "Public Service Cuts in the Northwest Territories: Economic Imperative or Political Choice?" (Parkland Institute, 2008) at pp. 17-18 <http://www.alternativesnorth.ca/pdf/>

**30** Lee, "Eroding Tax Fairness: Tax Incidence in Canada, 1990 to 2005" (CCPA, Nov 2007) at p.4 [http://www.policyalternatives.ca/documents/National\\_Office\\_Pubs/2007/Eroding\\_Tax\\_Fairness\\_web.pdf](http://www.policyalternatives.ca/documents/National_Office_Pubs/2007/Eroding_Tax_Fairness_web.pdf) accessed October 9, 2008.

**31** Following the income tax bracket system, earnings up to the 75th percentile of today's distribution would be taxed at the lower rate, and every dollar thereafter would be taxed at the higher rate. [ParklandReportOnNWTPublicServiceCuts.pdf](http://www.ParklandReportOnNWTPublicServiceCuts.pdf) accessed September 21, 2008.

progressive and make it more accurately target the problem of revenue leakage.

### Hotel tax and airport departure tax

A hotel tax also would help address the loss of revenues caused by some people taking on work in the NWT but living and paying taxes elsewhere. It would also help offset the costs of tourism that are borne by NWT residents.

Most provinces have a hotel tax, and the national average combined rate of provincial sales tax and hotel tax on room costs is around 8%.<sup>33</sup> In the NWT, with no sales tax and no hotel tax, the combined rate is 0%.

The GNWT is of the view that a hotel tax “would not be expected to have a material impact on tourism.”<sup>34</sup> This stands to reason, as it would be a small cost compared to the various costs of travel such as airfare, hotel, dining, and ground transportation. People travel to the NWT because of its beauty and unique charm, not because there is no hotel tax.

The same analysis applies to an airport departure tax. For a round trip flight between Edmonton and Yellowknife, a tax of \$40 per flight departing the NWT would constitute on the order of 2% to 6% of total flight costs.<sup>35</sup>

#### Recommendation

A hotel tax of 8% should be instituted immediately, which would raise approximately \$4 million per year.<sup>36</sup>

#### Recommendation

An airport departure tax of \$40 per flight leaving the NWT through Yellowknife should be instituted immediately, which would raise approximately \$4.7 million per year.<sup>37</sup>

### Tobacco taxes

Tobacco is the number one preventable cause of death in Canada, killing over 40,000 Canadians per year, or more than a hundred every day – more than die from AIDS, car accidents, suicide, murder, fires and accidental poisonings combined.<sup>38</sup> The smoking rate in the NWT is over 40%,<sup>39</sup> more than double that of Canada as a whole. Taxation is a proven method of reducing tobacco consumption, particularly among teenagers,<sup>40</sup> and in high income jurisdictions like the NWT,

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- 32** The Government payroll tax revenues would neither rise nor fall.
  - 33** Hotel Association of Canada, “Room Taxes on Lodging Industry in Canada” <http://www.hotelassociation.ca/forms/2008%20room%20taxes%20table.pdf> accessed September 20, 2008.
  - 34** Revenue Options Paper p.28.
  - 35** Assuming flight costs ranging from \$691 to \$1,700, depending on time of year and airline, based on internet flight searches conducted on [www.travelocity.ca](http://www.travelocity.ca) on October 10, 2008. The market price variation alone is thus more than 25 times as large as the proposed tax.
  - 36** Based on a new tax of 5% calculated to raise \$2.5 million per year: Revenue Options Paper p.30.
  - 37** Based on a new \$30 tax calculated to raise \$3.5 million per year: Revenue Options Paper p.36.
  - 38** Lung Association, “Smoking & Tobacco”: [http://www.lung.ca/protect-protegez/tobacco-tabagisme/facts-faits/index\\_e.php](http://www.lung.ca/protect-protegez/tobacco-tabagisme/facts-faits/index_e.php) accessed September 20, 2008.
  - 39** GNWT, Department of Health and Social Services, “Smoke Alarm: A Summary Report on Smoking in the Northwest Territories” [http://www.hlthss.gov.nt.ca/pdf/reports/tobacco/2001/english/smoke\\_alarm\\_executive\\_summary.pdf](http://www.hlthss.gov.nt.ca/pdf/reports/tobacco/2001/english/smoke_alarm_executive_summary.pdf) accessed September 20, 2008.

higher prices are required for effective addiction prevention.<sup>41</sup> Despite these facts, NWT tobacco taxes have not been raised in five years.<sup>42</sup>

Smuggling is a theoretical concern as tobacco prices go up, but the Revenue Options Paper points out that there is little evidence of smuggling. Furthermore, tobacco taxes are rising in almost all jurisdictions, reducing the incentive for smuggling. Finally, smuggling is breaking the law, and should be dealt with by law enforcement rather than lowering the price of a highly addictive substance responsible for high rates of disease and death.

### Recommendation

The tobacco tax should be increased immediately, to the point that it would raise \$1.3 million more per year.<sup>43</sup> Further such increases should be scheduled for subsequent years, and the Government should work with other provincial and territorial governments to establish higher tobacco taxes across Canada.

### Liquor revenues

Alcohol consumption causes significant personal and social harm, costing \$14.6 billion per year nationally in health care costs, lost productivity, and law enforcement costs.<sup>44</sup> The incidence of heavy drinking (five or more drinks per day) in the NWT is approximately one-third of the population.<sup>45</sup> This is three to four times the rate for Canada as a whole.<sup>46</sup>

Alcoholic beverages are distributed by a Government agency that collects a markup on purchase prices. When alcohol markups have been increased in the NWT, consumption has dropped.<sup>47</sup> The markup has not been increased in over five years. As with tobacco, any concerns over the possibility of smuggling or other violations of the law should be dealt with through law enforcement, not by lowering the price of a substance known to cause significant personal and social harm.

An increase of 10% in the markup, as proposed in the Revenue Options paper (p. 27), would raise \$1.2 million. It would result in the price of an average bottle of beer going up by about 7 cents, a bottle of wine going up by 58 cents, and a bottle of spirits going up by \$1.94.<sup>48</sup> Such an increase would be virtually unnoticeable, and unlikely to have a meaningful impact on alcohol consumption. An increase of 40% would raise prices by about 26 cents for beer, \$2.31 for wine, and \$7.75 for spirits. Such an increase, though still small

**40** Revenue Options Paper at p. 26.

**41** Alberta Health Services: Alberta Cancer Board, "Tobacco Affordability and Consumption," [http://www.cancerboard.ab.ca/NR/rdonlyres/85E65360-570A-4B68-8BB2-0FC7E3CD5CAC/0/TobaccoAffordabilityAug\\_2008.pdf](http://www.cancerboard.ab.ca/NR/rdonlyres/85E65360-570A-4B68-8BB2-0FC7E3CD5CAC/0/TobaccoAffordabilityAug_2008.pdf) accessed September 20, 2008.

**42** Revenue Options Paper at p. 26.

**43** As discussed in the Revenue Options Paper at p. 26. This would increase tobacco costs by about 10%.

**44** National Framework for Action to Reduce the Harms Associated with Alcohol and Other Drugs and Substances in Canada, "Reducing Alcohol-Related Harm: Toward a Culture of Moderation" at p. 3 [http://www.nationalframework-cadrenational.ca/uploads/files/FINAL\\_NAS\\_EN\\_April3\\_07.pdf](http://www.nationalframework-cadrenational.ca/uploads/files/FINAL_NAS_EN_April3_07.pdf) accessed September 20, 2008.

**45** GNWT Bureau of Statistics, "2006 NWT Addictions Survey" Table 1.2: Profile of Volume of Alcohol Typically Consumed <http://www.stats.gov.nt.ca/Stainfo/Health/alcdrug/Alcohol&Drug%20Reports/2006%20NAS%20Profiles.pdf> accessed September 20, 2008.

**46** The 1996 Addictions Survey reported a national rate of 8.8%, compared to NWT rate of 25.6%. GNWT Bureau of Statistics, "1996 NWT Addictions Survey – Highlights: Alcohol Consumption, Incidence of Heavy Drinking." <http://www.stats.gov.nt.ca/Stainfo/Health/alcdrug/report.html> accessed September 20, 2008.

**47** "Revenue Options," at p. 28.

**48** Assuming bottle sizes of 341 ml for beer and 750 ml for wine and spirits.

in relation to average prices,<sup>49</sup> would be noticeable and would raise approximately \$4.8 million.

### **Recommendation**

The alcohol markup should be increased by 40% over two years, which would raise approximately \$2.4 million in the first year and \$4.8 million in the second year. Further increases and a possible shift to an ad-valorem system (tax based on price rather than volume), should be considered.

### **Commercial freight toll**

The true costs of road transport include more than just the financial costs of building the road and maintaining it. Air pollution, CO2 emissions, and a host of other costs arise from motor vehicle use, bringing the total costs far higher than the purely financial costs, and creating distortions that harm the economy. Economists and environmentalists both recommend that the full costs of road transport be paid by road users.<sup>50</sup>

Fuel taxes in the NWT not only fail to cover the full social costs of road use, they fail to cover even the financial costs, raising “significantly less than the amount spent on highways.”<sup>51</sup>

The Revenue Options Paper outlines a toll proposal designed in 2001 which would apply to “both extra-territorial and intra-territorial commercial trucking of goods on the all-weather public highways”, but not to “local freight movements” (p. 35). Such a toll at 5 cents per tonne-kilometre would raise \$15 million per year.

### **Recommendation**

A commercial freight toll should be instituted immediately, ramping up over two years to 5 cents per tonne-kilometre. Such a toll would raise approximately \$7.5 million per year in its first year, and \$15 million per year thereafter.

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**49** See Yellowknife Liquor Store prices <http://www.yellowknifeliqorstore.com/default.asp>. These increases would be very roughly 15% for low-cost products, and less for more expensive products.

**50** For example, Maddison, Johansson, Pearce, *The True Costs of Road Transport* (Earthscan, 1996) <http://books.google.ca/books?id=dOyCDB-lztEC>.

**51** Revenue Options Paper at p.25.

### **Fuel taxes and a carbon tax**

Climate change is a serious problem, especially for northerners, who face profound changes in their environments, their economies, and their lives. Wildlife habitats are undergoing radical change, while loss of permafrost is affecting seasonal roads and damaging building foundations. Northerners therefore have every reason to urge the world to reduce global greenhouse gas emissions.

At the same time, the credibility of northerners asking the rest of the world for action can be compromised when northern governments fail to take serious action on greenhouse gas emissions.

A consensus is emerging that serious action means pricing of greenhouse gas emissions.<sup>52</sup> Carbon taxes now have the support of a wide range of researchers, financial institutions, and industry associations, including both the Canadian Association of Petroleum Producers and the Canadian Gas Association. Several Canadian jurisdictions are considering them or have already moved to adopt them.

Fuel taxes can help to reduce carbon emissions, but they also play a key role in conserving non-renewable fossil fuel resources. Transportation fuel taxes in the NWT are “among the lowest in Canada”<sup>53</sup> and significantly below the national average. The national averages are 33% to 122%<sup>54</sup> higher for gasoline, and 58% higher for diesel.<sup>55</sup>

While legislation would enable fuel taxes to rise along with surveyed market prices, the Government has not allowed those tax increases since 1997. This means that the percentage of transportation fuel taxes has effectively been halved since then.<sup>56</sup> The Revenue Options Paper acknowledges that fuel taxes could be increased by 95%.<sup>57</sup>

However, there is a major concern around the impact of heating fuel tax increases on lower income people. Any increase in heating fuel taxes should be implemented a few years after its announcement, so as to allow for a program of home energy efficiency retrofits that will reduce heating fuel consumption and costs. Such retrofits should be funded by revenues from fuel taxes and carbon taxes.

### Recommendations

Fuel taxes should be restored to their 1997 levels by increasing them to their full surveyed values over a period of two years for transportation fuels and four years for non-transportation fuels. This would raise approximately \$17.8 million in revenues by year four.<sup>58</sup>

A modest carbon tax, such as that introduced in BC, should be adopted and phased in over four years. This could raise on the order of \$41 million per year by year four.<sup>59</sup>

The fuel and carbon tax revenues should be applied to an intensive program of home energy efficiency retrofits (insulation, high-efficiency furnaces, renewable energy, etc), focussing first on housing of lower income residents, to be carried out over the next four years.

**52** See, for example, CBC News, “4 former PMs join call for climate change action” (September 9, 2008) <http://www.cbc.ca/news/canadavotes/story/2008/09/09/formerpm-climate.html> accessed September 21, 2008.

Underlying “call” document and signatories at: <http://pubs.pembina.org/reports/climate-statement.pdf>.

**53** Revenue Options Paper at p. 24.

**54** 122% for off-highway purchase.

**55** Thompson, “Public Service Cuts in the Northwest Territories: Economic Imperative or Political Choice?” op. cit. at p. 17.

**56** Gasoline prices have roughly doubled since 1997, while the tax per litre has remained static.

**57** Revenue Options Paper at p. 25.

**58** Revenue Options Paper, at p. 25. It would raise the on-highway gasoline tax by 8.7 cents per litre, and the off-highway gasoline by 5.2 cents per litre – approximately 3-6% of the total gasoline price.

**59** Revenue Options Summary at p. 10.

## Conclusions

The tax adjustments outlined above would add to general revenues an additional \$23 million in the first year, and \$62 million by year four. In percentage terms, this represents about 2% to 5% of total revenues, and 8% to 21% of own-source revenues.

Note that this total does not include the revenues from the resource income tax, which would not go into general revenues but rather into the Territorial Trust Fund.

Because these additional revenues arise from new taxes and tax rate increases, rather than increases in the tax base, they would not be clawed back by reductions in the federal transfer payments.

## Taxes that don't need to be changed

As outlined above, there are several taxes that could be instituted or adjusted to help serve important social purposes, and which would raise revenues to support improved public programs and services. This report recommends such tax adjustments.

The GNWT Revenue Options Paper also discusses other tax adjustment options which this report does not recommend, primarily because they are not necessary to help serve important social goals, and because other taxes recommended will raise significant revenues. Of these non-recommended tax options, three require a few extra comments:

- **Sales Tax.** The NWT does not currently have a sales tax, and the revenues from the taxes proposed above would make it unnecessary. A broad-based consumption tax could encourage more personal savings and investment, but the targeted consumption taxes discussed earlier (e.g. tobacco, carbon-fuel, alcohol) will also serve that goal. A sales tax – on its own – would be regressive, and would need to be offset by income support programs, reductions in income taxes for low and middle income earners, and exemptions for groceries and other necessities.
- **Healthcare Premiums.** Catching illnesses early and engaging in preventive healthcare (e.g. annual checkups and tests) can improve health outcomes and lower healthcare system costs. Healthcare premiums based on use would discourage people from accessing

the system when they need it, meaning illnesses that could have been prevented or treated early can end up in more expensive emergency wards or intensive care units. Unnecessary use of the health care system can continue to be managed effectively by healthcare professionals applying triage to determine priority of care. Healthcare premiums are a step toward privately funded systems like the US system, which is more expensive than Canada's and delivers worse health outcomes.<sup>60</sup> Alberta has recently decided to eliminate its unpopular healthcare premiums, leaving Ontario and BC as the only jurisdictions in Canada that still have them.<sup>61</sup>

- **Cost of Living Tax Credit.** Given the proposed income supports and reductions in income taxes for the large majority of people, raising this credit should not be necessary. Additionally, this credit favours those people who file tax returns, and it arrives infrequently, which is a problem for people with lower incomes. If it were to be adjusted, it should be raised for lower and middle income earners, and consideration should be made to how to distribute it (or an equivalent) more frequently throughout the year.

## Conclusions

The Revenue Options Paper and Summary rightly recognize that the tax system can and should be used to address a broad range of policy goals – environmental, social, and economic. Unfortunately, the Government's other communications downplay goals other than economic activity, growth, and savings.

The consultation documents propose two main options for raising net revenues: growing the tax base and increasing tax rates. On the former point, they fail to quantify the revenues that could be raised or the costs that would be incurred by growing either the population or the economy. Furthermore, they fail to clearly explain how fiscal policy would accomplish either population or economic growth to the extent needed to raise net revenues significantly. Thus, it is difficult to treat growing the tax base as a serious option.

Unfortunately, the other option presented – increasing tax rates – is undercut by what appears to be an anti-tax bias, particularly in the Revenue Options Summary and other communications. This bias is likely to affect the consultation and skew input from the public. Thus,

<sup>60</sup> Gibson and Fuller, *The Bottom Line: The Truth Behind Private Health Insurance in Canada* (NeWest Press and Parkland Institute, 2006) <http://www.ualberta.ca/PARKLAND/research/books/index.html> accessed September 21, 2008.

<sup>61</sup> Revenue Options Paper at p. 35.

this report recommends that the current round of consultations be ended, the consultation documents be withdrawn, and a new round begun using more balanced documents and communications.

The Revenue Options Paper does discuss a wide range of taxes that could be instituted or increased in order to raise revenues. This report has discussed these options and made a series of recommendations.

For individuals, this report recommends reductions in income and payroll taxes for the large majority of people (not the highest income earners), and an increase in payroll tax for high income earners so as to capture revenue “leakage.” For corporations, this report recommends no income tax increases, except a new Resource Income Tax to capture rents that currently leave the NWT. These rents would be placed in a Territorial Trust Fund, which could finance future investments in human capital and energy efficiency. In relation to consumption taxes, this report recommends no new sales tax, but rather targeted taxes on things that cause harm, such as tobacco and pollution.

These recommendations include both increases and decreases in tax rates as part of an integral package of tax system reforms. This package would raise net revenues by \$23 million in year one, rising to \$62 million in year four, while at the same time advancing important public policy goals such as equity, health promotion, resource conservation, and environmental protection.

The additional revenues raised by this package could be used for several important initiatives, including:

- an intensive program of home energy efficiency retrofits, to reduce energy consumption, polluting emissions, and homeowner costs;
- increases to social assistance, job training and education (especially for non-resource industry employment), in order to boost both social equity and economic diversification;
- programs to help prevent and treat tobacco, alcohol and other substance abuse and addictions; and,
- reversing some of the spending and job cuts that were announced without public consultation in early 2008.





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