

Revenue Sources for Government Spending

In a “mixed economy” such as Canada’s, goods and services are provided by the private and public sectors. In the case of the public sector, the tax system supports the provision of goods and services by that sector. Governments at all levels raise revenues via the tax system, to provide those goods and services.

A range of taxation tools exist to raise revenues needed for government operations, from the municipal to the federal government levels. The most commonly used sources of tax revenue include income taxes, sales taxes, property taxes and natural resource taxes or royalties.

Societies come to depend on the goods and services provided by government. It is therefore prudent to ensure the stability of the revenue stream supporting the expenditures needed to provide those goods and services.

Some provincial jurisdictions in Canada are fortunate in being endowed with significant stocks of (non-renewable) natural resources. These endowments are an accident of geological history, and the drawing of provincial boundaries. Furthermore, these endowments “belong” not just to current but also to future generations. Once sold or used, these resources are not necessarily available to future generations.

Owing to the political cycle, it is attractive for governments to sell non-renewable resources, and use the revenues from those sales for current consumption, rather than long-run investment. Spending resource revenues on current consumption represents a transfer of assets from future generations to the current generation. Also, a government’s reliance on natural resource taxation for revenues is risky, since such taxes can be highly variable, given the volatility of the natural resource prices on which these revenues are based.

A fairer approach to taxation and spending, when a high proportion of a government’s revenue base can be from non-renewable resource revenues, is to place a significant amount of those revenues in investments which will generate future returns. These returns then help to stabilize the government’s tax revenue stream. The tax system can then be further utilized to generate additional revenues from the current generation (via income or sales taxes), to support the provision of goods and services needed by that generation. This preserves the asset base of the economy, so that all generations may benefit from that asset base.

Income tax systems can be constructed so that they are “progressive”, with those who can afford to pay more in taxes paying higher absolute amounts of tax. This is broadly true of the income tax system in the Canadian economy. However, political pressure often yields an income tax system which contains “tax shelters”, enabling high income earners to reduce their tax liability.

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Sales tax systems are inherently “regressive”, such taxes being relatively more burdensome on low income earners. Taxes paid here have less to do with the income of the taxpayer. A sales tax system such as a “consumption tax” (the goods and services tax (GST) in Canada, or the value-added tax (VAT) in the European Union) has the merit that it is hard to avoid, as it is levied at the point of sale. However, since such taxes are regressive, it is important to compensate low income earners sufficiently, so that their tax liability is reduced. The GST system in Canada has this feature, allowing tax rebates to low income households.

The Canadian economy is rich in natural resources, many of which are non-renewable. The temptation must therefore be resisted to rely on the exploitation and sale of these resources to support current consumption. Such consumption depletes the asset base of the economy, and has the potential to reduce future productivity and prosperity. Alternatively, utilizing income and/or sales taxes avoids the inherent bias against future generations of natural resource taxation, and stabilizes the tax revenue stream. In addition, the shortcomings of income or sales taxes described earlier are relatively easier to manage, than the drawbacks of resource taxes.

*Christopher J. Nicol, Ph.D.,
Professor of Economics, University of Lethbridge*

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