

Paying for Government in Canada

J. R. Petrie

MOST Canadians are very much aware of the pattern of the cost of living index, which has risen by 87.4 points (86 per cent) since 1939. But there is less awareness of the volume of government expenditures and its impact on the cost of living. What should be recognized clearly is that dollar for dollar government expenditures are just as inflationary as consumer and business expenditures.

A comparative and classified statement of expenditures on current account by all governments, federal, provincial and municipal, in 1939 and 1948 is shown in Table I. The figures are for the fiscal years ending March 31, so that the 1939 data do not reflect any World War II

expenditures, and may be considered as typical of the post-depression pre-war peacetime years. 1948 is taken as a "normal" post-war year in which the economy was operating in the zone of full employment and budgeting was based on "normal" government requirements. It will be noted that the total outlay of all governments was \$2,917.1 million, nearly 147 per cent greater than in 1939. Governments spent \$226 per head of population in 1948, compared with \$102 per head in 1939. In terms of the national income, government expenditures were 27.5 per cent of the national income in 1939, and only 23.4 per cent in 1948.

TABLE I
Current Expenditures of All Governments in Canada
1939 and 1948¹
(millions of dollars)

Purpose of Expenditure	1939	% of Total	1948	% of Total	% Increase 1939 to 1948
Public Welfare ²	238.1	20.1	637.6	21.8	167.7
Debt Service ³	229.5	19.4	445.6	15.4	94.1
War and National Defence ⁴	189.3	16.0	622.5	21.3	228.8
Transportation ⁵	136.9	11.6	297.2	10.2	117.1
Education	122.5	10.4	280.8	9.6	129.2
Agriculture	60.0	5.1	60.1	2.1	.2
Public Domain	29.2	2.5	79.6	2.7	172.6
All Other	175.9	14.9	493.7	16.9	180.6
TOTAL	1,181.4	100.0	2,917.1	100.0	146.9

¹Compiled from *Bank of Canada Statistical Summary* 1950. *Supplement*, pp. 38 and 41. Excluded are payments to other governments, but payments out of funds received from other governments are included.

²Including general administration, old age pensions, relief and, in 1948, family allowances.

³Ex debt repayments, and after deducting revenue from investments.

⁴Including veterans' pensions and after care.

⁵Highways, streets, bridges, waterways, airways, and C.N.R. deficits.

Public welfare was the most important item on the list of expenditures in both of the years examined, and the outlay for this purpose was greater by nearly \$400 million (167.7 per cent) in 1948 than it had been in 1939. Most of this increase is accounted for by family allowances (\$263.2 million), unemployment insurance (\$35.1 million) and increased old age pensions (\$54.2 million).

The greatest increase in expenditures took place on account of war and national defence; the increase was \$433.2 million (228.8 per cent). But in that "normal" year of 1948 defence appropriations, high as they seem, amounted to only 5 per cent of the national income, compared with 4 per cent in 1939. Most of expenditure for war and defence in 1948 was a carry-over from World War II. Only 43 per cent of the total was represented by Department of National Defence appropriations for current defence requirements.

THE cost of general government rose substantially (180.6 per cent), and expenditures on public domain rose sharply. Education and transportation costs were

more than doubled. It is interesting to note that debt service charges had not increased to the extent of the items just mentioned. This was due in part to the fact that in 1947 and 1948 the federal government had reduced its net debt by \$1,049.7 million. The astonishing thing about the pattern of expenditures in 1939 and 1948 is the fact that expenditure on agriculture had barely changed over the decade.

So much for expenditures. They indicate the cash requirements of all governments at the time. The money had to come, of course, from the Canadian people in one way or another. They way in which the money was raised is shown in Table II. It will be seen that in 1939 the total current revenue of all governments was \$1,064 million, \$117.4 million less than the total amount expended. In 1948, however, the total revenue of \$3,684.1 million was \$767 million greater than current outlay. Most of this excess was accounted for by the \$676.1 million surplus of the federal government, all of which was applied to debt retirement.

In 1939 the Canadian revenue system

TABLE II
Total Revenue Collected from the Public
By All Governments, 1939 to 1948¹
(millions of dollars)

Revenue Source	1939	% of Total	1948	% of Total	% Increase 1939 to 1948
Real Estate Taxes	249.0	23.4	241.3	9.2	37.0
General Sales Taxes ²	144.8	13.6	440.5	12.0	204.2
Corporation Taxes ³	112.7	10.6	646.3	17.5	473.5
Customs duties	106.3	10.0	223.3	6.1	110.0
Personal Income Taxes ⁴	71.7	6.8	806.2	21.9	1,024.4
Liquor Taxes and Profits	54.4	5.2	229.8	6.2	320.6
Gasoline Taxes	53.1	4.9	124.3	3.4	134.1
Tobacco Taxes	42.1	3.9	199.3	5.4	373.4
Motor Vehicle Licenses	28.1	2.7	51.5	1.4	83.3
Succession Duties	27.8	2.6	54.7	1.5	96.8
Miscellaneous Taxes	53.3	5.0	237.9	6.5	346.3
Revenue from Public Domain	24.7	2.3	74.2	2.0	200.4
Licenses, Permits and Fees	18.5	1.7	32.2	.9	74.0
Other Revenue	77.5	7.3	222.6	6.0	187.2
Total Revenue	1,064.0	100.0	3,684.1	100.0	246.2

¹Compiled from *Bank of Canada Statistical Summary 1950 Supplement*, pp. 38 and 41. Excluded are amounts received from other governments.

²Includes taxes on profits and other taxes on corporations.

³Includes the federal sales tax, and provincial and municipal retail sales taxes.

⁴Includes withholding taxes on dividends, interest, etc.

was severely regressive. Real estate taxes accounted for nearly one-quarter of all the revenue raised, and along with sales taxes, corporation taxes and customs duties, accounted for nearly one-half of the total. The total taxes collected on personal income amounted to only \$71.7 million, or 6.8 per cent of the total. Indeed, personal income taxes were really insignificant, accounting for less revenue than paid by motorists on gasoline and licenses. The total tax on both personal and corporate income amounted to only \$150.1 million (14 per cent of total revenue.)

By 1948 the Canadian revenue system had been changed drastically as a result of the very heavy revenue requirements of the war years. The personal income tax had become by far the most important revenue source. Increased by more than a thousandfold, it accounted for 21.9 per cent of the total national revenue. Corporation taxes accounted for 17.5 per cent of the total, having increased by 204.2 per cent. Taxes on personal and corporate income in 1948 accounted for 37.6 per cent of all the revenue collected from the public as compared with 14 per cent in 1939. The yield of these two taxes on income rose from \$150.1 million to \$1,385.8 million (823.2 per cent).

Thus the revenue system had become more progressive, although commodity taxes still were a major element of the whole. In 1939 taxes on commodities accounted for 42.6 per cent of the total, and in 1948 they accounted for 39.6 per

cent. It will be noted that taxes on real estate, first in importance in 1939, had fallen to fourth place by 1948.

On the average in 1939 every Canadian contributed \$92 to governments, as opposed to \$285 in 1948. In terms of constant dollars (average for 1935-1939), the per capita revenue contributions were \$184 in 1948, compared with \$90 in 1939.¹ In terms of the national income, government revenues in 1939 amounted to 24.8 per cent of the national income, compared with 29.6 per cent in 1948.

As far as one can judge, the heavy cost of government and the even heavier revenue collections in Canada during 1948 resulted in no serious strain on the economy. Generally speaking incentives to produce, to save and to invest seemed relatively undisturbed, despite the fact that Canadians paid their governments twice as much of their purchasing power as they did before the war. Probably one of the reasons for this was the more progressive nature of the tax structure in 1948.

Development Since the Outbreak of Korean War

EVEN before the outbreak of war in Korea, the cost of government was rising sharply, partly as the result of increased commitments and partly because of inflated costs. Total expenditures of all governments in 1948 and 1950 are shown in Table III.

TABLE III
Total Current Expenditures of All Governments
in Canada, 1948¹ and 1950²
(millions of dollars)

Purpose of Expenditure	1948	1950	% Increase
Public Welfare	637.6	670.8	5.2
National Defence and War	622.5	658.5	5.8
Debt Services ³	445.6	439.1	-1.5
Transportation	297.2	332.1	11.7
Education	280.8	306.7	9.2
General Government, etc.	633.4	957.9	51.2
TOTAL⁴	2,917.1	3,365.1	15.3

¹Compiled from Table I.

²Compiled from *Bank of Canada Statistical Summary* September and December 1950 and April 1951.

³Note: transfer payments between governments excluded.

⁴Net debt, after deduction of "return on investments."

EXPENDITURES in 1950 were 15.3 per cent greater than they were in 1948. The two chief items, welfare and defence, increased modestly, as did education, while the cost of servicing the debt decreased slightly (thanks to federal government surpluses). But the cost of general government rose by 51.2 per cent. Placed on a per capita basis, the cost of government in 1950 was \$243 per person, compared with \$226 in 1948. Government outlay was almost exactly the same per cent of national income in 1950 as it was in 1948—23.5 and 23.4 per cent respectively.

The pattern of government revenues in 1950, compared with 1948 is shown in Table IV. While expenditures in 1950 were 15.3 per cent greater than in 1948, revenues were only 3.2 per cent greater.

of the national income, compared with 29.6 per cent in 1948.

IT appears that the considerable expansion of government expenditures between 1948 and 1950 was readily absorbed by the national economy. Revenues were buoyant because of the growing inflation, and the rapid growth in the national income enabled the economy to support the tax load without undue distortion. The fact that the total cost of government to the taxpayers was no more than 26.6 per cent of the national income indicates that the burden was still within manageable bounds.

But 1950 marked the end of anything resembling normalcy. After the outbreak of war in Korea the federal government began to formulate defence plans in late

TABLE IV

Total Revenue Collected from the Public

By all Governments, 1948¹ and 1950²

(millions of dollars)

Revenue Source	1948	1950	% Change
Personal Income Tax	806.2	669.5	-16.9
Corporation Taxes	646.3	709.6	9.8
General Sales Taxes	440.5	485.3	10.2
Real Estate Taxes	341.3	400.0	17.2
Liquor Taxes and Profits	229.8	230.2	.1
Customs Duties	223.3	225.9	1.1
Tobacco Taxes	199.3	215.3	8.0
Gasoline Taxes	124.3	138.3	11.3
Succession Duties	54.7	56.1	2.5
Motor Vehicle Licenses	51.5	56.7	10.1
Public Domain	74.2	71.8	-3.2
Miscellaneous Revenues	492.7	545.4	10.7
TOTAL	3,684.1	3,804.1	3.2

¹Compiled from Table II.²Compiled from *Bank of Canada Statistical Summary*, September and December 1950, and April 1951

An important reason for the relatively small revenue increase was the \$236.7 million decrease in personal income tax collections, resulting from rate decreases and increased exemptions. All the other important revenue sources showed a marked increase in yield. On a per capita basis, 1950 revenue collections amounted to \$274 per person, compared with \$285 in 1948. Revenue collections in 1950 were 26.6 per cent

1950 of an unprecedented peacetime magnitude, involving heavy increases in revenue requirements. At the same time inflationary pressures were pushing up the cost of government at all levels. The results are painfully apparent in the estimated budgetary expenditures of all governments for the current fiscal year, 1951-52 shown in Table V.

TABLE V

Estimated Total Expenditures of All Governments in 1951-52, compared with 1950 (millions of dollars)

Government	1950 ¹	% of Total	1951-52	% of Total	% Increase
Federal	2,159.9	64.2	3,453.0 ²	70.4	59.9
Provincial	695.2	20.7	850.0 ³	17.3	22.3
Municipal	510.0	15.1	600.0 ⁴	12.3	17.6
TOTAL	3,365.1	100.0	4,903.0	100.0	45.7

Note: transfer payments between governments excluded.

¹Compiled from *Bank of Canada Statistical Summary*, September and December 1950, and April 1951.

²Budget Estimates, after deleting transfer payments to other governments, and adding \$65 million

as extra cost of universal old age pensions, January through March.

³Computed from provincial budget speeches.

⁴Estimate based on assumption that municipal expenditures will increase relatively to an extent similar to the increase in provincial outlay. Between 1948 and 1950 municipal expenditures rose by 16 per cent.

IT will be noted that the forecast expenditure for the current fiscal year is \$1,537.9 million (45.7 per cent) more than in 1950. Most of the increase (about 85 per cent) is the result of increased federal expenditures, which are \$1,293.1 million greater than in 1950.

Total expenditures this year will amount to \$354 per capita, compared with \$243 per person in 1950, and the total outlay is 30 per cent of the estimated national income,² compared with 24 per cent in 1950.

It is difficult to forecast revenue, because inflated prices are resulting in astonishing tax yields. The estimated federal revenue as indicated in the Budget Speech of April 10, 1951, is \$3,730 million. If provincial and municipal expenditures are matched by revenues, the total of budgetary revenues in the current year would be \$5,180 million. But the federal revenue

estimates are conservative. In a press release of the Comptroller of Treasury, dated September 22, 1951, it was indicated that revenues from April 1 to August 31 were \$501.9 million in excess of expenditures. If the budgetary surplus this year is from \$400-\$500 million, then the total amount collected from the public by all governments would be in the vicinity of \$5,500 million. This amounts to over \$390 for every man, woman and child in the nation, or \$1,560 for a family of four, and it is exactly one-third of the estimated national income.

A recapitulation of the changing expenditure and revenue pattern since 1939 is shown in Table VI. It will be noted that in terms of constant 1935-39 dollars, estimated government expenditures in 1951-52 are 96 per cent greater than in 1939, while the cost to the public is 139 per cent greater.

TABLE VI

Per Capita Government Expenditures and Revenues in Current and Constant Dollars for Selected Years

	Expenditures		Revenues	
	Current Dollars	Constant Dollars ¹	Current Dollars	Constant Dollars
1939	102	100	92	90
1948	226	146	285	184
1950	243	146	274	164
1952 ²	354	195	390	215

¹"Constant Dollars" were arrived at by relating actual dollars to the cost of living index, the base period of which is 1935-39.

²The average of the cost of living for the first eight months of 1951.

IT has already been indicated that by far the greater part of the increased expenditures in 1951-52 is due to the federal government's requirements. The pattern of federal expenditures is shown in Table VII. Total estimated outlay on current account has increased by \$1,255.9 million (53 per cent) since 1950. About 97 per cent of this increase (\$1,214.9 mil-

tionally all of the forecast revenue increase is derived from taxation, which accounts for more than 92 per cent of all current revenue. The greatest tax increase is on corporation profits, an increase of \$374.6 million (62.3 per cent). This tax is now the most important single revenue source. The estimated yield of the general sales tax shows an increase of 48.7 per cent.

TABLE VII

Federal Budgetary Expenditure 1950-1952¹
(millions of dollars)

Purpose of Expenditure	1950	1952		% Change 1950-1952
		1951 Preliminary	Budget Estimates	
War and National Defence ²	658.5	982.6	1,873.4	184.5
Public Welfare ³	468.4	503.6	525.5	12.2
Interest on the Public Debt ⁴	348.3	336.1	340.4	-2.3
Transfer Payments to Provinces ⁵	104.0	123.9	115.1	10.7
General Government	777.9	866.5	758.6	-2.5
TOTAL	2,357.1	2,812.7	3,613.0	53.3

¹Compiled from *Bank of Canada Statistical Summary*, April 1951, p. 63.

²Includes Departments of National Defence and Veterans Affairs expenditures, gratuities and re-establishment benefits, mutual aid, other war and demobilization expenditures, and defence production.

³Includes family allowances, old age and blind pensions, health grants and unemployment insurance.

⁴Net debt interest, after deduction of "interest on investments."

⁵Includes statutory subsidies and special grants to the provinces, and payments to the province under the tax agreements.

lion) was on account of war and national defence. Up to this point, therefore, most of the increase in federal expenditures since 1950 has been the result of war and the continued threat of war. Over fifty per cent of the current federal budgetary expenditures represent items accruing from war and national defence.³

The Current Tax Burden

THE apparent effects of the federal government's cash requirements on the Canadian public are shown in Table VIII, in which the budgetary revenue estimates for the current year are classified by major revenue sources. When the actual collection figures are known, it is quite likely that the result will be from 10 to 15 per cent greater than estimated.

As it is, current budgetary revenue is 45.5 per cent greater than in 1950. Prac-

Special excises are increased by 46.8 per cent, customs duties by 39.4 per cent, and the personal income tax by 38.9 per cent. The corporation tax provides 26 per cent of the budget, while the personal income tax makes up another 25 per cent. Thus, the tax on corporate profits and personal income accounts for 51 per cent of the total revenue. Commodity taxes account for 40 per cent, succession duties for a little more than 1 per cent, and miscellaneous revenues for the remaining 8 per cent.

As an indication of the burden of taxation at present, it is noteworthy that the personal income tax is the only federal tax that is not as high or higher than during the peak of the wartime financing. The general sales tax is now 25 per cent higher than it was during the war, and the corporation tax on profits in excess of \$10,000 is now 52 per cent higher.

TABLE VIII

Federal Budgetary Revenues 1950-1952¹
(millions of dollars)

Revenue Source	1950	1951 Preliminary	1952 Budget Estimates	% Change 1950-1952
Personal Income Tax ²	669.5	614.0	930.0	38.9
Corporation Tax	601.4	810.0	976.0	62.3
Sales Tax	403.4	459.1	600.0	48.7
Customs Duties	225.9	298.0	315.0	39.4
Excise on Tobacco	205.4	206.6)		
Excise on Liquor	108.0	131.7)	577.0	46.8
Other Excise Taxes	79.6	127.5)		
Succession Duties	29.9	34.0	40.0	33.8
Total Taxes	2,323.1	2,780.9	3,438.0	47.9
Other Revenue ³	257.0	324.4	292.0	13.6
Total Budgetary Revenue	2,580.1	3,105.3	3,730.0	45.5

¹Compiled from *Bank of Canada Statistical Summary*, April 1951, p. 64.

²Includes withholding tax on dividends, interest, etc

³Includes sale of surplus war assets, refunds of war and demobilization expenditures, post office profit, return on investments, etc.

Speaking generally, the only direct tax (apart from succession duties) levied by the federal government is the personal income tax. It will be paid this year by some 2,500,000 taxpayers. The other 75 per cent of the federal government's costs will be diffused over the total population of 14 million persons.⁴

The impact of the new tax burden means that taxation is now more than offsetting the increase in average personal income. In other words, taxation at its current level must make inroads into the average man's standard of living, or his savings, or both. It is designed deliberately as a matter of government policy, to reduce inflationary consumer expenditures, and the writer subscribes fully to that feature of the government's fiscal policy. But the important question is "How high can taxes go before they become inflationary?"

ROSWELL MAGILL, an eminent American tax authority, and President of the Tax Foundation,⁵ writing in the *Saturday Evening Post* (September 1, 1951), quotes Colin Clark, the noted Australian economist, as saying "the critical level of taxation beyond which inflationary forces

come into play is around 25 per cent of the national income." It will be remembered that the 1951-52 cost of government to the Canadian public is about 33 per cent of the estimated national income.

At least this kind of comparison has the same virtue as an amber traffic light. Canadians should certainly be putting the brakes on government spending, and, of course, on taxation. Granted that new taxes will curb consumer purchasing power, they are also, to some extent, dislocating the economy. For example, the new tax on cigarettes (\$1.50 per 1,000) has reputedly reduced retail sales by 17 per cent since April, costing the tobacco growers a loss of \$4 million.⁶ This is a reminder of the 30 per cent tax imposed on candy in the "Baby Budget" of September 7, 1950. On April 10, of this year the Minister of Finance reduced this tax to 15 per cent apparently because it was taking too large a "bite" out of candy production.

All of this points to the trial and error process that is a necessary part of the imposition of extremely high taxation in a full employment economy. Nobody can foretell in advance what the point of diminishing returns of a given tax will be. But

it seems quite clear than many commodity taxes have already approximated (some have probably exceeded) that point.

This points to the obvious conclusion that there should be some really serious soul-searching before further government commitments are made. It now looks as though the level of government expenditures has approximated the point where the necessary matching revenues will eat into national income to an extent which would cause serious economic dislocation.⁷

It is therefore proper to take stock now. We are already committed by our government to a universal old age pension for everybody seventy years of age and older. That commitment was undertaken apparently, without thought of its implications in a semi-war economy. It will add a net \$250 million of inflationary expenditure to the national budget. At the same time pressure is being put on the government for a government-subsidized health insurance plan,⁸ which would add still further to a tax burden which is already showing signs of dislocating the national economy.

Conclusions

THE Canadian people are now contributing one-third of their income to their governments. It is questionable whether the national economy can support a greater tax burden without serious dislocation. Some commodity taxes appear to have reached the point of diminishing returns, curtailing sales and production.

The very heavy increase in taxation this year is for the most part a direct result of our defence commitments. But social security expenditures are also an important element in the overall cost of government. Universal old age pensions will add \$250 million to the federal government's outlay in 1952.

One of the serious aspects of the heavy increases in federal taxation is the overlapping at the provincial and municipal levels. Fortunately for the taxpayer the personal income tax is centralized in the hands of the federal government, and all the provinces save Quebec and Ontario have leased their corporation taxes and

succession duties to the federal government under the federal-provincial tax agreements. These agreements expire on March 31, 1952, and it is of the greatest importance that they be renewed. It is highly desirable that all ten provinces enter tax agreements with the federal government. The same urgency exists today as during the war, when income and corporation taxes were placed in the hands of the federal authority to avoid overlapping.

It is equally important that careful consideration be given to integrating commodity taxes. At present the federal government is levying taxes on commodities in the amount of \$1,492 million, and the provinces and some municipalities are adding another \$400 million of tax on a wide range of goods. The federal government levies a general sales tax of 10 per cent, and special excises of 15 and 25 per cent apply to a number of commodities. On top of all this five provinces add a retail sales tax on the same goods. The pyramiding of tax upon tax as a result of overlapping is costly to the taxpayer, and results in a substantial increase in his cost of living. Surely this is a problem deserving high priority in any programme for improving the Canadian tax structure.

The important question to be faced is how far we can go towards paying for a welfare state and securing it against external aggression without serious reduction in our living standards and curtailment of the production which in the final analysis is the only source of both our welfare and our defence. There can be no real choice between defence and social security. National security must come first, because without it, social security becomes meaningless.

IT is time to face facts. Government expenditures must be checked. They are a major factor in the inflation of the price level, and it is futile to talk of curbing inflation while letting government expenditures go their way. All new government projects, federal, provincial and municipal, should be carefully screened on a basis of strict essentiality. Stated in its simplest terms, the problem is not what ser-

VICES we want from government—rather, it is how much we can afford without causing an inflation of price levels which would result in disaster. The responsibility for exercising restraint rests upon both governments and the public. If the latter insist upon all the frills of a welfare state and an ever-expanding volume of

government expenditures, they will necessarily pay the final and inevitable price of still higher taxes, still higher prices, and a progressively decreasing standard of living. What is needed now is a determined and realistic approach to the gravest problem of our time. Self-discipline is the answer.

¹These figures were arrived at by using the cost of living index as the adjusting factor.

²My estimate is \$16,500 million, with a gross national product at market prices of \$21,000 million.

³I concede that there is a nice question of semantics here. In this item I have consistently included all items accruing from World War II (except debt interest) in war and defence figures. Another approach is used by a writer for the *Winnipeg Free Press*, who showed in that newspaper on September 10, 1951, that social welfare payments by the federal government will be \$760.2 million this year. In this figure he included \$151.3 million of payments to war veterans, which I have charged to war. There was also included \$87.4 million in federal pensions to civil servants and additions to the pension fund. I have charged this to general government costs.

⁴This statement assumes that the tax on corporate profits is shifted to the consumer in the form of higher prices. This view is held by the Minister of Finance. See *House of Commons Debates*, July 18, 1951, p. 4239.

⁵In the United States; not to be confused with the Canadian Tax Foundation.

⁶The *Globe and Mail* (Toronto), September 25, 1951.

⁷I have reservations on this point, which depend upon how much more inflation of national income we experience. But if price levels should level off, then my point is important.

⁸The Trades and Labor Congress advocated this plan at its annual meeting in Halifax, as reported in *The Globe and Mail*, September 13, 1951.

To Our Subscribers

Please check the expiry date of your subscription below your address on this issue of PUBLIC AFFAIRS. The last issue you are entitled to receive is indicated by volume and number on your address label. If it reads Vol. XIV, No. 1, your subscription expires with this issue. Do not run the risk of missing ONE issue of PUBLIC AFFAIRS, Canada's National Quarterly—renew your subscription now by using the convenient blank subscription form below:

Please renew my subscription to PUBLIC AFFAIRS for: 1 year (4 issues)

2 years (8 issues)

I enclose money order cheque for \$2.00 for \$4.00 Bill me

NAME.....

ADDRESS.....

OCCUPATION.....