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# ***Idle Speculation: Prefunding the Boomers’ ‘Frail Elderly’ Care and Legitimizing a Carbon Tax***

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John Richards<sup>1</sup>

*Simon Fraser University*

THE COHORT BORN IN THE TWO DECADES following WWII now straddles the traditional age 65 threshold between work and retirement. By 2030 all “boomers” will be over age 65; some will have died but, given present life expectancy, the majority will be alive, at an average age of about 75. This age is often used to mark entry into the “frail elderly” stage of life, at which average per capita health costs rise precipitously. Some fraction of their frail elderly health costs will be borne privately and that fraction may become the subject of an intergenerational political debate. Given a high level of public commitment to public health insurance across most OECD countries – including Canada – it seems reasonable to conclude that most costs will be assumed publicly. Contending with a looming rise in health care costs is one

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1 I thank Greg Marchildon, Fred Gorbet and Russ Robinson for comments on earlier drafts, and Nancy Olewiler for educating me on aspects of carbon pricing. Remaining errors, of fact or speculation, are the author’s.

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of the major fiscal dilemmas facing OECD member states.

Among the necessary – if far from sufficient – responses to global warming is to price greenhouse gas (GHG) emissions. According to the National Round Table on the Environment and the Economy, the price in Canada should ramp up over the coming decade to \$100/tonne of CO<sub>2</sub> equivalent by 2020, and to \$200/tonne by 2025 (NRTEE 2009). International experience with emissions markets as tactic to price emissions has been disappointing. Increasingly, attention is turning to the administratively simpler option of carbon taxes. That implies an ambitious and controversial reorganization of the tax system.

Beyond the fact that boomers' frail elderly health status and global warming are future events whose costs will emerge incrementally and that effective policy entails short-term political controversy that politicians are loath to incur, these appear to be entirely separable policy concerns. Is there a policy link to be made between them? Maybe ...

The chapter proceeds as follows. First is a section making the case that, given the magnitude of projected frail elderly health costs for the boomer cohort in Canada, prefunding a portion of the cost is desirable. There follows a discussion of the extent of popular opposition to increased taxing effort. It is profound. The final section suggests linking a campaign for prefunding to a campaign for a carbon tax.

### *The Case for Prefunding Frail Elderly Care of Baby Boomers*

Voter attitudes act as an ill-defined constraint on size of government. More on that theme later. A more explicitly defined constraint is financial market interpretation of voters' willingness to pay the taxes required to finance existing programs and redeem outstanding sovereign debt. In the 1990s, market scepticism played a powerful role in persuading Canadian politicians to undertake fiscal redress, and persuading voters to accept it.

There are long lags in the dynamics whereby fiscal credibility of governments is either created or lost. The roots of the loss of fiscal credibility in Canada in the 1990s lay in political decisions taken in the 1960s and 1970s, when Canadians opted for social programs of European generosity without ade-

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quately revising their willingness to pay taxes. Distracted by recessions in the early 1980s and early 1990s and by two prolonged and complex constitutional conflicts – which order of government has the better claim to resource rents, whether Quebec would stay within the federation – both orders of government long resisted redesign of their respective social programs and the increased taxing effort required to accord them fiscal credibility. Instead, Ottawa accused the provinces of moral hazard in designing inefficient social programs whose basic goal was to maximize federal spending under cost-sharing agreements. Such programs, Ottawa argued, obeyed the letter but not the spirit of the agreements. In turn, the provinces accused Ottawa of addressing its deficit by unilateral changes to regulations governing intergovernmental transfers and federal social programs, the effect of which was to oblige the provinces to increase spending in social policy ministries and incur larger deficits.

### Applying the C/QPP precedent

In the mid-1990s, finally, both orders of government did redesign many of their respective programs and increase taxing effort. Among the major federal initiatives was a restoration of actuarial credibility to the funding strategy for the Canada/Quebec Pension Plan (C/QPP). It required a near doubling of the earmarked payroll tax. The actuarial modeling undertaken prior to the program's launch in mid-1960s extrapolated post-WWII fertility rates, contemporary life expectancy after age 60 and then-prevailing labour productivity increases. Hence, the program did not incorporate the post-1960s fertility decline, productivity growth decline, increases in life expectancy and age-related medical expenses. Nor did it adequately incorporate the decline in average retirement age. Extrapolation of pre-reform tax rates implied exhaustion of the reserve fund within two decades and, thereafter complete reliance on a rising pay-as-you-go payroll tax (Department of Finance, 2007). The present partially pre-funded C/QPP design entails two central features: a payroll tax rate sufficiently high that it is expected to be constant over the next 75 years, and a reserve fund target. The payroll tax rate has been set (at 9.9 per

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cent) so as to permit the reserve fund to stabilize at approximately five times annual expenditures over the next 75 years.<sup>2</sup>

The reform improved intergenerational equity: it required those in the labour force to pay a higher share of their expected future benefits. It also improved long-term efficiency of the tax system by lowering what would otherwise be required marginal tax rates on labour income in future decades.

Based on this precedent, Bill Robson (2010) undertook an exercise in analyzing the levelized incremental taxing effort required over the next half century to accommodate publicly assumed frail elderly health costs for the boomer cohort. He projected core social program costs (health, education, elderly transfers and child/family benefits) over the next half century, using “middle-of-the-road” assumptions: a constant fertility rate, employment rate at pre-recession levels, an annual increase in labour productivity of 1.75 per cent, life expectancy rising according to Statistics Canada’s “medium” case, and extrapolation of present per student labour inputs for education costs and of present per capita labour inputs for eight age- and sex-specific groups in the case of provincial health costs. Under these assumptions, the total cost of these four services rises from under 16.5 per cent of 2011 GDP to 20.9 per cent of 2031 GDP, and 23.5 per cent of 2051 GDP.

Virtually all of this increase is due to projected increases in the age 60 and over share of the population and the consequent rise in public health care costs. Charts 1 and 2 help explain why the projected increase is so large. Chart 1 illustrates average per capita provincial expenditures. The overall 2008 average was \$3,350; for those age 75 and over they exceed \$10,000. Chart 2 illustrates the 2008 distributions by age cohorts of the Canadian population and of provincial health expenditures. Cohort-specific average expenditures are below the overall average for cohorts over age 1 and below age 60; they rise above it for older cohorts.<sup>3</sup> Cumulative statistics indicate the extent to which health expenditures are skewed to older cohorts. In 2008, the 81 per cent of the population below age 60 and the 19 per cent of the population age 60 and

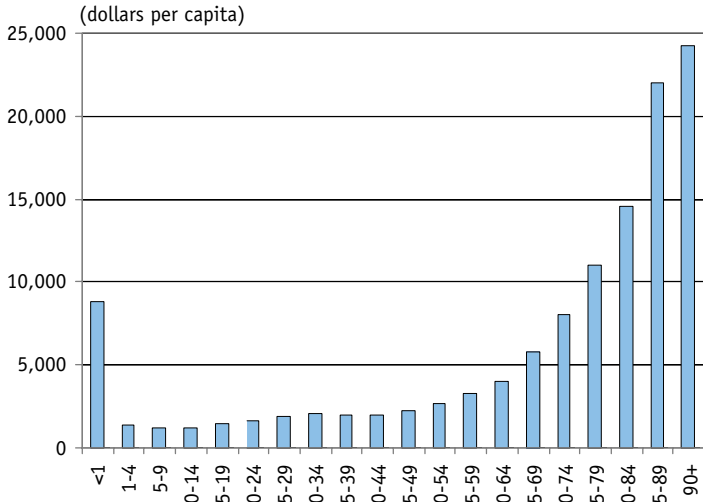
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2 See Department of Finance (2007) for a summary of the actuarial exercise underlying mid-1990s CPP reform.

3 The two distributions cross at the age 55-59 cohort. Members of that cohort incur average per capita health costs very close to the overall average.

**Chart 1**

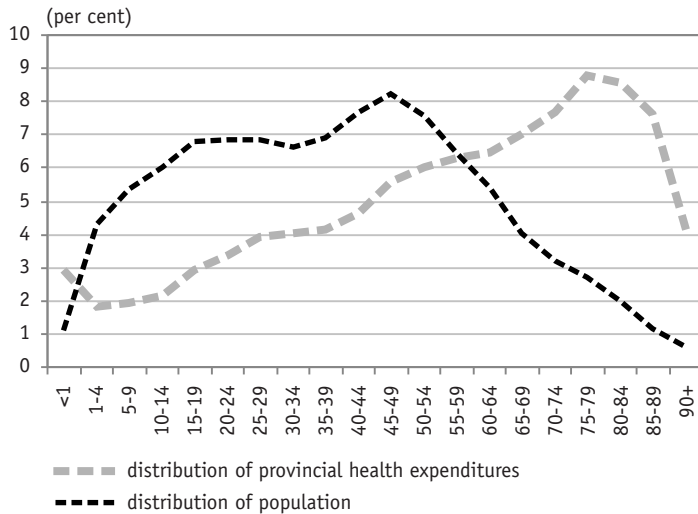
**Per Capita Provincial Health Expenditures, by Age Cohorts, 2008**



Source: CIHI (2010).

**Chart 2**

**Distributions of Canadian Population and Provincial Health Expenditure, by Age Cohorts, 2008**



Source: CIHI (2010).

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over each accounted for 50 per cent of health expenditures; the 6 per cent age 75 and over accounted for 29 per cent of expenditures.

Applying the C/QPP partial pre-funding precedent, Robson estimated the increase in taxing effort required to honour the implicit social contract of present age-specific health care intensity levels over the next half-century. The once-and-for-all increase in taxing effort amounts to 4.5 per cent of GDP. This estimate is sensitive to parameter choices but, even if alternate specifications generate a smaller required increase in taxing effort, the increase remains substantial.

Pierre Fortin (2011) has recently conducted a similarly motivated exercise to estimate the fiscal implications for Quebec of a shift in the age distribution of the provincial population combined with the cohort-specific distribution of provincial health expenditures. The impact by 2020 amounts to 1.7 per cent of 2010 provincial GDP. In addition, he estimates the decline by 2020 in own-source Quebec tax revenue due to a smaller adult population ages 15-64 cohort at 1.6 per cent of 2010 GDP.<sup>4</sup>

### Preserving the efficiency of a single-payer insurance system

As with the C/QPP, to rely on future pay-as-you-go increases in taxing effort would simultaneously lower intergenerational equity and increase long-term economic inefficiency. It would require an increase in pay-as-you-go taxing effort during the peak decades of boomers' frail elderly care well above the levelized rate. It would also raise questions of fiscal credibility: will the working-age population agree in the decades of maximum boomer-cohort health care to the pay-as-you go taxing effort consistent with the health benefits presently on offer?

One policy option is to relax the constraint on private health markets legislated in the Canada Health Act and related provincial laws. The Supreme Court's *Chaoulli* decision defined a right to buy private health insurance based

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4 Fortin estimates the age-induced increase in health care spending, by 2020 relative to 2010, at \$5.1 billion, 1.7 per cent of 2010 GDP of \$303.7 billion. He estimates lost own-source revenue by 2020 relative to a counterfactual in which the age 15-64 cohort increased from 2010 – 2020 at the same rate as over the decade 2000 – 2010. The lost revenue estimate is \$4.9 billion, 1.6 per cent of 2010 GDP.

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on the “security of the person” provision of the Charter. This decision may turn out to be precursor to a widespread choice of this option.<sup>5</sup>

Expansion of private health insurance can play a role in financing boomer cohort frail elderly care, but is not a panacea. It is worth stating briefly the equity and efficiency arguments for a single-payer insurance system continuing to dominate the health market. The equity argument for funding health care via a moderately progressive tax system is obvious. The efficiency argument depends on two effects. The first: maintaining a high level of population health without the impediment to mobility and employment implicit in employment-related insurance or needs-related conditional public subsidy improves labour force productivity. The second effect is that single payer systems potentially avoid significant costs arising from information asymmetry and other agency problems. Realizing the second effect rests ultimately on the quality of public management: applying cost/utility criteria in making major decisions (such as a list of drugs to include in a formulary of insured drugs) and in designing “internal markets” (such as regulations defining the market for ambulatory medical care). Most OECD countries have reasonable quality of public management, and have realized substantial efficiency and equity gains relative to the US history of relying primarily on voluntary private insurance plus public funding for the old and indigent.

### “Don’t let the health minister eat everyone else’s lunch”

A senior administrator – he would probably prefer not to be cited – has summarized his observations of the past decade’s cabinet budget deliberations at the provincial level: “when ministers gather to allocate revenues for new programs, the health minister eats everyone else’s lunch.” An example is the 2011-12 budget of British Columbia (British Columbia Ministry of Finance, 2011, p. 17). It estimated an increase in consolidated revenue fund spending of nearly \$1.1 billion between 2010-11 and 2011-12. The estimated increase in health spending exceeds \$900 million, leaving approximately \$150 million for

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5 For a discussion of the implications of *Chaoulli*, see the interviews with Allan Blakeney and Patrick Monahan (Morley, 2006; Poschmann, 2006).

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all other agencies. This is a typical outcome of provincial cabinet deliberations, repeated across the country since the end of the fiscal crisis of the 1990s.

That health care is absorbing the great majority of incremental provincial spending does not prove that other spending envelopes should be funded more generously. It is evidence of politicians' acute sensitivity to spending priorities of the baby boom cohort – and of a limited response to the case for incremental public spending elsewhere.<sup>6</sup> Given their age, members of the cohort born between 1945 and 1965 have an intense concern with relaxing the administrative constraints that define public health expenditures: use of waiting lists for elective surgery and access to expensive diagnostic services; imposition of co-payments on pharmaceutical drug insurance, and so on. Their above-average propensity to vote, relative to younger cohorts, augments the political salience of their priorities.

### *Prodding the Hornet's Nest*

Shortly after the 2010 US midterm elections restored Republican control of the House of Representatives, David Brooks (2011) forecast an aggressive House-led campaign to maintain taxing effort prevailing in 2008 and to lower spending to conform. He was right. The May 2011 general election generated a somewhat similar result in Canada. A plurality of voters afforded a parliamentary majority to the Conservatives who campaigned on maintaining Canada's "low tax advantage" and a promise to balance the federal budget by 2015 subject to current taxing effort. The implicit reference point for the "high tax disadvantage" was Canadian taxing effort in the 1990s.

Public scepticism to claims for higher taxes is a healthy feature of any democracy but, in both Canada and United States, political polarization has elevated scepticism in the last decade – despite the fact that taxing effort

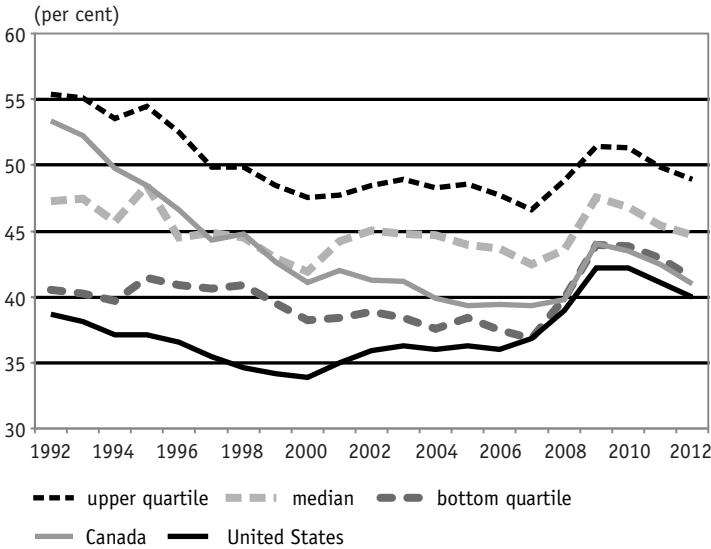
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6 After health, the second largest spending envelope at the provincial level is education. The OECD (2010b) undertook an exercise to estimate productivity gains from reducing the high school dropout rate in member states. The exercise measured the public and private returns to completion of upper level secondary studies (relative to not doing so). For Canada, the estimated private rate of return to a student from completion is about 13 per cent, and the public return about 7 per cent. Admittedly, the private and public returns on further lowering of the high school dropout rate are no doubt lower than the OECD estimate of average returns.



**Chart 3**

**Government Outlays as Share of GDP, Quartiles for OECD Member States, Canada and United States, 1992 - 2012**

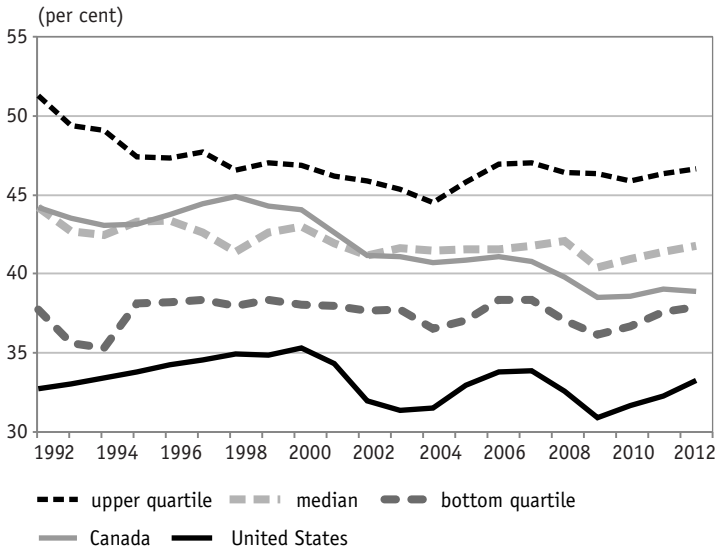


Source: OECD (2010a).

declined in both countries. In Canada, taxing effort declined from a level close to the top quartile for OECD countries in late 1990s to a level close to the bottom quartile in 2011. Similarly, government outlays in Canada declined from a level close to the top quartile two decades ago; since 2008, they have closely tracked the bottom quartile. As elsewhere in the OECD, Canadian outlays rose as a share of GDP during the post-2008 recession but remained at the bottom quartile. (See Charts 3 and 4.)

If we accept Robson's parameters and modeling rationale and we assume no cuts in share of GDP devoted to other programs, levelized prefunding of boomers' frail elderly care requires raising the Canadian taxing effort from its 39 per cent average since 2009 to about 43 per cent of GDP. This would return Canada to levels prevailing in early years of the previous decade and close to the projected OECD median for 2012. (See Chart 4.)

**Chart 4**  
**Government Tax plus Non-Tax Revenues as Share of GDP, Quartiles for**  
**OECD Member States, Canada and United States, 1992 - 2012**

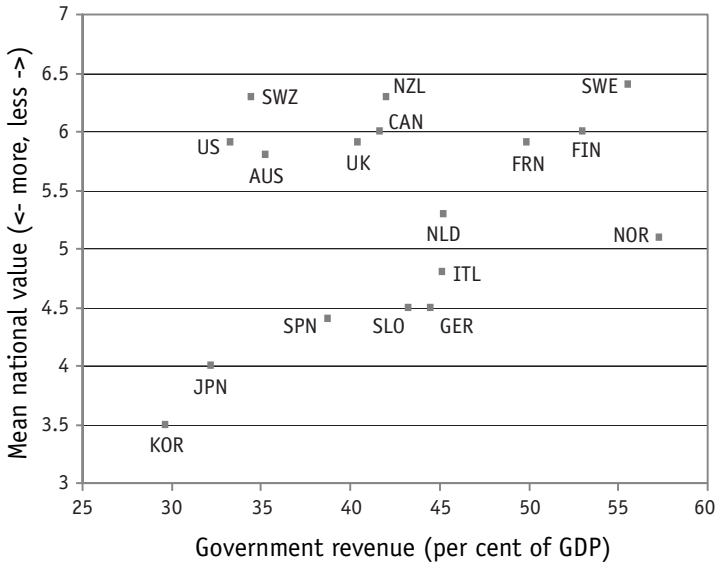


Source: OECD (2010a).

Beyond recent election outcomes, the World Values Survey (2011) affords evidence to the effect that both Americans and Canadians have in the previous decade been among the more adamant of citizens in OECD member states in not wanting government to “do more” than at present. In its 2005-08 round, respondents were asked to indicate the extent of their agreement or disagreement with the following propositions: “People should take more responsibility to provide for themselves” and “the government should take more responsibility to ensure that everyone is provided for.” Respondents could express complete agreement with the first statement (scored at 10), complete agreement with the contrary position (scored at 1), or degrees of (dis)agreement with each by choosing a number between 1 and 10. Chart 5 plots the average national scores among 17 OECD member countries against the average taxing effort in the country over the decade 1999-2008.

**Chart 5**

**National Public Expectations that Government Should Do Less or More, by Average Annual Ratio of Government Revenues/GDP, 1999-2008**



Source: author's calculations from OECD (2010a) and World Values Survey (2011).

The 17 country scores range from 3.5 to 6.4. As to be expected, scores shift toward “people taking more responsibility” at higher rates of taxing effort and, *mutatis mutandis*, shift toward the opposite proposition at lower rates of taxing effort. The Anglo-Saxon countries (US, Britain, Australia, New Zealand, Canada) – and Switzerland – are outliers. At any given taxing effort, these countries are significantly more inclined to conclude that people should be taking more personal responsibility.

Arguably, the direction of causation should be inverted in the medium term (extending over more than a decade): public opinion imposes a floor and ceiling on the ability of democratically elected governments either to tax and spend or not tax and not spend. Based on a crude regression across the 17 countries, a 4 percentage point increase in taxing effort might increase Canada's average score in a future survey from its present value of 6.0 to a value

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between 6.2 and 6.3, placing it close to the apparent ceiling of public tolerance for government “taking more responsibility.”<sup>7</sup>

Provincial and federal cabinet ministers are broadly aware of the implications of pay-as-you-go funding of the boomers’ frail elderly health care costs. Nonetheless, based on the budgetary evidence, it is fair to conclude that most subscribe to the conclusion that the preferred policy is to let health ministers eat everyone else’s lunch. Prefunding amounts to an increase in taxing effort and they are not prepared to prod the hornet’s nest of those opposed to higher taxes. In lieu of prefunding, a sizeable minority of cabinet ministers at both orders of government might well prefer to relax constraints limiting private health insurance.

In the 2008 general election, the Liberals campaigned for a national carbon tax. The result was their lowest-ever share of popular vote – until 2011. The Liberals’ 2008 performance has generated a consensus across national political parties on climate change policy equivalent to that surrounding boomers’ health care: to propose a carbon tax is to prod the hornet’s nest of public scepticism toward tax change, and assure electoral defeat; safer to advocate emissions trading at some time in the future, preferably sufficiently far in the future that it not impinge on any forthcoming election campaign. In addition to the precedent established by the Liberals’ 2008 election campaign, a combination of events has lowered political pressure to act: international diplomatic stalemate, symbolized by the failure of the Copenhagen meeting in 2009; a few ill-advised emails among climate scientists; and the public success of a handful of climate-change sceptics.

### *The Politics of a Carbon Tax*

The government of Canada’s stated target for greenhouse gas (GHG) emissions reduction is that they fall 20 per cent below 2006 levels by 2020, and 65 per cent below 2006 levels by 2050. To realize these targets, modeling for the

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7 The OLS results are as follows:  $y = 2.38 + 1.26x_1 + 0.06x_2$ , where  $y$  is the predicted national score,  $x_1$  is a dummy taking the value 1 for Anglo-Saxon countries (United States, Britain, Australia, New Zealand, Canada) and 0 elsewhere;  $x_2$  is average revenue / GDP over the decade 1999-2008. The adjusted  $R^2$  is 0.44; both regressors are significant at 0.025.

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latest report of the National Roundtable on the Environment and the Economy (NRTEE, 2009) envisions a carbon price of \$100/tonne of CO<sub>2</sub> equivalent by 2020, rising to \$200/tonne by 2025, combined with some international purchase of carbon offsets. To realize the targets domestically, without international trading, would require a \$300/tonne price. Maybe it should be treated as no more than coincidence but, based on 2008 Canadian GHG emissions and a carbon tax levied on major emitters responsible for 50 per cent of total emissions, a tax of \$200/tonne would raise 4.3 per cent of GDP, roughly Robson's prefunding target.<sup>8</sup>

While the odds are not – in the short run – good, there are two pragmatic arguments that suggest grappling simultaneously with the case for prefunding boomers' health care and implementing a carbon tax may improve the chances of success with both. First however is the Pigovian argument.

### The Pigovian argument

A valid concern with any increase in taxing effort is the impact on marginal effective tax rates (METRs). As opposed to prefunding via some other tax, introducing a carbon tax improves the social efficiency of the tax system. As a Pigovian tax, it addresses the divergence between private and social costs. Imposition of a significant carbon tax obviously increases dramatically the private METR of hydrocarbon-intensive activities, but do we want firms to invest in projects based on a private METR, or consumers to make consumption decisions based on prices that do not reflect GHG emissions?

A necessary condition for making the above argument is that we take into consideration abatement benefits accruing to the 99.5 per cent of the world population who are not Canadian. Is this simply altruism? No. Distributional considerations figure prominently in the post-2009 stalemate in climate change diplomacy. Developing countries, China and India in the lead, argue that, because the already industrialized countries account for the great majority of increase in atmospheric CO<sub>2</sub> over the last two centuries, they should

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8 While \$200/tonne is roughly the carbon tax rate required to prefund health care given Robson's parameter choice, there is no guarantee this remains true in the future. If Canada does reduce GHG emissions, the rate would have to be higher than \$200 to meet the revenue target.

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bear the brunt of the costs of reducing GHG emissions. Until they do so, developing economies should continue with “business as usual.” Per capita GHG emissions in Canada are the second highest among major industrial countries, close behind the United States. They are three times that of China, and ten times the comparable Indian statistic. Unblocking the stalemate in international climate change diplomacy will inevitably require United States and Canada to undertake far more ambitious climate change policy than either country has displayed to date.<sup>9</sup>

### Public opinion in British Columbia

The one major jurisdiction in North America to have introduced a significant carbon tax on major emitters is British Columbia. Introduced in 2008, the province’s carbon tax was subject to much partisan controversy. The NDP, Official Opposition to the governing Liberals, opposed it – advocating instead an emissions trading system to be implemented some time in the following decade. In the 2009 provincial election, the NDP promised to repeal the tax. The Liberals won re-election based, in part, on high-profile defections to the Liberals from the Green Party. In a closely fought electoral contest, the move toward the Liberals among many supporters of the Green Party probably provided the margin necessary for a Liberal plurality in the popular vote.<sup>10</sup> In April 2011, the Pembina Institute conducted a random opinion survey on current attitudes in BC toward the carbon tax three years after implementation. Several results are worth noting:

- “BC has taken several steps to address global warming (also known as ‘climate change’). Do you think the current BC government’s approach is too tough, is not

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9 For international GHG emission estimates see IEA (2010). In 2008, the top two emitters, China and United States, jointly accounted for 40 per cent of total emissions. The third through tenth – India ranks fourth and Canada seventh – accounted for 25 per cent. The remaining countries accounted for the final 35 per cent.

10 The final vote distribution changed little between the 2005 and 2009 elections. The Liberal vote share remained unchanged at 45.8 per cent; the NDP vote rose from 41.5 per cent to 42.2 per cent; the Green Party vote declined from 9.2 per cent to 8.2 per cent. However, the Green Party support was consistently at 13 per cent during the campaign, until the final week. Most of the five-point decline in Green Party support probably benefited the Liberals.

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**Table 1****“What are the Best Ways for Government to Collect Taxes?”**

rank	1st	2nd	3rd	4th/5th	score
weight	3	2	1	0	(min=0,
	(per cent)				max=3)
corporate income tax	66.4	18.9	6.7	8.0	2.437
carbon tax	13.3	40.7	16.6	29.4	1.378
sales tax	11.9	14.1	32.2	41.8	0.961
property tax	3.6	12.9	24.6	58.9	0.612
personal income tax	4.8	13.3	19.6	62.3	0.606

Source: author’s calculation from data in survey undertaken by Pembina Institute (Horne 2011).

Note: Respondents ranked each of five taxes in response to the following question: “*The provincial government needs to raise revenue to provide various services to British Columbians, such as health care and education. Much of that revenue comes from taxes. In your view, what are the best ways for government to collect taxes.*” The rows indicate distribution of ranks of each tax. The taxes are ranked based on a linear weighting.

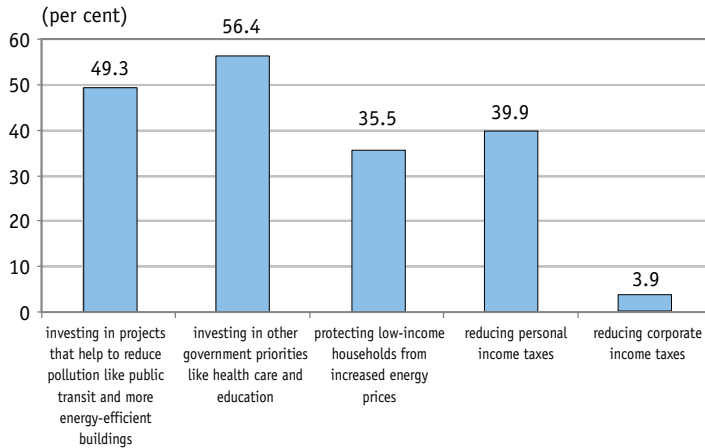
*tough enough, or about right?*” Fifty-two per cent responded “not tough enough”, as opposed to 36 per cent who responded “about right”, and 13 per cent “too tough.”

- “*The carbon tax is applied to all fossil fuel combustion, but isn’t applied to other sources of pollution that causes global warming like methane decomposing from landfills or carbon dioxide being stripped from raw natural gas. Do you agree or disagree that the carbon tax should be applied equally to all sources of pollution that cause global warming?*” Sixty-nine per cent “strongly” or “somewhat agree”; 21 per cent neither agree nor disagree; 10 per cent “somewhat” or “strongly disagree.”
- “*Every year, the carbon tax has been increasing by \$5/tonne, and the schedule currently stops in 2012 when the tax will be \$30/tonne. Do you think the carbon tax should continue to increase after 2012 as part of BC’s efforts to reduce pollution?*” A minority, 29 per cent, want the rate to continue to ramp up, as opposed to 51 per cent opposed, and 21 per cent “don’t know.”

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## Chart 6

### “Appropriate Uses” for Incremental Carbon Tax Revenue



Source: Horne (2011).

Note: The survey posed the following question: “In the future BC’s carbon tax could generate more revenue than the \$1.1 billion currently forecast for 2012. For you, what would be the appropriate uses for any new revenue from BC’s carbon tax?” Respondents chose as many uses as they thought “appropriate” among the five options.

- “The provincial government needs to raise revenue to provide various services to British Columbians, such as health care and education. Much of that revenue comes from taxes. In your view, what are the best ways for government to collect taxes.” Respondents were invited to rank three of five tax options. Scoring the choices on a linear scale, carbon taxes emerged as the second most desirable, admittedly far below corporate income taxes in popularity. (See Table 1).
- “In the future BC’s carbon tax could generate more revenue than the \$1.1 billion currently forecast for 2012. For you, what would be the appropriate uses for any new revenue from BC’s carbon tax?” Respondents were invited to check any of five uses they thought “appropriate.” (See Chart 6.)

After three years, the tax has achieved widespread acceptance, ranking second among preferred tax sources from which the government should obtain revenue. However, ramping up the tax to a level consistent with prefunding health care requirements or NRTEE recommendations clearly does not enjoy majority support.



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It may be relevant that, of the options in Chart 6, spending on health care and education ranked highest, above options reflecting a desire for revenue neutrality. This suggests another parallel with C/QPP reform in the 1990s. Canadians accepted a large increase in a payroll tax conditional on revenue being earmarked for a consensual goal. No major political party has subsequently proposed rolling back the increase and resorting to pay-as-you-go financing. Some of the opposition to the Liberals' 2008 carbon tax proposals can probably be explained by voter mistrust that the incremental revenue would be dissipated in special interest projects, and that any promise of revenue neutrality was not credible.

### "Black-green" realpolitik

Many spokesmen for the oil and gas industry concede that international public anxiety with respect to climate change is sufficient to derail or interminably delay large-scale Canadian hydrocarbon projects – including tar sands expansion – unless there exists a substantial national emissions pricing policy. A recent report published under the auspices of the Calgary Chamber of Commerce and the Canada West Foundation (Brunnen *et al.*, 2011, p. 25) discusses emissions pricing favourably. The report advocates "a national level carbon strategy. This could take different forms such as a carbon tax, which would be the most simple to implement." The authors qualify endorsement of a carbon tax by reference to "other options such as a regulatory approach with a performance standard and multiple compliance options." And industry leaders would lobby that much of the revenue raised by a carbon tax be returned to the sector in the form of R&D subsidy.

Among the executives acknowledging the case for pricing GHGs and accepting a carbon tax as instrument is Michael Cleland, former head of the Canadian Gas Association:

[Energy] prices should include environmental costs, including whatever cost society chooses to attribute to carbon. Carbon policy needs to come to grips with the politically fraught fact that the worst thing that can be done with carbon costs is to impose them and then try to hide them ... [to] argue for cap and trade as a way of disguising the fact that it is a tax. Consumers are smarter

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than policy elites give them credit for. They will find out and they will punish deceivers. Just possibly, if we avoid trying to fool consumers and instead engage them we may be able to find ways forward that they will trust even if they don't relish them. (Cleland , 2011)

The emergence of qualified support for a national carbon tax among oil and gas executives affords an opening for environmental activists and governments (NRTEE, 2009). A carbon tax is, as stated, "simple to implement" relative to the alternative, emissions trading. From the perspective of firms calculating net present value of hydrocarbon investments, an advantage of a carbon tax over the "cap and trade" alternative is greater certainty of future costs. Trading in emissions permits has generated volatile prices. From the public perspective, a tax assures that revenue from addressing the GHG externality accrue to the public, as opposed to private agents with market or political advantage.<sup>11</sup> In addition, collapse of many derivatives markets in 2008 has dampened enthusiasm for trading complex contracts governing hypothetical changes in hydrocarbon use.<sup>12</sup>

## *Implementation*

Implementation of a prepayment scheme via an earmarked carbon tax is certainly feasible given our history of complex federal-provincial fiscal arrangements. All revenues from a federal carbon tax should be credited to a medicare "prepayment account", to be managed at arm's length from Parliament. The account managers would become responsible for annual disbursements to

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11 Launched in 2005, the largest functioning "cap and trade" market is the European Union Emission Trading System. Initially, EU governments issued too many permits and the permit price collapsed. Control of the supply of permits has tightened in recent years, but the market price remains subject to much uncertainty over the range of emitters to which the system will apply and schedule of permit supply in future years. At time of writing in July 2011, the emissions permit price/tonne of CO<sub>2</sub> is C\$18 (Point Carbon, 2011), less than the rate imposed by BC's carbon tax. For a dispassionate assessment of implementing a carbon tax vs emissions trading, see Price Waterhouse Coopers (2009). An important advocacy group engaged in this debate is the Carbon Tax Center (2011).

12 To appreciate the complexity of carbon trades, see the glossary of terms prepared by Point Carbon (2011).

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provinces based on deviations from a population distribution that serves as benchmark. A census, say that for 2011, could provide the data on provincial population by age cohorts; subsequent censuses would provide data on provincial cohort deviations from the benchmark distribution. The Canadian Institute for Health Information (CIHI) already estimates cohort-specific provincial health expenditures. The managers of the account would accordingly have available the data necessary to calculate provincial claims on the account. Account managers would also be responsible for investing surpluses generated in early years in the capital market.

It is an understatement to acknowledge that implementation presents many problems that the above sketch ignores. I conclude with brief mention of three.

### Benefit creep

While politicians may precipitate a new C/QPP crisis by enlarging benefits without equivalent tax adjustments, well defined benefit regulations provide credibility to the program's financial viability. No such administratively well defined regulations exist to constrain health care benefits.

At present, the financial credibility of public health insurance programs rests on public willingness to pay the required pay-as-you-go taxes, as interpreted by provincial and – to the extent Ottawa is prepared to share costs – federal politicians. As medical technology improves and the age 65 and over population share rises, there will be intense pressure to increase age-related health benefits. If the age 65 and over cohort-specific health costs rise beyond the provisions of the prefunding formula, then prefunding will not preempt the need for future increases in pay-as-you-go taxes and/or abandonment of a single-payer system.

### The value of equalization

Provincial governments are the locus of most major policy decisions with respect to health care. If a prefunding arrangement is to have any chance of gaining credibility, the provinces must retain and strengthen a political/administrative culture able to internalize both the costs and benefits of incremental public spending. Equalization is crucial to that end. At various times in

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the 2000s equalization was in danger of degenerating into a predetermined entitlement for traditional “have not” provinces.<sup>13</sup>

In the words of the Constitution Act (s.36 (2)), “Parliament and the government of Canada are committed to the principle of making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation.” Equalization is a valuable institution inasmuch as it enables reconciliation of Canadians’ expectations of comparable services across the country with tax-spending coincidence at the margin, and a form of interregional insurance against regional economic shocks. It provides appropriate incentives for provincial politicians to internalize both the costs and benefits of incremental public spending. In the context of health budgeting, this entails health decisions based on pragmatic cost/utility considerations.

### Pharmaceuticals

Ottawa has provided statements of principle (viz. the national standards of the Canada Health Act) with respect to health insurance, and assumed roughly a quarter of provincial expenditures via intergovernmental cash transfers. Arguably, prefunding would be easier to implement and the quality of Canadian public health management would improve, if federal officials became more familiar with the complexities of health care management by themselves assuming responsibility for elements of the system. The ideal candidate is pharmaceutical policy. Already Ottawa plays a role: in undertaking clinical trials on drugs and in legislating the extent of patent protection. Pharmaceuticals are the most rapidly growing major component of health spending; they now comprise about a sixth of provincial health costs, about 1.5 per cent of GDP. As with other major health care envelopes, pharmaceutical use is skewed toward older age cohorts.

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13 Paul Martin’s ad hoc 2004 deal to allow Newfoundland to keep its equalization allocations intact despite rising offshore oil royalties severely damaged the program’s credibility. Al O’Brien’s report (Department of Finance, 2006) provided the basis for restoring credibility in the short run. However, equalization continues to be subject to ad hoc federal amendments, and public understanding of the program’s rationale is limited.

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The present agreement governing Ottawa's share of provincial health care budgets was negotiated in 2004 for a period of ten years. At the time of negotiation in 2004, the provinces proposed that Ottawa assume responsibility for pharmacare, with the hope that Ottawa organize a national formulary, undertake bulk purchasing of generic drugs, and standardize pharmaceutical insurance on a national basis (Marchildon 2006). Ottawa refused the provincial offer, preferring to transfer cash instead.

The provincial offer of 2004 still makes sense. Of all major health care components, pharmaceuticals are the most likely to demonstrate scale economies – in cost/utility evaluations necessary for formulary design, potential to exercise market power in bulk purchasing, and so on. If Ottawa managed pharmaceutical policy, it should be eligible to draw from the prefunding account in the same manner as the provinces.

## *Conclusion*

In the current environment of public scepticism toward increased tax effort, the above exercise is open to the charge of idle speculation. Writing in another context (preserving the credibility of the euro), Larry Summers (2011) has summarized the “art of economic policy making [as] reconciling the political and the technical or arithmetic imperatives. You cannot move forward in democratic nations without sufficient political support ... But we ask our political leaders not simply to take the preferences of their citizenry as a given.” Idle speculation has its place. At a minimum, it invites advocates of particular agendas to address the politics of taxing, and to assess seriously the need for alliances if they are to achieve goals that they are unlikely to realize alone.

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