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Editor's notes

I have just returned from an "appreciation of the reality of government" holiday—which is to say, I took a trip to central Canada. My first stop was in Ottawa, where I admired the city's statuary, particularly the stunning war memorial, looked at the paintings in the National Gallery, sat in a plush chair at the National Arts Centre, and drove by the homes of our prime minister and governor-general. (I did not go in for tea.) I also took the opportunity to take one of the many short tours of the Parliament buildings, and was impressed by the beauty of the buildings themselves, but a bit disappointed at how small they seemed in real life. Parliament was not in session, so the halls were devoid of politicians and the hustle and bustle of governance in action.

In order to see real, live politicians, I travelled to Montreal to attend the Institute's tribute to Prime Minister Brian Mulroney. At the event, the former prime minister received the Institute's TP Boyle Founders Award, which honoured him for his contributions to free trade—a contribution that each of us benefits from every day, but like so much that is essential to our good lives in North America, most of us take for granted. An audience of about 500 heard Mr. Mulroney's acceptance speech, including many current and former federal and provincial politicians, as well as senators and policymakers. It was a peculiar sensation to be in the company of many of the people who pass laws and set the policy agenda for so many of the rules and regulations that govern our daily lives.

The event marked the formal launch of The Fraser Institute into Montreal. "L'Institut Fraser" opened its doors in the summer, but this well-attended gala event on October 4th was the first big statement of the Institute's presence in the province. To recognize the opening of the new office, this issue of *Fraser Forum* includes news about the office as well as a list of some of its forthcoming events. This issue also includes articles that focus on Quebec's public policies, including its health care and investment climate.

You'll be hearing much more from and about the Institute's Montreal office in the next months and years; *Fraser Forum* will help keep you up to date.

* * * *

This issue also marks a change for *Fraser Forum*. A new colleague has joined the Publications department. With this issue, Kristin Fryer, a graduate of Trinity Western University, will begin helping with the editing, design, and layout of the magazine. I know that she will have many new ideas she can bring to the contents and look of *Fraser Forum* and I hope you will join me in welcoming her.

—Kristin McCahon (kristinm@fraserinstitute.ca)

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A Modest Proposal for Ottawa

End Provincial Liquor Monoplies

by Mark Milke

Given the recent ascent of the Canadian dollar, more Canadians than ever will cross the Canada-US border to vacation and to buy goods in American stores. As a result, most will become familiar with our federal government's regulations which restrict the amount of goods that can be brought back tax and duty-free: $50 worth of goods for those on the other side of the border for 24 hours, $400 for those absent for two days, and $750 for those out of the country for a week (amounts in Canadian dollars).

But consumers shouldn't expect that such rules apply equally. If, for example, they bring back that hard-to-find Californian wine or too much beer for the next hockey game, cross-border shoppers will quickly find such goods are not included in the above exemptions. For those who wish to treat themselves to inexpensive American alcohol, the duty and tax-free limit is 1.5 litres of wine (two common-sized bottles) and 24 cans of beer. Beyond that, Canadians should prepare to hand over the credit card to pay excise tax, GST, provincial sales tax, and the "mother" of all border taxes on wine, beer, and spirits: the provincial liquor mark-up fee (Canada Border Services Agency, 2007).

Case in point: after my recent weekend trip south to the small Washington state town of Ferndale, I brought back 11 bottles of American wine. Prices ranged from $3.33 (!) to $11.99 USD. Because even Alberta's liquor taxes are higher than those found in US states, I would estimate similar wine would cost $9 to $25 CDN per bottle in Calgary.

Including tax, I paid $71.84 in Washington state for my 11 bottles of wine, or approximately $6.53 per bottle, most of which I had never seen on Canadian shelves. But then I drove back to the border where Canada Customs charged me $3.22 in GST, $4.19 in federal excise tax, and $45.63 for Alberta's provincial liquor mark-up fee.

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Regrettably, the provincial premiers didn't understand the employment benefits of free trade.

The exchange rate wasn't quite one-to-one that day, but to keep it simple assume it was. So my $71.83 purchase actually came to $124.88. My $6.53 bargain bottles were now $11.35 each.

That's half a decent deal. But had I lived in any other province, where provincial mark-ups are higher than Alberta and where residents must pay provincial sales tax, buying US alcohol would be a lose-lose proposition for my palate and my wallet.

That border experience made me wonder why, 19 years after the Canada-US free trade agreement was made, Canadian consumers must pay anything extra at the border on beer, wine, and spirits.

After all, if I had bought clothes instead of wine my $72 purchase would have been waved through at the border. The answer is found in the federal government's protection of provincial governments' quasi-monopolistic liquor stores, and their exorbitant liquor mark-ups.

The father of free trade, Brian Mulroney, was regrettably the one who, back in 1992, cut a deal with provincial governments to ensure consumers could only bring back a limited value of goods from the United States. That year, after one of those first ministers meetings that regularly produce pliant prime ministers, Mulroney promised the premiers he would fight cross-border shopping (*The Province*, 1992).

In 1992, newspapers reported that the border shopping program crackdown would include measures to stem the

continued on page 13

The Curious Case of Quebec

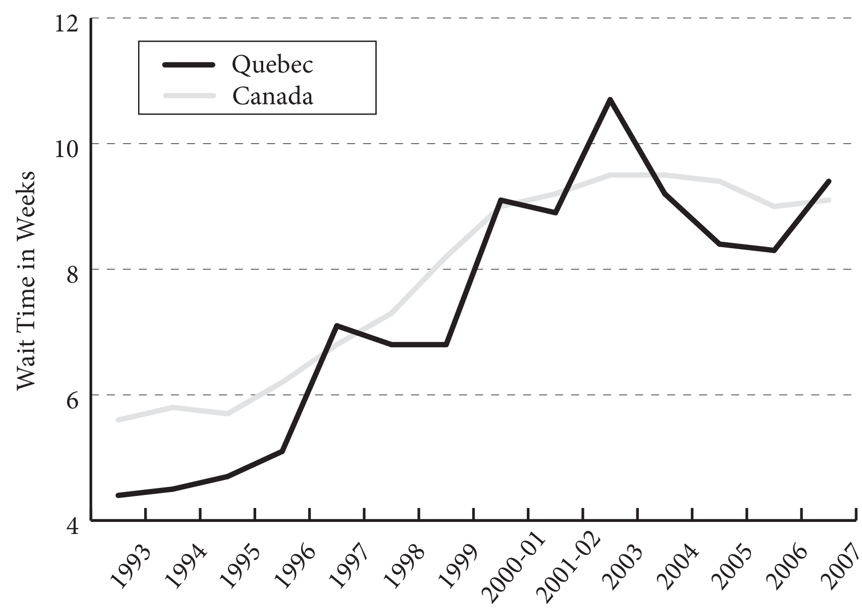
by Nadeem Esmail

Defenders of the status quo in health care often suggest that Canada's health care programs would benefit from stricter controls on pharmaceutical spending and a stricter ban on the availability of privately funded care. They claim such policies would make health care more financially sustainable for the future and would ensure that all Canadians have equal access to a tax-funded health care program, without affecting the quality or quantity of care delivered to Canadians. But the performance of *la belle province* suggests they are wrong.

Consider that, in 2007, Quebecers experienced the third shortest weighted median wait time for treatment, averaged across 12 medical specialties, after seeing a specialist among the provinces. Furthermore, as figure 1 shows, Quebec's overall wait times from specialist to treatment have only crept above the national average in four of the last 14 measurements of wait times produced by The Fraser Institute (Esmail and Walker with Bank, 2007).

What's surprising about this performance is the fact that Quebec manages it without spending more on health care than the other provinces. In 2004, the most recent year for which comparable data are available, Quebec's total health spending per capita was the lowest in Canada (figure 2). Looking at only provincial government health expenditures per capita, and adjusting for the age and sex of the population, no provincial government spent less on health care than Quebec that year (CIHI, 2006).

Figure 1: Weighted Median Wait Time from Specialist to Treatment, 1994-2007



Source: Nadeem and Walker with Bank, 2007.

Quebecers also enjoy lower rates of growth in their health expenditures than most other provinces. As table 1 shows, between 1996 and 2004, Quebec's total and public health expenditures per capita grew at an average rate of 5.7%, the second lowest rate of growth in Canada in both instances (CIHI, 2006).

Quebec maintains below average wait times (see figure 1) and a lower level of spending (relative to other provinces) by doing two things that would shock many of Canada's pro-status quo pundits: it spends a lot of money on pharmaceuticals and allows competition

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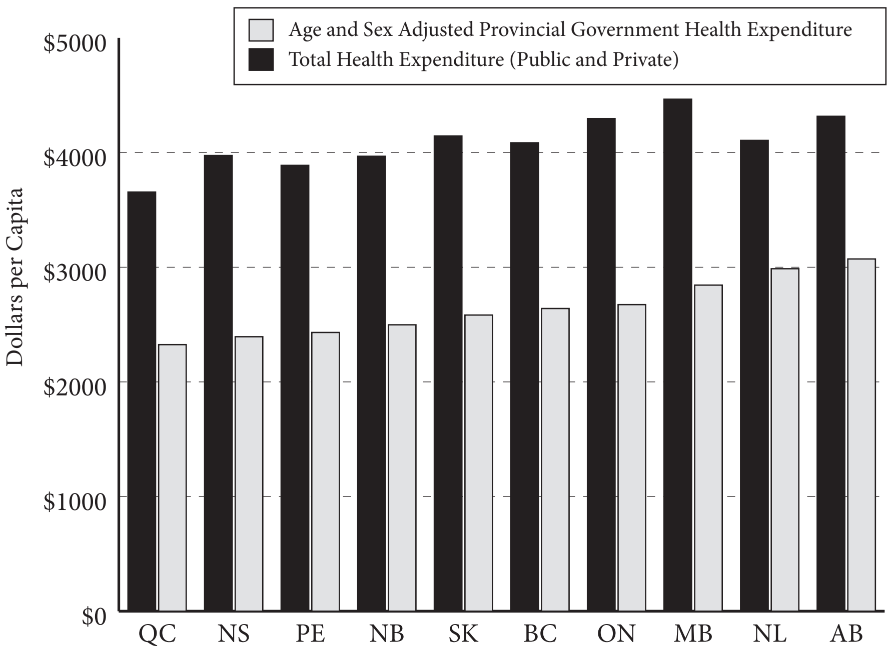
Figure 2: Health Expenditures per Capita, by Province, 2004



Source: CIHI, 2006.

Table 1: Average Annual Growth in Per Capita Health Expenditures, 1996-2004

Province	Total	Public	Private
Newfoundland	7.9%	7.8%	8.6%
Prince Edward Island	5.8%	6.2%	5.1%
Nova Scotia	7.5%	7.6%	7.2%
New Brunswick	6.5%	6.1%	7.5%
Quebec	5.7%	5.7%	6.0%
Ontario	6.1%	6.0%	6.4%
Manitoba	6.9%	7.1%	6.4%
Saskatchewan	6.9%	6.9%	6.6%
Alberta	8.4%	8.6%	7.8%
British Columbia	5.5%	5.0%	6.8%

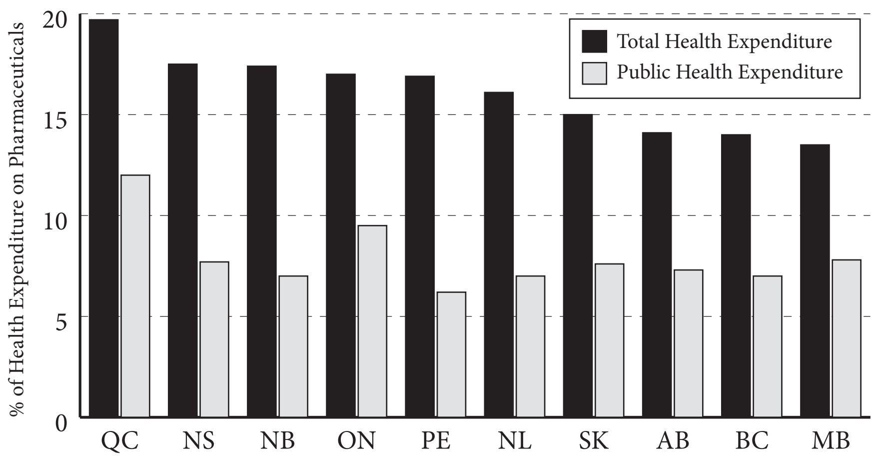
Source: CIHI, 2006; calculations by author.

from a privately-funded sector delivering medically necessary health services.

According to economic research, spending money on newer (and generally more expensive) drugs can actually reduce health care expenditures overall. For example, Frank Lichtenberg examined the relationship between the age of pharmaceuticals Americans were taking and the number of non-drug medical events that these individuals experienced that were associated with the same condition (Lichtenberg, 2001). He found that individuals who were taking newer drugs actually experienced fewer and shorter hospital stays than those who were consuming older drugs. The group using newer drugs also used less non-drug health care services overall, including physician visits. He estimated that switching from a 15-year-old drug to a 5.5-year-old drug would increase the cost of a prescription by about $18, but would reduce the expected number of hospital stays (about 6 fewer stays per 1,000 prescriptions), the length of those stays, and the number of health services used, thus saving $71 overall.

There is evidence that higher drug expenditures can reduce waiting times, partly because of the effect described above and partly because pharmaceuticals can act as a substitute for surgical interventions. A study of wait times in Canadian provinces from 1993 to 1998 found that provinces that spent more on health care had neither shorter nor longer waiting times than provinces that spent less, and had no higher rates of surgical specialist consultations and procedures.[1] Instead, provinces that spent more actually had lower rates of procedures and major surgeries. Expenditures on pharmaceuticals specifically, however, were related to lower waiting times (Zelder, 2000). A follow-up study that looked at wait times from

Figure 3: Percent of Health Expenditure on Pharmaceuticals, by Province, 2004



Source: CIHI, 2006.

1993 to 2003 using a similar methodology found that health expenditures (other than those on pharmaceuticals and doctors) were actually correlated with increases in waiting times, while spending increases targeted at doctors or pharmaceutical expenditures were related to a reduction in wait times. The relationship between pharmaceutical expenditures and waiting times was robust but not statistically significant.[2]

These lessons appear not to have been lost on Quebec. In 2004, Quebecers committed 19.7% of their total health expenditures to pharmaceuticals, the largest proportion among the provinces (figure 3). That gap between Quebec and other provinces grows substantially when only public expenditures on drugs are compared (CIHI, 2006). In addition, research has suggested that these higher levels of drug expenditure have likely meant longer and more enjoyable lives for Quebecers (Frech and Miller, 1999; Crémieux *et al.*, 2005; Lichtenberg, 2003).

A private parallel health care sector... would give individuals the freedom to choose when and where their health care is delivered.

Quebecers have also benefited from their government allowing one of Canada's largest private health care sectors to flourish (Shimo, 2006).[3] A privately funded health sector provides a competitive restraint for the government sector by offering patients the opportunity to protest for better quality by choosing to purchase services privately instead of receiving them through the tax-funded program. Such an environment also encourages efficiency and innovation. If patients were not permitted to opt for higher quality accommodations, surroundings, or care from the private comprehensive system that provides such services, the public health care system would not need to consider offering them (Boucher and Palda, 1996). More importantly, a private parallel health care sector, where individuals are free to seek care on their own terms with their own resources, would give individuals the freedom to choose when and where their health care is delivered, regardless of whether the government is willing to offer it.

While those who believe that the status quo can only be sustained by strict controls on pharmaceutical expenditures and bans on private health care may be shocked by Quebec's performance, those who know the facts should not be surprised at all. While much can be done to improve the performance of all health care programs in Quebec and Canada as a whole, some provinces are now doing some things that are making a difference in the everyday lives of their citizens. Following Quebec's example, by freeing up health spending on pharmaceuticals and allowing the delivery of privately financed health care, would be a step in the right direction for all Canadian provinces. Following the advice of the status quo pundits will only make things worse.

Notes

1 The study controlled for differences across provinces, including differences in disposable income per capita and in the percentage of elderly people in each province.

2 While the relationship between drug spending and waiting times was not found to be statistically significant, the author ran six alternate statistical models and found that drug spending was related to shorter waiting times, regardless of the model's specifications.

3 The private health care sector in Quebec existed before the Supreme Court struck down Quebec's prohibition of private

health insurance in the Chaoulli decision and before the Quebec government's half-hearted policy response to that decision. Quebec changed its policy to allow private insurance for cataract surgery and hip/knee replacement, but only after implementing a care guarantee for these services.

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Quebec's Dismal Investment Climate

by Keith Godin, Jason Clemens, & Milagros Palacios

Business investment is a powerful driver of economic growth, providing the resources for new machinery, equipment, and technologies, which are necessary, first to improve productivity, and then to improve wages. Politicians, bureaucrats, and the general public are becoming more aware of the importance of business investment as a determinant of current and future prosperity. Unfortunately for Quebec, it has one of the worst investment climates in Canada.

In a recent study, the Canadian Provincial Investment Climate Report (Clemens *et al.*, 2007) provides an empirical analysis of the relative investment climates of the Canadian provinces. The policies included in the report were determined by seven years of survey data from Canadian investment and pension managers. Specifically, the study evaluates provincial investment policies in seven areas: corporate income tax, fiscal prudence, personal income taxes, infrastructure, corporate capital taxes, labour market regulation, and regulatory burden.

The results for Quebec are nothing short of disastrous. The province ranked ninth overall amongst the 10 provinces with a score of 3.0 out of a possible 10. Quebec only outpaced Prince Edward Island, which received a score of 2.6. It also significantly underperformed compared with Ontario, Canada's other highly populated province; Ontario ranked fourth with a score of 5.0. Quebec was far behind Canada's two leading provinces, Alberta and British Columbia, whose investment climates received scores of 8.9 and 6.0, respectively.

Fortunately for Quebec, its poor performance in specific areas is also a path to an improved investment climate. For starters, Quebec ranked last in four of the seven indicators examined: fiscal prudence, personal income tax, corporate capital tax, and the regulatory burden (table 1). Quebec's record of fiscal prudence—a measure of the government's ability to balance its books and constrain spending—was determined

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Table 1: Highlighting Quebec's Performance, Ranked in Relation to the Other Provinces

Indicator	Quebec's Score (out of 10)	Quebec's Rank
Overall	3.0	9
Corporate Income Tax	10.0	1
Fiscal Prudence	2.2	10
Personal Income Tax	0.7	10
Transportation Infrastructure	3.3	9
Corporate Capital Tax	2.1	10
Labour Market Regulation	2.1	8
Regulatory Burden	0.0	10

Source: Clemans *et al.*, 2007.

to be worst in all of Canada. In fact, Quebec's government spending and debt payments remain among the highest of the provinces.

Another reason for Quebec's dismal investment climate is high taxes. While Quebec boasts low corporate income taxes, it continues to maintain the highest personal income taxes and highest corporate capital taxes in Canada. Quebec's use of damaging and costly corporate capital taxes is particularly disconcerting in terms of attracting investment, as Quebec continues to be the country's heaviest user of capital taxes.

The regulatory burden, which measures the costs imposed on Quebec from provincial regulations, was estimated to be 4.5% of the Quebec economy in 2005. One way to understand regulatory costs is to think of them as invisible taxes. Thus, regulatory costs impose an additional 4.5% tax on the entire Quebec economy.

Unfortunately, poor fiscal prudence, high taxes, and a high regulatory burden are not the only problems that the province faces. Quebec also performed poorly (eighth) in labour regulation. In fact, Quebec's labour laws were determined to be one of the most rigid and biased in all of Canada. Biased and rigid labour laws result in slower job growth, higher rates of unemployment, and lower levels of investment and economic growth (Godin *et al.*, 2006).

While Quebec has the worst investment climate among the Canadian provinces, its actual performance in attracting investment is stronger than one would expect. That discrepancy is the result of a "home bias."[1] That is, Quebec is attracting more investment than one would expect given its public policies because of a built-in predisposition for domestic or home-based investment in that province. Such a predisposition is based on a greater awareness and understanding of one's home jurisdiction.

That Quebec has one of the highest concentrations of financial firms and investors in Canada explains why it performs reasonably well on survey-based assessments and attracts better-than-expected investment. The risk to Quebec is that it will fall further and further behind, while other provinces with more sound economic policies move ahead, which will eventually mitigate the beneficial effects of the home bias.

Quebec's investment climate needs repair unless the province is satisfied with its continued low performance and over-reliance on Montreal's financial class. The best way for the province to improve its economic performance through more investment is to improve its weak areas. Specifically, the province must reduce personal and capital taxes, improve its finances, promote investment in infrastructure, implement balanced labour laws, and dramatically reduce regulatory costs. These policies will establish a strong and viable foundation for improved economic and investment performance in Quebec.

Notes

[1] For more information on home bias, see Coval and Moskowitz, 1999.

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Applying the Brakes on Federal Spending

by Jason Clemens, Niels Veldhuis & Milagros Palacios

When the Conservatives first came into office, they were committed to limiting the growth of government spending and reducing taxes. Regrettably, federal spending growth has not slowed and continues to impede the government's ability to materially reduce Canada's tax burden. Former Liberal Finance Minister John Manley recently suggested that Canada needs a new fiscal anchor in the post-deficit era (*Financial Post*, 2007). As the 2009 federal budget approaches, the Conservative government would do well to heed Mr. Manley's advice by implementing tried and tested spending rules.

The size and recent growth of federal government spending is startling. The federal government expects program spending to reach $199.6 billion in 2007-08 (Department of Finance, 2007), an increase of $24.4 billion or nearly 14% from just two years ago.[1] The rate of growth in spending is well beyond what was needed to compensate for inflation and population growth, which was the goal of the Conservative Party during the election. More worrying is that the size of the federal government as a share of the economy is expected to increase from 12.8% of the GDP two years ago to an estimated 13.3% of the GDP this year.

Understandably, controlling the finances of a nearly $200 billion organization is a daunting task. Compound the size of the federal government with the unique incentives faced by those operating in the public sector, and the task of controlling spending becomes that much more difficult.

Thankfully, two tried and tested rules-based solutions are available.

The first has been used by a number of governments both in and outside of Canada, and was trumpeted by the Conservative Party itself during the election. It is a rule (i.e., law) that would limit the growth in total government spending to population growth plus inflation. As a result, per person spending by the federal government would increase at the rate of inflation. To ensure that the spending limit would be followed, all federal ministries would be required to report quarterly on their spending performance, and senior bureaucrats and ministers would have part of their compensation tied to performing within this rule. In 2001, British Columbia undertook such steps in order to rein-in government spending. Specifically, Ministers faced a salary holdback of up to 20% if the ministries under their control did not achieve their spending targets.

Secondly, the federal government should consider Pay-As-You-Go requirements (PAYGO), which were extraordinarily successful in the United States under President Clinton. PAYGO requires that any new spending programs must be financed by reductions in existing programs. As a result, existing spending is better scrutinized and funds are reallocated to higher purposes when appropriate. Put differently, a PAYGO rule would force the government to find low yield spending and would slow the growth in government spending. The Congressional Budget Office in the United States found that PAYGO rules contributed to the improvement of the government's fiscal outlook in the mid-1990s (Congressional Budget Office, 2007). In fact, the growth rate of US federal government spending only exceeded population growth and inflation once between 1993 and 2001.

To fulfill their commitment to limit government spending, the federal government must look at implementing

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rules-based solutions. If implemented, the result would be a better use of existing resources and, at minimum, a slowdown of the growth in government spending. Ultimately, if spending with low returns is eliminated and more fiscal room for tax relief is created, then taxpayers will receive better value for their money. With federal program spending approaching $200 billion and Canadians paying nearly half of their incomes in taxes, the time has come to apply the spending brakes.

Notes

[1] Program spending in 2005-06 was $175.2 billion (Public Accounts of Canada, 2005-2006).

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Creating the BC Advantage

by Niels Veldhuis
Jason Clemens

For more than a decade, Albertans have enjoyed the benefits of Canada's most successful economy, which is largely due to the Alberta Advantage. The widely recognized Alberta Advantage is based on the combination of Canada's lowest tax rates, smallest government, and most attractive investment climate. However, the province's focus on the Alberta Advantage has been slowly eroded. British Columbia now has an opportunity to surpass Alberta and create a BC Advantage, consisting of the lowest personal income and business taxes in Canada. With relatively little effort, BC Finance Minister Carole Taylor and the governing Liberals can make the BC Advantage a reality in the next provincial budget.

To understand the opportunity that lies before British Columbia, it is important to examine what has transpired in Alberta. Since 1994-95, the year in which Alberta began its recent string of budget surpluses, the province's program spending has increased at almost double the rate needed to compensate for inflation and population growth. In other words, Alberta's spending on a per person basis (adjusted for the effects of inflation) has risen tremendously over the last decade. Regrettably, increased spending has come at the expense of securing the most important pillar of the Alberta Advantage: low personal and business tax rates. Unsustainable increases in spending and a lack of tax relief over the past few years clearly signal a shift away from the very policies that created the foundation of Alberta's current prosperity.

With Alberta's government appearing to flounder, British Columbia now has the opportunity to top Alberta and create a tax advantage over the rest of the country. *2010: BC Tax Advantage*, a recently released study by The Fraser Institute, proposes a three-year fiscal plan that would give British Columbia Canada's lowest personal income and business taxes.

This fiscal plan acknowledges more realistic revenue expectations. Consider that the government has recorded much higher revenues than expected in each of the past four years. Specifically, the BC government has accumulated $10.6 billion more in revenue than it expected from 2003-04 to 2006-07. In


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2006-07 alone, the province collected $3.1 billion more than was budgeted.

While the public perception is that the excess revenue is the result of booming resource revenues, the opposite is the case. Natural resource revenues have actually fallen short of expectations by $166 million over the past four years, while personal and corporate income tax revenues exceeded expectations by $1.6 billion and $791 million, respectively.

More accurate expectations of future revenues provide the resources to implement meaningful and sizeable tax relief. Specifically, the *2010: BC Tax Advantage* study recommends a three-year, $7.1 billion tax relief plan that includes:

- reducing the number of personal income tax brackets from five to two, and reducing the remaining top personal income tax rate from 8.15% to 8.0%;
- reducing the corporate income tax rate from 12.0% to 8.0% percent;
- increasing the threshold for income eligible from $400,000 to $1 million for the small business tax rate;
- eliminating the financial corporate capital tax; and,
- harmonizing the provincial sales tax with the GST.

This five-point plan would invigorate and strengthen the BC economy. Having Canada's lowest personal income tax rates for all taxpayers would dramatically improve the province's incentives for effort, risk-taking, and entrepreneurship, and would aid in attracting and retaining professional and skilled workers.

A substantial tax advantage for businesses would also be created. Maintaining the country's lowest corporate income tax would promote and encourage investment and development in the province. In addition, increasing the small business threshold would create a great advantage for small businesses in British Columbia by mitigating the impact of facing a much higher

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The Failure of Labour Sponsored Funds

by Douglas Cumming and Keith Godin

Entrepreneurial activity is increasingly being recognized as a critical determinant of a prosperous economy. To encourage more entrepreneurial firms, many Canadian governments have created Labour Sponsored Venture Capital Corporations, commonly referred to as labour sponsored funds. Despite good intentions, labour sponsored funds have turned out to be a significant waste of tax dollars. They cost Canadian taxpayers nearly $300 million per year but do not actually increase the amount of funding available to entrepreneurs. If Canadian governments wish to stimulate investment in entrepreneurial activity, then the elimination of labour sponsored funds would be a good place to start.

Labour sponsored funds are tax-subsidized investment funds that attract contributions from individual investors through generous tax incentives, and then invest in entrepreneurial businesses. These tax credits result in a significant cost to the federal and provincial governments in the form of foregone tax revenue—a cost that is ultimately borne by Canadian taxpayers.

In 2006, federal tax credits for labour sponsored funds cost the federal government $150 million. Quebec, which spent $98 million, spent significantly more credits than any other province, while Ontario and British Columbia both spent $20 million. In total, Canadian governments spent approximately $300 million on tax credits to support labour sponsored funds in 2006 (Cumming *et al*., 2007).

Canadian taxpayers receive little to no value for the $300 million spent each year.

Unfortunately, Canadian taxpayers receive little to no value for the $300 million spent each year. Most critically, the generous tax credits provided to investors of labour sponsored funds do not actually increase the total amount of money available for Canadian entrepreneurs; instead, they displace money from private venture capital funds. Furthermore, there is evidence to suggest that they may have even lowered the total amount of money available to entrepreneurs. It is estimated that federal labour sponsored funds have resulted in a decrease of more than 400 venture capital investments per year, Canada-wide, representing nearly $1 billion (Cumming *et al*., 2007).

Generous tax credits are ultimately the reason why labour funds discourage the presence of private venture capital. Since these credits are not available to investors of private, non-labour funds, the required rate of return on labour sponsored funds can be lower than the comparable rate for private funds. In effect, the tax credit partially substitutes for a rate of return and allows labour sponsored funds to outbid private funds. As a result, returns to private funds may be lower, which discourages non-labour fund investors from contributing money.

Labour sponsored funds also tend to maintain large amounts of cash (uninvested capital), since they raise billions more then they actually invest. This uninvested capital is partly the result of a requirement that labour sponsored funds hold between 20% and 40% of all contributions in low-risk investments like government bonds (Cumming *et al*., 2007). As a result, fewer businesses are being created than would be the case if labour sponsored funds were actively investing all of the money they raised.

Another striking fact about labour sponsored funds is their poor rates of return, which are consistently below those of risk-free investments like

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30-day Treasury Bills. While it is reasonable that some of the new firms that labour sponsored funds invest in will fail, overall, fund managers should be expected to make good decisions and generate reasonable rates of return for investors. Ultimately, the poor rate of return on labour sponsored funds indicates that they have not been successful at financing high-growth entrepreneurial businesses.

Labour sponsored funds charge investors significantly more than private funds to invest their money. That is, labour sponsored funds have high expense ratios—fees charged by fund managers—despite their poor rate of return. According to Morningstar.ca, the median labour sponsored fund management expense ratio is 5.5%, which is more than twice that of the average-managed mutual fund in Canada.

It's clear, therefore, that Canadians are investing in labour sponsored funds to get generous tax credits, and not because they want to invest in Canadian entrepreneurs or expect to earn a high rate of return.

Ensuring that Canadian high-growth entrepreneurial firms have access to sufficient capital is critically important to the health of our economy. Labour Sponsored Venture Capital Corporations, however, are not the answer. It's time for Canadian governments to eliminate tax subsidies to labour sponsored funds, and consider other more effective policy options.

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A Modest Proposal for Ottawa: End Provincial Liquor Monopolies

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flow of American cigarettes and liquor across the border. Then-premier of Ontario Bob Rae confirmed that the plan would include a proposal to collect provincial sales taxes from Canadians bringing back American consumer goods (*The Province*, 1992). The ostensible reason for the measure in 1992 was unemployment. Regrettably, the provincial premiers didn't understand the employment benefits of free trade.

However, the more likely reason was that provincial governments wanted more revenues, and wanted to protect government liquor stores and excessive provincial liquor mark-ups. In that respect, little has changed. Every province with the exception of Alberta still runs government liquor stores and every province still charges significant alcohol mark-ups. It is part of the reason beer, wine, and spirits are lower-priced south of the Canadian border.

I would suggest two modest proposals to the federal government. First, the federal government should stop collecting liquor mark-ups on behalf of the provinces. Ottawa doesn't concern itself over the loss of a private sector mark-up if, for example, a consumer buys a cheaper stereo at an American Wal-Mart instead of a Canadian version (assuming the mark-up here is higher). The fact that provincial governments own and run the liquor distribution systems in their respective provinces does not ipso facto mean Ottawa must protect their monopolistic margins.

Besides, the ostensible reason for the cross-border crackdown in 1992, unemployment, is now at a four-decade low. So Ottawa can happily inform the provinces that their concern has been dealt with and that the federal government will no longer police the border for that extra, over-the-limit six-pack. Border agents could instead devote more energy to matters of safety and security, such as spotting terrorists.

If that proposal seems too much to enact at the present, at the very least, Ottawa should include beer wine and spirits in the existing $50, $400 and $750 exemptions. Again, it is not as if border customs agents charge Canadian consumers for other consumer goods that are valued under those allowable limits.

Federal Conservatives shouldn't be shy about trumpeting such a unilateral policy change. Most Canadians like the at-par Canadian dollar and plan to spend more time and money on products from the United States, including beer, wine, and spirits. Such consumers (and voters) would welcome the saved time at border crossings and the break on excessive provincial mark-ups. In addition, freeing up consumers is a useful way to deepen support for free trade as it allows consumers to get regular exposure to how free trade was meant to work.

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Canada's Stake in the Security and Prosperity Partnership

by Alexander Moens & Michael Cust

The Security and Prosperity Partnership of North America (SPP), agreed to by the United States, Canada, and Mexico in 2005, represents a set of discussions among government officials in various departments of the Executive Branch, who were assisted by business advisory groups. Their shared goal is to achieve more common standards, harmonized regulations, and coordinated policies on a wide selection of trade, product, transportation, and cross-border security issues. The leaders have agreed to an annual summit at which they will approve progress and set new targets.

The SPP is not a new venture, but a renaissance of the various trilateral working groups that were created during the NAFTA negotiations. These groups were given the task to identify and overcome non-tariff barriers to trade. But by 2000, most of these working groups had lost their momentum (Anderson and Sands, 2007). The SPP also builds on cross-border consultations, such as the Shared Border Accord and the Cross-Border Crime Forum, that precede 9/11. Many of these ideas were incorporated in the 30 point Canada-US Smart Border Action Plan of 2001 and a similar proposal agreed to by Mexico and the United States in 2002. As such, the SPP "signals a moderate advancement" in North American integration (Ackleson and Kastner, 2005).

There is too much at stake for Canadian consumers and business to let the SPP die.

The talks kept a low public and political profile in both Canada and the United States until recently. Most experts in the field of Canadian-American relations continue to harbour low expectations, realizing that "Canada-US integration had been driven largely by the pull of market forces: proximity, consumer choice, investment preference, and firm behaviour" (Hart, 2007). According to this view, the true dynamic for regulatory harmonization should really be bilateral, and not in a NAFTA-like mechanism such as the SPP.

Leaving aside the value of joint declarations, new processes, or shared goals, we can list the following concrete outputs of the SPP negotiations as of September 2007 (SPP, 2005b; SPP, 2006; White House, 2007):

- The modernization of procedures for temporary entry provisions for professionals to the NAFTA Free Trade Commission, in order to speed up the process and increase the number of permits;
- A scientific and risk-based agreement on BSE, coordinated by animal health officials of all three countries;
- A Canada-United States agreement to enable the simultaneous exchange of information between virtual national laboratory networks, so as to help deal with the spread of infectious disease;
- A Canada-United States agreement to increase compliance in data sharing, staff exchanges, and joint training for cross border pipelines;
- The harmonization of air navigation standards;
- The expansion of the NEXUS pilot project for pre-clearance border crossings;
- A joint United States Coast Guard-Transport Canada verification of vessels entering the St. Lawrence Seaway;

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- Liberalized rules of origin for exporting household appliances, precious metals, and various machinery and equipment parts. These items—estimated to account for $100 billion in trade by the end of 2007—will qualify as duty free;
- A Canada-United States agreement on reciprocal recognition of security measures for containers used in dangerous goods transportation;
- A Canada-United States "open skies" agreement for air cargo transportation;
- A Canada-United States five-year program to harmonize automated commercial information systems; and,
- A trilateral agreement to harmonize energy performance standards for household appliances and consumer products.

On the basis of this list, we can draw three conclusions. First, while these are modest outputs—some of which could have been achieved without the SPP—they nevertheless offer concrete benefits to Canadian consumers and businesses. Second, these outputs demonstrate that Canada and the United States have, in fact, been able to achieve bilateral goals within the SPP triangle. Therefore, the concern that the SPP would not produce Canada-US progress may have been too pessimistic (Moens, 2007). Third, recent attacks on the partnership talks by protectionists in Canada and, even more so, in the United States should be seen as posing a threat to the political conditions needed to continue SPP talks.

On the Canadian side, small protest groups, as well as the Council of Canadians, are alleging that the SPP offers the United States a channel by which to encroach on Canadian sovereignty and gain access to resources such as water. Their arguments—and their demand that Canada stop all SPP talks—bear an "uncanny resemblance to the rhetoric" used during the debates over the Free Trade Agreement and, later, NAFTA (d'Aquino, 2007).

On the American side, several news programs, such as *Lou Dobbs Tonight*, have raised the spectre that the SPP is a secret government-to-government plan to form a North American union akin to the European Union. Incredibly, some predict the imminent loss of American sovereignty (Corsi, 2007).

Just as NAFTA and the FTA generated very strong growth in trade... regulatory harmonization and cross-border regimes will make Canadian industry more competitive and will add to Canadian prosperity.

Others believe that the American Administration is using the SPP as a vehicle to normalize the inflow of illegal migrants from Mexico (Edwards, 2007).

Rising opposition in the United States, including Congressional moves to tie appropriations to greater transparency in SPP negotiations and planning, as well as the coming American elections—which will result in the election of more trade protectionists—and a lack of much visible progress at the Montebello Summit, has caused some commentators to declare the SPP "dead" and "defunct" (Ibbitson, 2007).

There is too much at stake for Canadian consumers and business to let the SPP die. Over 50% of total exports from the United States come in by truck and over 70% of exports go out by truck (Transport Canada, 2006). Border transit costs, in terms of paperwork and waiting time, are estimated to be between 2% and 3% of trade volume (Hart and Dymond, 2006). Consequently, lowering the cost of the border is of vital importance to Canadian manufacturing, especially given the high value of the Canadian dollar (Hart and Dymond, 2006). Different product standards and regulatory divergence on either side of the border for identical products impose an artificial cost on production that is borne disproportionately by the smaller Canadian side. Given that a large part of our trade is intra-firm trade, these costs render North American business less competitive on a global scale. Just as NAFTA and the FTA generated very strong growth in trade—especially in Canadian exports—regulatory harmonization and cross-border regimes will make Canadian industry more competitive and will add to Canadian prosperity.

The SPP method of technical talks, rather than negotiating a treaty with the United States, is also in Canada's interest because, in the current protectionist political context, treaty

negotiations are much more difficult. In addition, legislatures are likely to challenge some of these negotiations, and each country is able to set its own implementation rules. However, there is no design in the SPP that allows bypassing Congress or Parliament. Another smart feature of the SPP is that it copies the right lessons from Europe: it promotes economic convergence, but leaves out any attempt to set up supranational institutions. Begun in 1986, regulatory convergence has improved European competitiveness overall (Allen *et al*., 1998).

In order to maintain the SPP and its beneficial effects, the Canadian government should consider two options. First, it should attempt to gain a commitment from the current American administration that measurable progress will be made by the 2008 summit. It should also devise a strategy to intensify Canada-United States specific agreements within the SPP for 2009. Regulations, product standards, and border processes are already very similar between the two countries (Hart, 2007). Nevertheless, both countries should examine alternatives, do cost-benefit analyses, and check potential trade compatibility problems before they issue new regulations and product standards. Michael Hart argues that adding mandatory bilateral consultation to this practice would go a long way towards gradually overcoming what one politician called the "tyranny of small differences" (Hart, 2007). The Canadian government should consider simply starting this consultation habit unilaterally, and then persuading the American side to reciprocate.

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Citizens' Assemblies: *A New Kind of Direct Democracy*

by Gordon Gibson

Most of us are proud to live in a democracy, but many of us are quite discontent with how it actually works. Many people do not feel listened to or well represented.

Meanwhile, governments remain a large part of our economy, and our old systems don't seem to be keeping up with the more complex modern world. We are faced with the challenge of keeping government optimally sized and efficient on the one hand, and under control on the other. Keeping the government "under control" is our business as citizens, but it is something we aren't very good at. We aren't well trained nor do we have the right tools. Moreover, we are usually either too busy to care about it or too convinced that there is nothing we can do anyway. But there is hope for improvement thanks to an emerging form of engagement: deliberative democracy.

Our current balancing and connecting system, devised by constitutionalists long ago in Britain, is the idea of "representative democracy." Under this system, we choose representatives to act as a bridge between us and the experts and bureaucrats, but we remain their overseer and controller. In a direct democracy, voters make the decisions themselves. The problems of both representative democracy and the existing options of direct democracy (e.g. the Initiative) are well known. In a representative democracy, the representation is imperfect, especially under existing electoral rules, and our representatives may be captured by special interests (including their own), or may be short term in outlook and less caring about the general good. The alternative—the tools of direct democracy—are, in their current nature, blunt and almost dangerously powerful, leading to all kinds of unintended consequences. They tend to be used out of frustration and to lack wide vision. And both kinds of democracy can be very generous with other people's money.

Consequently, we have excellent reason to constantly seek ways to improve our democratic process. The latest addition to the reformer's toolkit is a form of deliberative democracy. Deliberative democracy adds to the mix a new set of representatives, different from those we elect. As things stand now, decision making, whether done by representative or (very rarely in Canada) by direct democracy, is highly influenced—almost captured—by experts and special interests. The idea of deliberative democracy, on the other hand, is to import the public interest, as represented by random panels, as a muscular third force.

Where the institutions of representative democracy resist advisory reform from inside, the plenary status of Citizens' Assemblies... can be tools powerful enough to force improvement from the outside.

The traditional representatives we elect are chosen by majoritarian consensus, and are professionals with unlimited jurisdiction to act in our name, for an extended period of time. The new representatives, however, are chosen at

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random, and are ordinary citizens who have specified and limited purposes, for a short period of time. These citizens form a randomly constituted body, fully empowered to reach specific recommendations that are guaranteed to be presented for citizen validation and passage into law following a referendum, with no governmental mediation or interference between the launch and the conclusion.

In British Columbia, this kind of democracy has already been tested, through the BC Citizens' Assembly (CA). In essence, the CA uses a random panel of citizens to study an issue in great depth, and then makes a recommendation for approval (or rejection) in a referendum.

Though several American states also provide for lawmaking by referendum, the process is often dominated by interest groups. In British Columbia, new machinery was added for the formulation of referendum questions: the Citizens' Assembly. The involvement of the CA in this way marks a crucial difference in the British Columbia referendum system. Being involved in this way, the CA was able to do two things of very great importance: it ensured a thoroughly considered and responsible question, framed only by ordinary citizens with no axes to grind, and, as a consequence, it gave the ensuing question a huge boost in public respect.

The magic combination of ingredients here turned out to be a body that is constitutionally empowered, with a carefully defined and limited mandate and a randomly selected membership. I believe each of these ingredients to be essential.

In order for an assembly like the CA to be successful, several factors must be in place:

- *Empowerment*. An Assembly must have guaranteed access to a popular vote to implement (or reject) its recommendations. This gives it the power of the Legislature in a carefully defined area, and this power

Democracy in Action: Citizens' Assemblies in BC and Ontario

In the 1996 BC provincial election, the Liberals obtained more votes than the NDP but fewer seats. Gordon Campbell, who was then the Opposition Leader, began to think about electoral reform. But as politicians have a deep conflict of interest on this topic, he concluded that this would be better pursued by an objective independent body. In 2001, Mr. Campbell became Premier and the following year he hired me to design what became the Citizens' Assembly (CA).

The eventual recommendation of the CA was been strongly supported in referendum votes. In the 2005 referendum, almost 58% of voters—an amazingly high number—supported the Assembly's recommendation of a new electoral system they called Single Transferrable Vote (STV), as used in Ireland. This did not quite clear the government's implementation threshold of 60%, but support was so powerful that the referendum question will be re-asked in 2009, with new information as to exact riding boundaries.

Ontario recently used the same Citizens' Assembly process but experienced rather different results. The Ontario CA recommended a very different system called Mixed Member Proportional ("MMP"), as used in Germany and New Zealand. This recommendation bombed, garnering only 37% approval.

The provinces' different referendum results could be partly explained by the fact that STV weakens parties and empowers voters and backbenchers, while MMP does the reverse. But in addition to this, unlike in BC, the Ontario referendum question was almost ignored during the election in that province, despite a much larger publicity budget.

But why did similar systems come up with two very different recommendations? The BC CA was initially much enamoured of the MMP system, but after a long summer break, it swung strongly over to the STV model. The Ontario group, in contrast, did not have that much reflective time. Was time for maturation of viewpoint important? Or is the Ontario political culture that different from that of BC?

The Centre for the Study of Democratic Institutions at UBC is working on this intensively, using polling data in both referendums and in depth interviews with Assembly members. Hopefully, we will be able to use this research to better understand the differences and thereby further validate the stability and usefulness of this new technique.

brings respect from the public and other political actors.

- *Legitimacy*. The Assembly must be seen as a valid proxy for "us." Every citizen must see someone roughly like themselves in that place. The makeup of the Assembly must be a good mirror of the citizenry.

- *A carefully defined and very limited mandate*. This is extremely important—perhaps the single most important variable.

As a practical matter, a limited mandate makes it much easier to secure empowerment from the Legislature. The tighter the limits on the mandate, the lower the potential threat that might be posed to elected officials by this new power centre. For the same reason, proposals for permanent, multi-purpose Citizen Assemblies will be vigorously opposed by legislatures, and properly so, in my view. These are not suitable as alternate governments.

Citizen Assemblies are big deals. They are the heavy artillery of deliberative democracy. They are expensive and time consuming. They can be very powerful and respected, but those characteristics will be attenuated if plenary Assemblies are used very often or for small questions.

Certainly representative democracy is and should remain the usual way of doing the public business. That is not to say that representative democracy is working well—far from it, in many cases. Consequently, where the institutions of representative democracy resist advisory reform from inside, the plenary status of Citizens' Assemblies—if invoked one way or another—can be tools powerful enough to force improvement from the outside. 🕮

Opening the Door for Environmental Goods and Services Markets

by Glenn Fox

The idea that rural lands produce ecological goods and services is a relatively new one to the Canadian policy agenda. Pilot projects are currently underway, and more are being proposed, to explore the feasibility of provision of environmental goods and services from rural lands. Ecological goods and services can be defined as the benefits that human populations derive, directly or indirectly, from healthy, functioning ecosystems which encompass air, water, soil, and biodiversity (Soil Conservation Council of Canada). Examples of ecological goods are potable water, quality food, fuel, wood and fibres, genetic resources, and pharmaceuticals; examples of ecological services are greenhouse gas mitigation and carbon sequestration, erosion control, soil quality improvement, ecosystem enhancement, water purification, and waste treatment (Soil Conservation Council of Canada).

Transactions in environmental goods and services are a relatively new and limited phenomenon in Canada. Normally, we expect that when demand increases for a good or service, entrepreneurs will perceive this latent opportunity and coordinate factors of production to attempt to serve this emerging market. There are some indications that the demand for environmental goods and services from rural lands is growing, as incomes rise and values change in Canadian society. But the supply side, at least at this point, does not seem to be responding.

There may be something peculiar about environmental goods and services that prevents the normal entrepreneurial process from operating. Perhaps environmental goods and services present a situation in which there are incentive problems that discourage entrepreneurs from supplying them in a normal market fashion.

Public goods often designate goods or services that are provided by governments and financed by taxpayers. These goods are said to be non-rival in consumption in that one person can consume as much of a good or service as he or she wants but this consumption does not reduce the quantity of that good or service available for others to consume. This is an unusual and rare property. It is sometimes claimed that clean air, clean water, and outdoor recreation are public goods. However, two people cannot drink the same glass of

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clean water at the same time or breathe the same lung-full of clean air simultaneously. Thus, clean air and clean water are rival in consumption and are not, therefore, public goods. Likewise, two cross country skiers cannot occupy the same spot on a cross country ski trail at the same time, and two canoes cannot occupy the same spot on a river at the same time. Thus, outdoor recreation services are also rival in consumption and, therefore, cannot be public goods.

Ultimately, there is nothing peculiar about public goods that explains why market transactions in environmental goods and services are underdeveloped. But understanding, economically, why environmental goods and services transactions are rare can play an important role in designing strategies to facilitate the provision of this category of goods and services. There are four economic explanations for the limited extent of market transactions in environmental goods and services in Canada: transaction costs, insufficient demand (relative to supply), policy constraints, and government ownership of natural resources.

The theory of exchange explains that, at the level of a single voluntary market transaction between two individuals, if individual A exchanges an item of property for an item of property owned by individual B, then we can safely conclude that individual A valued the item of property formerly owned by B more than the item of property that A owned herself, and vice versa for individual B. Both A and B expected to gain from the exchange, since they both valued what the other person owned more highly than they valued what they owned themselves before the exchange. This voluntary exchange of private property generates a price, which is an objectively measurable magnitude that provides an indication of hidden valuation information.

If an expectation of mutual benefit can be inferred after the fact with voluntary market exchange, and if there is a growing demand for environmental goods and services, then why don't we see markets emerging more robustly? One factor is transaction costs—the costs associated with using market exchange relationships as a means of social coordination. According to Nobel Prize winner Ronald Coase (1960), there are three subcategories of transaction costs: search costs (looking for potential partners for a market exchange), negotiation costs (exploring the terms of the negotiation with the identified exchange partner), and concluding costs (verifying that the terms of the exchange were met).

The significance of transaction costs, in the present context, is that even when market conditions appear favourable, market exchanges may not take place if transaction costs are high enough. Therefore, high transaction costs, relative to potential gains from exchange, are one explanation for the limited development in environmental goods and services transactions in Canada to date.

In any emerging market or industry, transaction costs are a significant impediment until potential buyers become aware of potential sellers and vice versa. But in emerging markets, communication networks, including advertising, are undeveloped and search costs are high. Also, since transactions in an emerging market are, by definition, novel, negotiation costs can also be high, due to the wariness of first time buyers and first time sellers.

Policy constraints are another reason that the development of a market for environmental good and services might not be taking place. Sometimes government regulations prohibit mar-

Services Provided By Ecosystems

Generally speaking, there are four categories of services provided by ecosystems:

1. Provisioning services: products obtained from ecosystems, such as food and fiber, fuel, genetic resources, biochemicals, natural medicines and pharmaceuticals, ornamental resources, and fresh water.

2. Regulating services: benefits obtained from the regulation of ecosystem processes, such as air quality maintenance, climate regulation, water regulation, erosion control, water purification and waste treatment, biological control, pollination, and storm protection.

3. Cultural services: nonmaterial benefits obtained from ecosystems, such as cultural diversity, spiritual and religious values, educational values, inspiration, aesthetic values, social relations, sense of place, cultural heritage values, recreation, and ecotourism.

4. Supporting services: services necessary for the production of all other ecosystem services, such as soil formation, nutrient cycling, primary production.

by Heather Holden

ket transactions in environmental goods and services, even on private land. An example of this would be a regulation that prohibits land owners from charging hunters to hunt game on their land. If the consequences of selling an environmental good or service are negative—for example, fines or imprisonment—it is hardly surprising that such transactions are not commonplace, or that they tend to be done informally when they do occur. In some cases where demand is strong enough relative to supply conditions, transactions take place in a manner that is not officially reported.

Price distortions are another possible explanation for limited market transactions. Distortions can arise if there is a regulated maximum price for some good or service, as in the case of rent controls or maximum gasoline price regulations. Such a situation results in buyers wanting to buy more than suppliers are willing to offer at the regulated price. Price distortions are also due to subsidized provision of that good or service, which keeps the price below what would prevail in the free market. In this case, either the government supplies the goods and services directly, or it subsidizes firms to provide them at a price that does not reflect the full costs of provision. An example of this situation would be camping services in Ontario, in which the provision of recreation services generally falls short of cost recovery. There is little incentive for independent operators to compete in this market, since the subsidized price that prevails because of government provision of this service is so low.

Finally, a fourth explanation of the lack of market exchanges in environmental goods and services is state ownership of natural resources. Governments act differently than private citizens and voluntary associations when they participate in markets. Because they have the power to tax, governments are not subject to the financial constraints that private citizens and voluntary associations face. Moreover, governments in Canada have often been reluctant to sell these resources, at least in the twentieth century.

Determining what is responsible for a lack of observed market transactions in environmental goods and services is a challenging undertaking. Economists have not devoted much effort to this diagnostic task. The subjective theory of value reminds us of this difficulty. According to this theory, if preferences are subjective mental states that exist only in human minds, whether these are the minds of buyers or sellers, then the economist must acknowledge that there is no objective process for measuring these valuations, independent of observed actions. In the absence of market exchanges, therefore, it could be that the subjective valuations of buyers are not high enough to result in attractive terms relative to the subjective valuations of sellers. Or, it could be that the subjective valuations of buyers and sellers are not high enough jointly to overcome the subjective valuations of transaction costs. Unfortunately, very little economic research has been undertaken to identify factors that influence the magnitude of transaction costs, let alone how to reduce them.

Transactions in environmental goods and services are a relatively new and limited phenomenon in Canada.

For political, financial, and environmental reasons, rural lands in Canada are attracting increasing attention as a source of environmental goods and services. Current discussions of alternative approaches to facilitating the provision of environmental goods and services have not made a careful enough distinction between government-funded programs and user-pay programs.

User-pay programs, which take a free market environmentalist approach, enjoy a critical informational advantage over government-funded programs when it comes to the identification of the value of environmental goods and services. To illustrate the nature of this advantage, these two approaches can be compared to what Nobel Prize winner Friedrich Hayek called a planned order and a spontaneous order. A spontaneous order, which corresponds to the free market approach, is a pattern of human social interaction that is the product of human action, but not the product of human design. There is no one in charge of a spontaneous order. Hayek's 1945 essay comparing spontaneous and planned orders illustrates the informational advantages of spontaneous orders, especially when the subjective theory of value is taken into account. If preferences are subjective and can't be objectively measured, and if information about preferences, expectations, and opportunities is widely dispersed among members of a society, then coordination of human action under a planned order approach faces significant challenges. How can the coordinating agency possibly know what it needs to know about this inaccessible information?

Contrary to many suggestions in policy statements about environmental goods and services, accessing this information is not a matter of scientific approach nor is it a hurdle that can be overcome with comprehensive consultation. Only voluntary transactions among consenting adults, that is, free market exchanges, offer us an opportunity to see aspects of this subjective and dispersed information, to which we would not otherwise have access. Historical prices are our only window into this subjective knowledge. Without access to this price information, how could we possibly know what specific environmental goods or services are worth, and to whom? Hayek's essay may have been concerned with the problems of comprehensive economic and social planning, but his concerns are equally applicable to the task of facilitating the provision of environmental goods and services from rural lands.

In addition to its information disadvantage, the planned order approach to the provision of environmental goods and services faces another challenge. Ultimately, this approach relies on tax revenues to operate. This pits the provision of environmental goods and services against other increasingly strong demands for tax revenues. It puts environmental goods and services in competition with health care and education. In the long run, health care and education will win this competition.

Recognizing the advantages of the spontaneous order, the challenge is to find ways to make institutional changes for this approach to emerge. If transaction costs were reduced, more potential market exchange arrangements could lead to the realization of the latent mutual gains from exchange that markets make possible. Both views are germane to the topic of environmental goods and services, and the role of economic research in facilitating the interaction of willing buyers and sellers of those goods and services. Case studies, pilot projects, and feasibility studies are one means of identifying the institutional changes required to extend market exchange relationships more deeply into the realm of environmental goods and services.

Understanding, economically, why environmental goods and services transactions are rare can play an important role in designing strategies to facilitate the provision of this category of goods and services.

In order to advance the environmental goods and services agenda in Canada, we must take a number of steps. First, we need to acquire a better understanding of the critical differences between planned order and spontaneous order approaches to the provision of environmental goods and services. Access to personal subjective valuation information is necessary to address the question of how much these goods and services are worth. Second, trial markets and pilot programs should be implemented, as they are a good practical first step to explore alternative approaches. These social experiments may lead to reform of the policy-based impediments to the emergence of market approaches discussed earlier. Third, the government may have some role in reducing transaction costs by helping to develop communication and advertising tools. This function, however, may also be accomplished by other types of organizations such as associations and cooperatives composed of similar interests. Either way, transaction costs are likely to reduce as markets develop. Fourth, if the culprit turns out to be insufficient demand, then, at least for now, we may need to accept that it would not be beneficial to coerce a transaction. Finally, we should take steps to restore customary common law, following Elizabeth Brubaker's agenda (Brubaker, 1995), which, in this context would include a repeal of right to farm legislation and agricultural zoning.

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Putting a Value on Environmental Goods and Services

by Heather Holden

If we are to improve natural resource management, we need to provide a methodology by which to estimate the value of goods and services associated with particular ecosystems. Managers need a framework for assessing the value of the losses likely to result from ecosystem degradation, as well as the long-term benefits of investment in natural resource management. In so doing, we can improve the current and future management of these natural resources, and provide information essential to evaluating tradeoffs in ecosystem management and in potential development decisions.

The economic valuation of ecosystems goods and services attempts to estimate the value of those services which are provided by natural resources. Resources have both 'use' and 'non-use' values, which when considered together can be referred to as the Total Economic Value (TEV). These values are generally divided into direct use, indirect use, and option values.

Direct use values include provision of food (a consumptive use) and opportunities for tourism and recreation (a non-consumptive use). Indirect use values include ecosystem services such as water filtration and storm protection. Option values are derived from preserving the option to use ecosystem services in the future (this is sometimes also called bequest values). Non-use values include values such as existence values, which are the values humans place on the fact that a resource exists, even if they may never visit or use it. Option values are frequently the most controversial values and have the greatest uncertainty attached to them.

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As ecosystem services are typically not traded in conventional markets, a variety of methods have been developed to estimate their value. One method simply examines the change in an ecosystem service that results from a change in the state of the environmental resource; but it is challenging to determine and model the relationship between changes in the state of an environmental resource and the impact on the provision of a specified ecosystem service.

Another method uses certain attributes of a given site to determine its value. In this model, environmental attributes can be used and analyzed for their impact on the market price of the site. This technique has been used to investigate the impact of negative environmental effects such as air pollution on land values. A challenge with this technique is ensuring that all attributes are included in the analysis, which can cause potentially large data collection requirements.

The travel cost method uses data about visitation to a site or set of sites to construct a demand curve for an environmental resource. This method is primarily used to determine recreational use values of a resource, based on its attributes. A key challenge of this approach is the considerable amount of detailed data required for estimating accurate values.

Replacement cost techniques value environmental services by determining the cost of replacing the service that is provided by the environment in its current state. For example, this technique could be used to assess the value of removing nutrients from wetlands. Use of this approach relies on the assumption that the society in question would actually pay to replace the service.

Yet another model of valuation considers the costs that are avoided as a result of having a given environmental service. This technique is often used to estimate the damages avoided if the ecosystem provides protection against natural disaster events such as earthquakes, hurricanes, and flooding. The challenge of this technique may be in determining the value to place on areas that are threatened as well as the hypothetical natural disaster scenario.

Another way to establish a value for ecosystem services is by asking respondents to state their willingness-to-pay (WTP) for a specific set of ecosystem services or for changes in those environmental services. This method is most useful in assessing the non-use values associated with ecosystem services such as the value of simply knowing an ecosystem exists, even if one never intends to visit or use it. The challenges of using this technique include the need for careful survey design and application of the results.

Receiving Treatment Outside Canada

by Nadeem Esmail

In recent years, a number of companies aiming to provide Canadians with easier access to medically necessary treatments have appeared in Canada and elsewhere. Of course, leaving Canada for medically necessary treatment is nothing new—Canadians have been doing so for many years, either in response to the unavailability of certain treatments in Canada or in response to long wait times for medically necessary treatment. This has left many asking the question: exactly how many Canadians receive treatment outside of Canada each year?

While data on this topic are difficult to come by, it is possible to roughly estimate that number, using the results of The Fraser Institute's *Waiting Your Turn* survey and the counts of procedures completed each year in Canada, provided by the Canadian Institute for Health Information (CIHI).[1] While the computations below are rough, "back of the envelope" calculations, they are the most complete estimates available in Canada today and should provide some insight into how many Canadians are choosing to seek care on their own terms, outside of Canada. The calculations also provide some insight into the number of Canadians who might choose to stay in Canada and pay for treatment in their home province, if only that province's government would deviate from the status quo and allow them to do so.

Methodology

Each year, The Fraser Institute's *Waiting Your Turn* survey asks physicians across Canada, in 12 major medical specialties, the question, "Approximately what percentage of your patients *received* non-emergency medical treatment in the past 12 months outside Canada?" (emphasis in original). The answers to this question are averaged for each of the specialties studied in *Waiting Your Turn* for each province, producing a table that reports the average percentage of patients receiving treatment outside of Canada (see table 11 , p. 61, in Esmail and Walker with Bank, 2007). In 2007, 1.2% of all patients in Canada were estimated to have received non-emergency medical treatment outside of Canada, an increase from 1.0% in 2006.

Combining these percentages with the number of procedures performed in each province and in each medical specialty gives a rough estimate of the number of Canadians who actually received treatment outside Canada.

Two data-related issues must be noted before discussing the estimate. First, the number of procedures performed in Canada is not readily available from the Canadian Institute for Health Information (CIHI). Furthermore, Alberta and Quebec do not provide complete discharge abstract data (DAD) to CIHI, which is the source for the procedures counts data used in *Waiting Your Turn*. The authors of *Waiting Your Turn* deal with this concern by making a pro-rated estimate of procedures using older hospitalization data. These estimated procedure counts fill in for the actual number of procedures in Alberta and Quebec.

Second, there is a temporal mismatch between the timing of The Fraser Institute's *Waiting Your Turn* survey and CIHI's annual DAD data release. Specifically, procedure counts data used for *Waiting Your Turn* are typically one year behind—the 2007 edition of *Waiting Your Turn* used procedure counts from 2005-06. While the calculation below uses the temporally mismatched procedures counts to provide up-to-date information, adjusting for the temporal mismatch does not appear to materially affect the trend witnessed in the overall count of Canadians. However, it does, as expected, affect the actual counts of Canadians (Esmail, 2007).[2]

The counts of the number of patients receiving treatment outside Canada each year that are produced by this methodology are likely to underestimate the actual number of patients treated outside Canada. This is the result of a few factors. First, and most importantly, these numbers are based on specialist responses, which means that patients who leave Canada without consulting a specialist are not likely to be included in this count. Put more simply, patients who leave Canada without consulting a specialist, and patients who leave but are not recognized

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as having done so by specialists, will likely not be included in the numbers shown in table 1. Second, the counts are based on the number of procedures estimated to have been performed in Canada, which is less than the total number of patients consulted and less than the total number of Canadians who would have required treatment, including those who left.

An Estimated Count

The products of the percentage of patients receiving non-emergency treatment outside of Canada, and the number of patients treated in Canada as estimated in *Waiting Your Turn* are shown in table 1.

In addition to the significant number of Canadians receiving treatment outside Canada in 2007, there has been a notable increase in the overall number of patients receiving treatment outside Canada between 2006 and 2007. Specifically, an estimated 39,282 Canadians received treatment outside Canada in 2006, while 47,044 were estimated to have done so in 2007. Sizable declines in the estimated number of patients going outside Canada for treatment were seen in Prince Edward Island (101 to 20) and Newfoundland (743 to 519). Conversely, British Columbia (5,391 to 6,273), Alberta (5,180 to 5,451), Saskatchewan (682 to 715), Manitoba (1,216 to 1,608), Ontario (18,736 to 25,121), Quebec (5,855 to 5,888), New Brunswick (611 to 624), and Nova Scotia (767 to 824) all saw increases in the estimated number of patients treated outside Canada.

This national increase in the estimated number of patients treated outside Canada happened at the same time as a slight increase in the wait time for medically necessary treatment. Specifically, the national median wait time for treatment after consultation with a specialist was 9.0 weeks in 2006, and 9.1 weeks in 2007. However, the same is not true among the provinces—wait times fell in British Columbia, Saskatchewan, Ontario, New Brunswick,

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Table 1: Estimated Number of Patients Receiving Treatment Outside of Canada, 2007

Treatment	BC	AB	SK	MB	ON	QC	NB	NS	PE	NL	Canada
Plastic Surgery	23	6	0	0	202	30	0	14	—	0	276
Gynaecology	431	157	0	19	1,272	179	14	16	—	175	2,262
Ophthalmology	253	372	40	37	1,624	1,533	8	38	0	9	3,914
Otolaryngology	91	135	15	10	578	121	63	0	—	0	1,013
General Surgery	357	309	243	358	2,192	131	111	105	0	0	3,806
Neurosurgery	66	41	0	0	326	13	36	5	—	—	488
Orthopaedic Surgery	413	1,013	18	155	1,274	96	43	50	0	0	3,063
Cardiovascular Surgery	117	45	24	—	264	161	25	34	—	0	670
Urology	598	342	—	72	1,703	1,018	58	137	—	0	3,928
Internal Medicine	1,081	632	50	304	3,471	903	6	53	7	45	6,552
Radiation Oncology	—	0	15	0	98	1	7	11	0	0	132
Medical Oncology	99	15	—	—	861	26	5	13	1	0	1,020
Residual*	2,744	2,384	309	654	11,254	1,678	249	348	11	290	19,921
Total	6,273	5,451	715	1,608	25,121	5,888	624	824	20	519	47,044

* The residual count was produced using the average provincial percent of patients receiving treatment outside of Canada and the residual count of procedures produced in *Waiting Your Turn*.
Note: Data regarding oncology refer only to procedures done in hospitals. Most cancer patients are treated in cancer agencies. Therefore, the oncology counts must be regarded as incomplete. Also, the procedure data reported generally include only those procedures performed in public facilities. A large number of ophthalmological surgeries are performed in private facilities. The distribution of surgeries between public and private facilities varies significantly between provinces. Therefore, the ophthalmology counts must also be regarded as incomplete.

Source: Esmail and Walker with Bank, 2007; calculations by author.

Economics & Property Rights

by Walter E. Williams

Economic theory does not operate in a vacuum. Institutions, such as the property rights structure, determine how the theory manifests itself. Similarly, the law of gravity isn't repealed when a parachutist floats gently down to earth. The parachute simply affects how the law of gravity manifests itself.

Failure to recognize the effect of different property rights structures on outcomes leads to faulty analysis. Think about several questions. Which lake will yield larger, more mature fish—a publicly owned or a privately owned lake? Why is it that herds of cows flourished and buffalos did not? Who will care for a house better—a renter or owner?

The answer to each question has to do with the property rights structure. In a publicly owned lake, everyone has the right to the fish. In order to assert his right, a person has to catch a fish. This can lead to overfishing because the person who tosses back an immature fish doesn't benefit himself. He benefits someone else who will keep the fish. It's a different story with a privately owned lake. The owner, who does not need to catch a fish in order to assert his rights, can let the fish mature. It's the same principle with buffalo and other wildlife that's publicly owned. Through various rules and regulations, governments, though imperfectly, attempt to solve this property rights problem with licenses, fishing and hunting seasons and setting limits on catch and size.

Private property rights force the owner to take into account the effect his current use of the property has on its future value.

Private property rights force the owner to take into account the effect his current use of the property has on its future value. A homeowner has a greater stake in what a house is worth 10 or 20 years from now than a renter. An owner would more likely make sacrifices and take the kind of care that lengthens the usable life of the house. But owners have methods to make renters share some of the interests of an owner through requiring security deposits against damage.

A completely ignored aspect of the effect of restrictions on private property rights is the restrictions on profits. Pretend that you're an owner of a firm. There are two equally capable employees that you might hire. The pleasant employee demands $300 a week while the disagreeable employee is willing to work for $200. If you hired the disagreeable employee, your profits would be $100 greater. But what if there were a 50 percent profit tax? The profit tax reduces your rights to profit and reduces your cost of discriminating against the disagreeable employee. Instead of foregoing $100 without the profit tax, you'd forego only $50 by hiring the pleasant employee. The more the cost of doing something goes down, predictably, the more people will do of it. Wherever private property rights to profits are attenuated, we expect more choices to be made by noneconomic factors. That's especially the case in nonprofit entities like government and universities.

There are numerous issues and problems that are otherwise inexplicable unless we take into consideration the property rights structure. 📖

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Erratum

The percentages of gun ownership in Table 4 in the "Gun Bans and Murder Rates" article in October's *Fraser Forum* were in error. The correct values are shown below.

Table 4: Homicide Rate and Household Gun Ownership in Canadian Provinces

	Homicide Rate	Percent of households owning guns
Atlantic	1.62	28
Quebec	1.32	18
Ontario	1.74	13
Manitoba	4.16	21
Saskatchewan	4.33	25
Alberta	3.35	17
British Columbia	2.30	15
Territories	2.89	41
Canada	2.04	17

Note: The Atlantic provinces and the territories have been grouped into regional categories because the GPC 2000 survey of firearm ownership did not distinguish between provinces or territories in these regions.
Sources: Populations and homicide data from Juristat (2005), *Crime in Canada*. Firearm ownership from GPC Research, 2001.

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and Prince Edward Island, but increased in Alberta, Manitoba, Quebec, Nova Scotia, and Newfoundland.

Conclusion

In 2007, an estimated 47,044 Canadians received non-emergency medical treatment outside Canada. This estimate is a noteworthy figure and is likely to be an underestimate of the actual number of patients who received treatment outside Canada that year. Moreover, that number represents a significant potential economic loss to Canada, since provinces that were willing to allow the private financing of medically necessary care by their citizens could likely have captured the dollars spent by many of these patients who went abroad.

Notes

[1] This includes estimates for some provinces that do not provide comparable data to the CIHI.
[2] Specifically, the Canadian counts with the temporal mismatch for 2004, 2005, and 2006 were 49,392, 44,022, and 39,282 respectively. Accounting for the mismatch, results in counts for 2004 and 2005 were 47,011 and 45,776 respectively (Esmail, 2007).

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Creating the BC Advantage
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corporate income tax rate as the business grows.

By eliminating the financial capital tax, British Columbia would join Alberta and become the only other Canadian jurisdiction to have completely eliminated this particularly costly and damaging tax.

Finally, harmonizing the provincial sales tax with the GST would exclude business inputs from taxation and would reduce compliance costs on businesses by combining the paperwork and related efforts into one system instead of two.

It is also important to recognize the cautious nature of the proposed plan. It includes a cumulative surplus of $1.4 billion over the three-year period, increases spending by $2.2 billion above the government's current plan (in order to fully account for expected inflation and population growth), and increases the amount of the contingency fund to deal with any unforeseen variances.

Though British Columbians are currently enjoying a period of strong economic prosperity, the province can do even better. The government has a unique opportunity to ensure a brighter future for all British Columbians. Creating a BC Advantage would lay the foundation for years of continued economic prosperity.

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In Closing...

L'Institut Fraser Opens its Doors

In June 2007, The Fraser Institute began operating its first office in Montreal. Though it started with a staff of one, it grew to four over the course of the summer. On September 11, L'Institut Fraser officially opened its doors to the public.

People

The Montreal office is headed by Tasha Kheiriddin, Directrice pour le Québec et la francophonie and former Vice-President of the IEDM. A native Montrealer, Tasha is a lawyer, author, media commentator and university lecturer. She is the co-author of the best-selling *Rescuing Canada's Right* and has previously worked as a television host and producer for CBC and CPAC.

Working with Tasha are Sebastien Coté, Manager, Events and Development (Montreal); Julie Lajoye, Commmunications and Publications Officer (Montreal); and Johana Krizova, Office Administrator. Assisting l'Institut Fraser in raising funds and building relationships with Quebec-based partners and donors will be Michel Kelly-Gagnon, Senior Special Advisor, Strategy and Partnerships. Michel is a leading figure in Quebec's business and policy community and a frequent commentator in Quebec media. He is the past president of the IEDM and is a former Trustee of The Fraser Institute.

Events

On September 11 and 12, the Montreal office held two open houses, with a total of 100 people in attendance, to celebrate its opening. Then, on October 4, The Fraser Institute hosted its first Montreal Gala, a sold-out 475-person tribute dinner to the Right Honourable Brian Mulroney on the 20th Anniversary of Negotiations of the Canada/US Free Trade Agreement. The event received national media attention, including an item on CTV national news, stories in all national newspapers, and a dozen dailies across the country, including all those in Quebec.

Former Prime Minister Brian Mulroney (left) poses with Tasha Kheiriddin, Directrice pour le Québec, and Mark Mullins, Executive Director of The Fraser Institute, at the Montreal Gala on October 4th.

L'Institut Fraser also has its own "Behind the Spin / Ça se discute" speaker series. The series, held at Montreal's OPUS Hotel, is modeled on the highly successful "Behind the Spin" series in Vancouver, Calgary, and Toronto. The series features three events: a debate between journalist Vincent Marissal and Me Eric Allan de Bargis, president of the Union française in Montreal, on the reforms of French President Nicolas Sarkozy and their applicability to Quebec (October 24, 2007); a discussion with internationally renowned environmentalist Bjorn Lomborg on climate change (November 29, 2007); and a book launch for David Frum, author of the forthcoming book, *The U.S. After Bush* (January 24, 2008).

Publications

In January, L'Institut Fraser will launch a quarterly French version of *Fraser Forum* with articles of particular interest to Quebecers, including reasonable accommodations, environment, population aging, health care, and education.