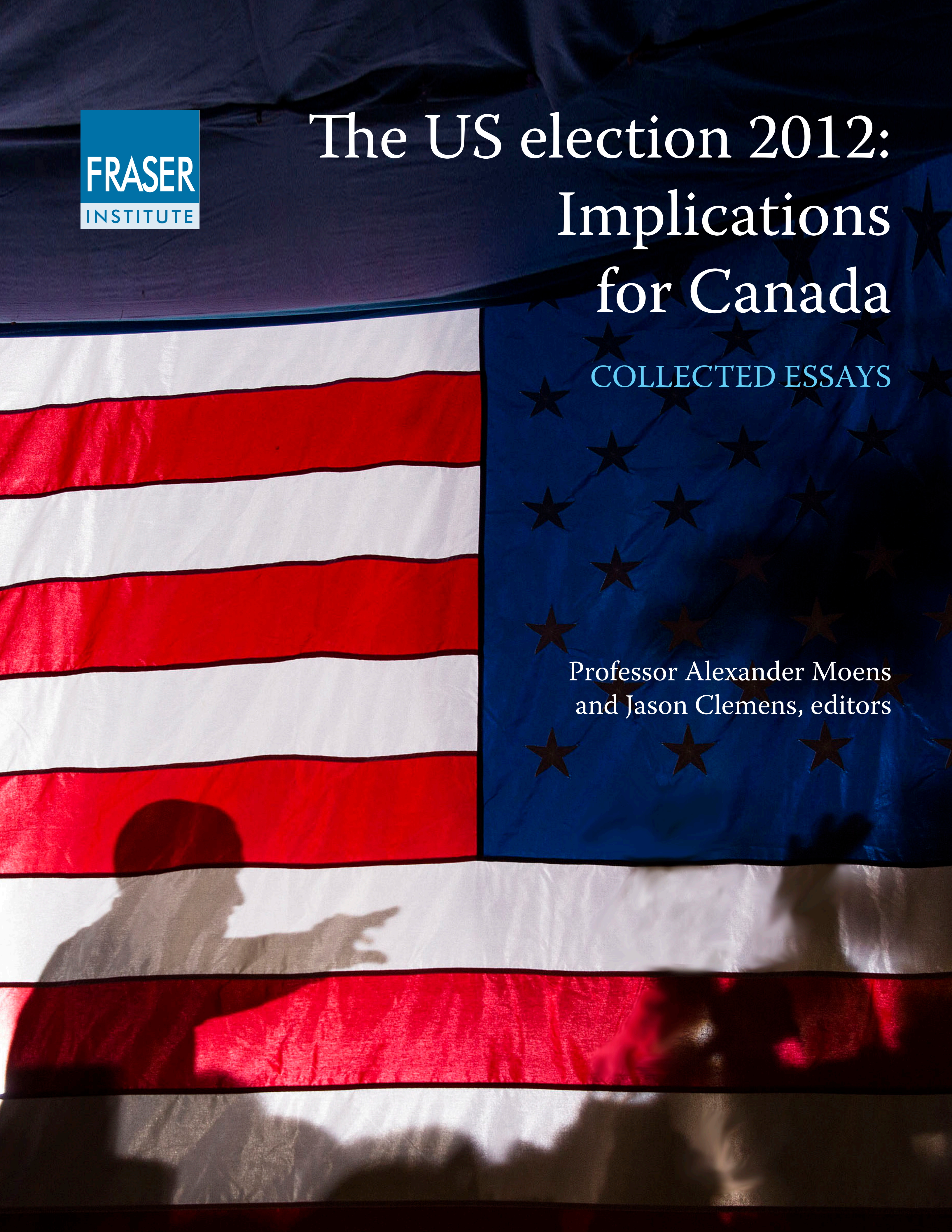

The US election 2012: Implications for Canada

COLLECTED ESSAYS

Professor Alexander Moens
and Jason Clemens, editors

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Despite a weak economy, market volatility, numerous international challenges, and several brewing scandals, US voters returned a status quo government to Washington, DC in early November 2012. President Barack Obama becomes only the second Democrat since Franklin D. Roosevelt to win re-election as President of the United States. The Congress remains divided with the Democrats controlling the Senate and the Republicans (GOP) in charge of the House of Representatives.

The Peace Arch outside of Vancouver, British Columbia, which borders the US near Blaine, Washington, has an inscription on it that sums up the enduring nature of the Canada–US relationship: "Let These Gates Never Be Closed." There is simply no disputing the integrated, interdependent relationship between our two countries. The fact that almost three out of four dollars of exports from Canada goes to the United States is but one statistic highlighting the importance of each country to the other.

So, while Canadians are not allowed to vote in US elections, our fortunes and prosperity are intimately affected by the electoral decisions of our American neighbours. The Fraser Institute asked ten noted Canadian and American scholars to write about the implications of the US election on Canada in a number of key policy areas. Each essayist was asked to answer, to varying degrees, three questions relating to the results of the US election: (1) What are your expectations for policy in the near future (two to four years)? (2) What are the problems or opportunities with such policies? (3) And what are the implications of such policies for Canada?

Policy uncertainty

A consistent theme ran through almost every essay: the continuing high level of economic uncertainty is hampering the recovery in the US and the nation's future prospects. Put differently, almost every essay contains some discussion about the uncertainties that US government policies are creating and how that uncertainty is adversely affecting the

performance of the US economy by making it harder to invest, build a business, undertake entrepreneurial endeavours, and generally make business decisions.

While Canadians are not allowed to vote in US elections, our fortunes and prosperity are intimately affected by the electoral decisions of our American neighbours.

Professor Nicholas Bloom of Stanford University, a leading scholar in the area of how policy-induced uncertainty affects the economy, wrote on this very topic. The measurement of policy uncertainty by Professor Bloom and his colleagues and their insights into the direct effects of uncertainty on the economy have garnered international exposure.

Professor Bloom's work has shown two things. One, heightened policy-induced uncertainty since the recession (2008) has had a direct adverse effect on US economic performance. And two, of critical importance for Canada, Professor Bloom concludes that "much of Canada's current economic policy uncertainty is due to contagion from the US." Bloom also concludes (as expected, given the interdependence of the two economies) that uncertainty about US policies has a large, material economic impact on Canada.

Much of Canada's current economic policy uncertainty is due to contagion from the US.

Unfortunately for Canadians, Professor Bloom's work indicates continued high levels of policy uncertainty in the United States for the next several years. Negotiations over the debt ceiling, uncertainty over medical reforms, changes to Medicaid and Medicare, and ongoing political intransigence have all contributed to Professor Bloom's conclusion that policy-based uncertainty will linger. Such uncertainty will continue to impede economic recovery in the US, which, as Professor Bloom explains in his essay, will also constrain economic prosperity in Canada.

Fiscal and monetary policy

A nearly unprecedented bi-partisan level of fiscal and monetary stimulus has been injected into the US economy since the Great Recession of 2008-09. Three essays in this collection relate to fiscal and monetary policy in the United States.

The first of two essays on the state of fiscal policy in the US is by Chris Edwards, Director of Tax Policy Studies, and Tad DeHaven, Budget Analyst, both of the Cato Institute in Washington, DC. Mr. Edwards was born and raised in Ottawa and has collaborated with the Fraser Institute on a number of projects over the years. Their essay focuses on the state of deficits and debt in the United States.

A continuing high level of economic uncertainty is hampering the recovery in the US and the nation's future prospects.

As to the likelihood that the United States will achieve a balanced budget in the short term, and stabilize its debt held by the public over the longer term, their prognosis is nothing short of grim. Edwards and

DeHaven quote estimates from the Congressional Budget Office based on the current policy structure indicating that public spending as a share of the economy will soar to roughly 40 percent of the economy (from 23 percent today) over the next three decades, which will cause US federal debt held by the public to skyrocket from its already worrying level of roughly 70 percent of GDP to 250 percent.

> The White House is providing no real leadership on spending reductions, spending reform, and particularly entitlements.

Edwards and DeHaven argue that the White House is providing no real leadership on spending reductions, spending reform, and particularly tackling the problems in America's three key entitlement programs. As the authors explain, the drivers of increased future spending (and thus increases in the debt held by the public) are growth in Medicare (health care for the elderly), Medicaid (health care for the poor), and Social Security, which the Obama Administration has shown no interest in reforming in any real sense. The authors also point out that the current spending patterns are bi-partisan in nature: "Republicans have shied away from trying to actually end programs or downsize federal agencies."

> Republicans have shied away from trying to end programs or downsize federal agencies.

Given the US federal government's continuing proclivity to delay and defer acting on its deficits and debt, Edwards and DeHaven rightly remind readers that a day of reckoning is coming, in which the required reforms will be much deeper and more radical than what is currently needed. Although Edwards and DeHaven don't say so specifically, the US delay gives Canada an opportunity to close the remaining gaps in tax competitiveness. This opportunity emerges from the fact that the US will likely not be in a position to implement serious tax relief within a balanced budget environment for the foreseeable future. The Canadian federal government, on the other hand, could be in such a position within a few years.

Manitoba-born and raised economist David Henderson, who teaches at the Naval Postgraduate School in Monterey California and who was a senior economist with President Reagan's Council of Economic Advisers, offers insights into tax competitiveness between Canada and the US in the second essay focused on fiscal policy. Professor Henderson's general observation is that Canadians will bear a slightly heavier personal tax burden than their American counterparts for the next few years while Canadian companies will be taxed much lighter than American firms. Beneath this general conclusion, however, are a number of important insights regarding the tax opportunity for Canada.

> Therein lies the opportunity for Canada: balance budgets, then reduce personal income taxes.

Professor Henderson outlines the competitive disadvantage Canadian income earners face relative to their American counterparts with respect to income taxes. Simply put, Canadians face higher income tax rates that become effective at lower

income levels than do Americans. Herein lies the opportunity for Canada over the next decade or so: balance budgets, then reduce personal income taxes.

Professor Henderson also explains how other individual taxes, such as payroll, dividends, and capital gains taxes, are all lower in Canada than in the United States, which to some extent offsets the disadvantages in personal income taxes. Income taxes are without a doubt the largest source of revenues for both governments and the single largest tax for the top half of income earners. It is, therefore, critical that on income taxes Canada gain some level of comparability, if not a competitive advantage over the US.

Thankfully this has already been achieved on the business tax side, as Henderson explains. Indeed, Henderson ends his essay with a wonderful line capturing his argument: "Canadian governments are saying to Americans, in effect, 'Send me your huddled corporations yearning to keep more of their earnings; I lift my lamp beside Vancouver, Calgary, and Toronto.'"

The other source of nearly unprecedented stimulus in the US has been monetary policy. Former President of the Cleveland Federal Reserve Bank and Fraser Institute Senior Fellow Jerry Jordan penned an essay on the prospects and implications of US monetary policy. Among a number of worrying insights in his essay is the exploding nature of the Federal Reserve's balance sheet, the subsequently ineffective nature of previously used monetary devices such as the Federal Funds rate to influence monetary policy, and most ominously, the prospect of higher inflation rates in the future.

> For better monetary policy, constrain government spending in order to avoid having the central bank act as a financier for the government.

Jordan identifies a key issue in US monetary policy: the Federal Reserve's current willingness to finance large, ongoing federal government fiscal deficits. In Jordan's words, "monetary policy is a fiscal instrument—a way of financing government." Thus, the key to better monetary policy, according to Jordan, is constraining government spending in order to avoid having the central bank act as a financier for the government. Simply put, Jerry Jordan doesn't see the US central bank as having the political will, or the independence, to reduce or even constrain its support for fiscal deficits.

The implications for Canada and other small trading countries are fairly clear. As the US, Europe, and Japan become more tolerant of inflation, their currencies will likely depreciate while the currencies of smaller, open economies like Canada will appreciate. Such currency changes mean that exporters and exporting countries like Canada will face increasing challenges. Jordan explains that such currency challenges often lead to worsening policy responses, such as trade protectionism.

Energy policy

Given the energy sector's importance to the Canadian economy and the integrated nature of energy markets in North America, this collection of essays would have been

delinquent had it not addressed energy policy in the US. Two essays were commissioned on energy-related issues.

Former Resident Scholar of the prestigious American Enterprise Institute and recently appointed Senior Director of the Fraser Institute's Centre for Energy and Natural Resource Studies Kenneth Green provided the first.

Green first explains the dichotomy between the rhetoric of the Obama Administration regarding fossil fuels and the reality of oil and gas production and consumption. The essay describes the Administration's distinct antipathy towards fossil fuels that simply doesn't match the reality in which oil and natural gas production are expanding markedly. Importantly, Green explains how much, if not most of the growth, has been on privately-owned and state-controlled land rather than on federally-controlled land, where oil production has grown much slower. The overarching reality, however, is that both oil and, to a great extent, natural gas production and consumption have grown and will likely continue to grow under the new government.

> Canada needs to develop its capacity to market and ship energy products to other markets.

This leads Green to what he considers the most significant impact on Canada from the practical reality of US policies, which is that the US will soon need to buy less oil and gas from Canada and will increasingly become an export competitor. The implication for Canada is clear: this country needs to develop its capacity to market and ship energy products to other markets. For example, nearly all growth in Canadian exports to the US over the last decade has been in energy products.

This risk to Canadian energy exports is somewhat tempered by the argument contained in the second essay provided by Competitive Enterprise Institute energy scholar Christopher Horner. Horner argues that the Obama Administration can, and likely will, introduce a host of environmental and safety regulations aimed principally at the energy sector, and more specifically the oil and gas sector, which will adversely affect production. For example, Horner suggests that the federal government will likely centralize oversight of hydraulic fracking, which has been key to the boom in natural gas production. Such a change would certainly constrain the future development of this source of energy and thus temper the ability of the US to produce and export natural gas.

> The risk for Canada is that we harmonize rules that will likely adversely affect the US energy sector and incur the same or similar adverse effects.

Another, perhaps more ominous aspect of Horner's analysis with respect to the effects on Canada is the risk of harmonizing bad regulations. As Horner points out, Canada has a history of harmonizing our rules with US regulations, and NAFTA guidelines encourage such harmonization. Horner lists a number of regulations that are either being drafted, or are expected to be released over the next two years, which will likely adversely affect the energy sector in the US. The risk for Canada is that we harmonize such rules domestically and incur the same or similar adverse effects.

Canada–US relations

Two essays in the series focus on the state and future of Canada–US relations. Alexander Moens, a professor of political science at Simon Fraser University and the co-editor of this series, and Laura Dawson, the president of Dawson Strategic and a former senior adviser to the US Embassy in Ottawa on economic affairs, both provided essays on the prospects for improvements in Canada–US relations.

> Canada will face enormous diplomatic and bureaucratic challenges due to the low priority accorded Canadian issues.

Moens and Dawson agree that in the future, Canada will face enormous diplomatic and bureaucratic challenges due to the low priority accorded Canadian issues, including trade and security. Both authors conclude that Canada and its areas of interest are low priorities for the Obama Administration.

Dawson acknowledges that there have been gains made under both the Beyond the Border Declaration (to speed up the movement of cargo and people across the border) and the Regulatory Cooperation Council (to align bilateral product standards, testing, and certification) although both initiatives are behind schedule with respect to implementing agreed-upon deliverables. While the potential gains are enormous, Dawson explains the complexity behind any achieved improvements and the heightened need for greater political and bureaucratic attention.

Professor Moens' analysis of bilateral relations with the US concentrates on the need for Canada to pursue genuine diversification strategies, particularly with respect to trade. He suggests that Canada would benefit from such diversification both with respect to increased market access for more countries and from greater leverage with the United States.

Finance services regulation

Rounding out our series are two essays focused on specific policy areas, beginning with financial services regulation. University of Alberta professor and Fraser Institute senior fellow Moin Yahya offers his thoughts on the implications of US financial regulations for Canadians.

Professor Yahya concludes that the re-election of President Obama will lead to the full implementation of what is popularly referred to as the Dodd-Frank Act, which imposes new regulations on the financial services sector in the US. According to Professor Yahya, about half of the expected regulations emanating from Dodd-Frank have been written with the remainder expected over the next couple of years.

> The impact of Dodd-Frank and its accompanying regulations on the US financial system is highly uncertain... its impact on Canada's financial system is even more unclear.

The impact of Dodd-Frank and its accompanying regulations on the US financial system is highly uncertain, and in fact, uncertainty seems to be the only certain impact. The impact of Dodd-Frank on

Canada's financial system is even more unclear. The reason is two-fold. First, some specific provisions of Dodd-Frank deal with foreign banks, but many of the rules have yet to be developed by the Federal Reserve Board. Second, there are other rules that may apply inadvertently to Canadian companies that happen to be doing business in the United States, such as brokerage firms that trade American stocks for clients in either the United States or Canada.

Clearly, there will be effects on the Canadian banking and financial services sectors from the regulations being imposed by US legislators; the adverse effects from these regulations will not be constrained to the shores of the United States.

Health care

The second issue-specific essay pertains to President Obama's signature first term legislation: The Affordable Care Act (ACA), or what is more commonly referred to as Obamacare. Western Washington University economics professor and Fraser Institute Senior Fellow Steven Globerman has contributed the final essay on US health care reform.

Professor Globerman's essay provides a broad overview of the US health care system, the ways in which the ACA will change American health care, and its implications for Canada. One of Globerman's key concerns is that the ACA will likely reduce rates of health care-related technological change in the US which, in turn, will reduce the availability of such new technology to Canada.

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The United States is the leading source of new health care products and services, including medical equipment, pharmaceuticals, and surgical and clinical techniques. Other countries, including Canada, benefit by importing products developed in the United States, often at marginal cost. Canadian health care providers also benefit by waiting until new procedures and techniques are proven effective in the United States before adopting them in Canada. The ability of the Canadian sector to acquire technology and knowledge from the United States reduces the need for Canadian investment in expensive research and development, clinical testing and the like, thereby making state-of-the-art health care services less expensive for Canadians. If the ACA reduces innovation in the United States, other countries, including Canada, will presumably need to spend more on health care innovation to improve the quality of their health care.

The anticipation of shortages and wait times in the US health care system due to the ACA's expected reforms also have implications for Canada. Provincial governments can potentially save money by using spare capacity in the US health care system as a buffer against "excessive" waiting times in Canada. Rather than depending upon the United States to absorb Canadian patients to deal with long wait times for some procedures, provincial governments will presumably need to add domestic capacity or increase waiting times for Canadians.

Conclusion

While polls in Canada consistently show overwhelming support for President Obama, the reality of his re-election, combined with a divided Congress, presents a number of real, immediate risks and opportunities for Canada. Some of the risks and problems discussed in these essays can be managed through sound domestic policies. For example, the Canadian trend of lower corporate tax rates is making the Canadian economy a more competitive place to do business.

Other risks cannot be managed to the same extent. In the short term, Canadians are more or less exposed to the degree to which our two economies remain interdependent. For example, in the oil and gas sector, the combination of strong growth in US production coupled with US federal regulations restricting access for Canadian products to the US market leaves Canadian policy-makers no alternative but to pursue diversification. These risks require political leadership in Canada to mitigate them to the greatest extent possible.

For Canadian policy-makers, the challenge is to mitigate the risks from the US turmoil while maximizing new opportunities to gain economic advantages.

Most of our essayists agree that the combination of policy uncertainty and domestic political gridlock in the United States is harming American economic growth and prosperity. The result of uncertainty and political intransigence in the US will continue to adversely affect economic prospects in trading partners such as Canada. In addition, a number of essayists recognized the perilous course American policy continues to follow. They've indicated that at some point—perhaps a point already upon us—other countries, including Canada, will attain sustainable, policy-based advantages over the United States. For Canadian policy-makers, the challenge is to mitigate the risks from the US turmoil while maximizing new opportunities to gain economic advantages.

1 Killing the Economic Engine: Policy Uncertainty and Economic Growth in the US and Canada

Nicholas Bloom, Professor of Economics, Stanford University

Policy conflict and fiscal crisis in the United States and Europe have spurred concerns about economic policy uncertainty and its economic effects. Many policymakers, businesspeople and the media suggest that the political crisis in Washington is leading firms and consumers to postpone hiring and spending decisions, thereby stalling the recovery from the 2007-2009 recession. This essay seeks to investigate this assertion by answering three questions. First, is economic policy uncertainty high in the United States and Canada? Second, if so, is this damaging the economy? Finally, what are the prospects for future policy stability and economic growth?[1]

Measuring economic policy uncertainty is not easy—uncertainty is a subjective concept. But we can generate a proxy for policy uncertainty, using three groups of observable measures and combining them into one measure of economic policy uncertainty. Policy uncertainty in the US varies over time, rising after major wars (such as the first and second Gulf Wars), elections, and terrorist attacks. However, and critically important for the purposes of this essay, our analysis shows that policy uncertainty surged upwards in 2008 and has remained high.

So, in short, policy uncertainty appears to have remained stubbornly high since 2008. Before analyzing the potential impact of policy uncertainty it is worth briefly summarizing the three sub-components included in our measure. The first quantifies newspaper coverage of policy-related economic uncertainty. It uses computer searches of 10 major US newspapers, including the *New York Times* and *Wall Street Journal*.

The second component reflects the number and size of federal tax code provisions set to expire in future years. It uses the Congressional Budget Office's list of the dollar value of expiring tax code provisions, and a 50% annual discount rate (thereby focusing on near-term expirations) to generate a tax expiration index.

1 In addressing these questions I will draw heavily on the academic paper by Baker, Bloom, and Davis (2013) as well as the data provided online at www.policyuncertainty.com.


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The third component captures disagreement among economic forecasters in the Philadelphia Federal Reserve's Survey of Professional Forecasters. This component combines the interquartile range of 1-year-ahead quarterly forecasts of federal, state, and local government purchases (normalized by a backward looking moving average of GDP) and the interquartile range of Consumer Price Index forecasts.

To create our overall measure of policy uncertainty we place a ½ weight on the news index, and a 1/6 weight on each of the tax-expiration, government purchases disagreement, and CPI disagreement indices. Next, each measure is normalized to have a standard deviation of 1. The index is then finally normalized to have a value of 100 prior to 2011.

Using this data we can also break down the key policy terms leading to changes in uncertainty over time. By doing so, we have determined that tax, government spending, and health care policy uncertainty are the key factors driving the increases in uncertainty in the US since 2008.

Intriguingly, monetary policy uncertainty does not appear to have risen particularly dramatically since 2008. Potentially this is because low and stable inflation and interest rates mean the mainstream US new media does not perceive any increase in monetary policy uncertainty.

Canada's index of economic policy uncertainty shows a similar time profile to the US. My view is that much of Canada's current economic policy uncertainty is due to contagion from the US. Canada has had a relatively stable monetary and fiscal policy over the recent crisis and recovery, and economically has not suffered as much as the US. Nevertheless, policy uncertainty in the US and its accordant adverse effects on the US economy has a large economic impact on Canada due to the integrated nature of our two economies.

There are theoretically many reasons why uncertainty can damage growth. One of the earliest studies on this issue was by the current Chairman of the Federal Reserve, Ben Bernanke, who pointed out that increases in uncertainty lead firms to defer investment, creating short, sharp recessions. But how big is this negative impact in practice?

To attempt to estimate the impact of policy uncertainty my colleagues and I (Baker, Bloom, and Davis, 2013) use a statistical analysis based on vector auto regressions estimations for GDP growth and employment on our index for economic policy uncertainty, plus other key economic factors like interest rates, inflation, and stock-market levels. Our analysis concludes that increases in policy uncertainty forecast future drops in economic growth and employment. These magnitudes are also large—an increase in policy uncertainty of the size seen on average between 2006 and 2011 will be

Much of Canada's current economic policy uncertainty is due to contagion from the US.

followed by industrial production drops of 2.5 percent and employment declines of 2.4 million (US).

An obvious concern is causality. Since policy making is forward looking and responds to the economic cycle, perhaps our results simply reflect a tendency for policy to become more volatile and unpredictable when an economic downturn looms on the horizon. So we can also examine qualitative evidence—surveys from businesses and consumers about the factors influencing their decisions, which also suggest a role for policy uncertainty. For example, the 2012 National Federation of Independent Businesses small firm survey reports that 35 percent of small firms complain about "uncertainty of government actions" as a critical problem. The top concerns, however, were the "cost of health insurance" (52 percent) and more general "uncertainty over economic conditions" (38 percent) (Dunkelberg and Wade, 2012).

The prospects for policy uncertainty falling in the near term do not appear bright. There are two reasons for pessimism: one is linked to the current political agenda, and the other to the polarization of the US political system.

> An increase in policy uncertainty of the size seen on average between 2006 and 2011 will be followed by industrial production drops of 2.5 percent and employment declines of 2.4 million (US).

The first relates to the current US policy agenda. The deal reached at the end of 2012 to avert the so-called "fiscal cliff" did little to address the long-run US structural deficit. This is both large and trending upwards due to rising health care costs, primarily from Medicare. To address this, either Medicare costs have to be contained, or taxes have to be raised substantially. The Democrats have fiercely resisted extensive controls on Medicare expenses while the Republicans have fiercely resisted extensive increases in taxes. As such, the current scenario of lurching from policy crisis to policy crisis as each new debt-ceiling deadline arises appears likely to continue. This is not a particularly US problem. Many other OECD countries have budgetary challenges, but because US expenditure on health care as a share of GDP (roughly 19 percent) is approximately double the OECD average, these cost challenges are particularly acute in the US.

Another factor hampering the ability to reach a compromise in Washington is the political system's increasing polarization. In the House of Representatives, redistricting has led to an increasing share of congressional districts that are either strongly Democrat or strongly Republican. This means that the biggest threat to incumbents is not challenges from the opposition party, but in their primaries from other party members. As a result, politicians have little incentive to move to the middle of the political spectrum to defend against the opposition party, but instead want to move to the middle of their own party activists' political spectrum. This is leading to an increasingly large gap between the policies and voting behavior of the two parties. For example, Caroll et al. (2008) report that while the 90th Congress of 1967/68 showed considerable overlap in the voting patterns of Democrats and Republicans, the 110th congress of 2007/2008 showed almost no overlap. Hence, getting agreement on policies in the House and even the Senate is becoming more difficult over time as politicians polarize into one of two camps.

In conclusion, economic policy uncertainty has surged since the beginning of the 2007-2009 recession and has not fallen since. This is true in the US, but also in Canada

and Europe. This uncertainty appears to be stalling the recovery from what has been the deepest recession since World War II.

Nobel Prize winning economist Milton Friedman had a "guitar string" theory of recessions. When you pluck a guitar string it bounces back, much like the economy. And the harder you pluck the string, the faster the rebound. But the stalled recovery following the 2007-2009 recession makes it appear as though the guitar string has snapped; the weight of historically high levels of policy uncertainty is what is stalling the recovery.

The outlook ahead is bleak. US businesses and consumers are going to have to live with many more years of heightened policy uncertainty. Given the integrated and interdependent nature of the US and Canadian economies, this US-based economic policy uncertainty will continue to impede and adversely affect Canadian economic growth. Put simply, the US and Canadian economies would benefit demonstrably if economic uncertainty emanating from policy were reduced. Unfortunately, this looks unlikely to occur soon. Economic policy uncertainty is the new normal.

Prospects for policy uncertainty falling in the near term do not appear bright.

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2 America's Spending Crisis

Chris Edwards, Director of Tax Policy, Cato Institute and Tad DeHaven, Budget Analyst, Cato Institute

Despite four years of annual budget deficits of over US$1 trillion and the most sluggish economic recovery since World War II, voters have rewarded President Barack Obama with a second term. The president has supported a huge growth in federal spending and deficits, believing it to be an economic stimulus. But while there is little evidence that such Keynesian policies actually work, electoral ratification of the president's approach has further engrained the idea in Washington that higher spending is beneficial.

> Spending will rise from 23 percent of GDP to more than 40 percent by the mid-2040s, causing federal debt held by the public to soar from 70% today to 250%.

Sadly, this pro-spending mindset is leading America into a deep fiscal hole that will damage the economy for decades to come. The recent "fiscal cliff" negotiations illustrate how the Democrats resist even the slightest trims to social programs and the Republicans block any reductions to military spending—even though both areas of the budget have expanded greatly in recent years. Overall federal spending as a share of gross domestic product (GDP) jumped from 18 percent when President George W. Bush came to office in 2001 to 23 percent today under Obama.

Congressional Budget Office (CBO) projections show where the federal spending juggernaut is headed. With no changes in policy, spending will rise from 23 percent of GDP to more than 40 percent by the mid-2040s, causing federal debt held by the public to soar from 70% today to about 250% by that time. The situation is even worse than that because the CBO's basic projections don't take into account the negative effects of rising spending and debt on GDP growth. As spending and debt rise, GDP growth will fall, and these ratios will rise even faster in a sort of fiscal death spiral. How that death spiral ends—in a catastrophic financial crisis or a long-term economic recession—nobody knows for sure.

> The Obama administration has proposed no serious restructuring to reduce costs.

The situation is even more disturbing because of the Obama administration's completely unserious approach to fiscal reform in the past four years. Budget analysts almost universally agree that the main "entitlement" programs—Social Security, Medicare, and Medicaid—are the major drivers of the coming fiscal disaster, yet the Obama administration

has proposed no serious restructuring of these programs to reduce costs. The administration has generally ignored the bipartisan Simpson-Bowles fiscal reform plan, and some Democrats in Congress fight even the smallest reductions to entitlement programs.

The administration's main response to the looming debt crisis has been to campaign non-stop to raise marginal tax rates on high-income earners. Sadly, imposing higher tax rates on entrepreneurs, doctors, angel investors, and other highly productive people will suppress GDP growth in coming years, and thus will not help the situation, but instead accelerate the fiscal death spiral.

... Republicans have shied away from trying to actually end programs or downsize federal agencies.

Even if raising tax rates on high-income earners didn't damage the economy, it would make only a small dent in federal deficits. In the recent fiscal cliff deal, President Obama was able to get his pound of flesh from the wealthy in the form of higher income tax rates on those earning more than $400,000 (single) and $450,000 (married). However, the president's long-sought victory for income redistribution is only expected to raise about $600 billion over the next decade, which is tiny fraction of otherwise previously expected deficits of about $10 trillion over that period.

The lack of seriousness in the Obama administration's fiscal approach was exemplified by the president's initial proposal to Republicans to avoid the fiscal cliff. It included $50 billion in new spending to supposedly stimulate the economy, which comes on the heels of more than $5 trillion in deficit-spending over the last four years. At the same time, the administration seems to ignore that its own Treasury Department publishes estimates showing that the long-term unfunded liabilities of Social Security and Medicare are in the tens of trillions of dollars.

The US fiscal situation is grim.

For their part, many Republicans acknowledge that spending must be cut substantially if the United States is to avoid a debt crisis. Unfortunately, the actual proposals put forth by the GOP to address overspending have fallen far short. Even the supposedly radical budget proposal by House Budget Committee chairman Paul Ryan (R-WI) is short on details and has few actual program terminations.

Furthermore, despite the 2010 congressional elections that put dozens of "Tea Party" fiscal conservatives in the House, the Republicans have shied away from trying to actually end programs or downsize federal agencies. Indeed, on the few House votes taken on eliminating specific welfare-state programs in the past two years, large numbers of Republicans have joined the Democrats in blocking cuts.

The message to a Canadian audience is that the image of American Republicans as a band of budget-cutting zealots with chainsaws is, unfortunately, far off-base. Jean Chretien and Paul Martin had far more success at cutting budgets in the 1990s than Republicans have ever had. Meanwhile, American Democrats share the same big-spending philosophy as Canada's New Democratic Party.

The upshot is that the US fiscal situation is very grim. Most members of Congress and the Obama administration support increased spending in the face of the ongoing flood of red ink. The huge deficits combined with a highly-skewed tax code that exempts about half of the public from paying income tax means that many people don't feel the direct pain of big-government

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spending. At the same time, the government is able to finance its more than $16 trillion in debt held by the public at very low interest rates, which encourages policymakers to borrow even more.

And yet the American public does occasionally rise up and revolt against big government excesses, as it did in 1980, 1994, and 2010. It is also true that Republicans forced through the 2011 Budget Control Act, which put legal caps on non-entitlement spending for the next decade. It is true as well that growing numbers of policymakers are thinking about America's place in the global economy and are realizing that the country may go the way of Greece if it isn't careful. There has also been growing interest in Washington regarding successful foreign reforms, including Canada's impressive fiscal reforms of the 1990s.

However, balanced against those points of optimism are numerous risk factors to the US fiscal outlook that are often overlooked. Even if the economy recovers in the next couple of years and federal revenues rise, policymakers will likely find new reasons to spend more money and keep deficits high. Another economic downturn would bring forth demands for more Keynesian spending stimulus. A new military conflict would push up the already bloated defense budget. And as we've seen in the wake of Hurricane Sandy, every unexpected natural disaster is an excuse to open the spending floodgates for infrastructure and aid payments.

The fiscal reality is that policymakers have no choice but to sharply reduce spending if the US is to head off the looming fiscal train wreck. Unfortunately, it does not appear that they are prepared to make the necessary spending cuts at this time. Unfortunately, the longer they wait, the more difficult will be the reforms.

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3 How Canada Could Take Advantage of Changes to US Tax Policy

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The latest increase in tax rates on high-income people in the United States that Congress and President Obama agreed to earlier this month gives the United States one of the most steeply progressive federal income tax systems in the G7 countries. That is, the income tax rates are much higher for high-income people than for low-income people. But even given those increases, two things are clear: for at least the next few years, and probably the next decade, American individuals and couples will still be more lightly taxed than Canadians, and American corporations will be much more heavily taxed than Canadian corporations.

Apart from these two broad generalizations, there are some interesting differences between the two countries on the estate (or death) tax and the taxation of dividends and capital gains.

> Over the next decade, America's individuals will still be more lightly taxed than Canadians, and American corporations will be much more heavily taxed than Canadian corporations

First, the big picture. The main source of revenue for both Canadian and American governments is individual income taxes. At first glance, the US tax system seems much harsher on individuals than does Canada's: the top marginal tax rate in Canada is 29 percent; in the US it is now 39.6 percent. But the details reveal a different picture. In 2012, Canada's top 29 percent rate was on all income above a CA$132,406 threshold. By contrast, the US's top 39.6 percent rate is on all income above US$450,000 for married couples and $400,000 for singles. Americans making the US equivalent of $132,406 pay a marginal rate of 25 percent (married) or 28 percent (single). Canadians with income between $85,414 and $132,405 (the vast majority of Canada's upper middle class), pay a marginal rate of 26 percent. Their US counterparts pay 28 percent (single) and 25 percent (married).

So the rates look roughly comparable. But this ignores state and provincial income tax rates. Almost all provincial governments have much higher taxes on individual income than almost all state governments. In Ontario, for example, the second highest

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income tax rate on individuals, 17.41 percent, kicks in at an income of only $80,441. That means that an Ontarian making $80,441 pays a combined federal and provincial marginal tax rate of 43.41 percent. In Texas, which has no income tax, that same person would pay 28 percent (if single) and only 25 percent (if married.)

That's the difference between keeping only 57 cents of every additional dollar earned and keeping at least 72 cents of each additional dollar earned. The comparison for Quebec is even more striking. The 24 percent top rate starts at an income of $80,200. At that income level, Quebecers keep only half of every additional dollar earned. Only Alberta, with a top income tax rate of 10 percent, threatens to compete with the United States.

Payroll taxes, on the other hand, are much lower in Canada. To fund its Canada Pension Plan, the Canadian equivalent of Social Security, the government taxes employers and employees 4.95 percent each on the value of employment between $3,500 and $50,100. Compare that to Social Security taxes in the United States, which are 6.2 percent each for employer and employee on all employment income up to $113,700. The vast majority of Americans earn below $113,700. Moreover, the US government taxes all employment for Medicare, its socialized medical system for the elderly, at 1.45 percent each for employer and employee with no upper limit on the amount of employment income covered.

A particularly unfair tax on individual income is the tax on dividends and capital gains. These taxes are unfair because they amount to "double taxation." Someone who earns, say, $1,000 pays tax on it when he earns it, but pays no additional tax, other than a sales tax, if he spends it. But if he saves and invests the after-tax amount, he pays a tax on any dividends and a further tax on his capital gain when he sells his investment. Recognizing this fact, former President George W. Bush and Congress cut the tax rates on "qualified dividends" and on long-term capital gains to 0 percent for low-income people and 15 percent for higher-income people. Under the new law, the top rate for the highest-income people will be 20 percent. That's not all. Beginning this year, there is an added 3.8 percent tax rate on investment income for high-income people. It's part of the health care law, often called "Obamacare," passed in 2010. So the top tax rate on dividends and long-term capital gains has just risen from 15 percent on the highest-income people to 23.8 percent, a 59 percent increase. And that does not include state taxes on capital gains. In the highest-tax states, combined federal and state taxes on capital gains for high-income people are now over 30 percent.

Lighter tax treatment of both capital gains and dividends is an advantage for Canada.

In Canada, by contrast, people are taxed at normal income tax rates on half of their capital gain. That makes the top federal tax rate on capital gains 14.5 percent. Add in provincial tax rates on capital gains and the overall rate goes from 19.5 percent in Alberta to 25 percent in Nova Scotia. In short, capital gains for high-income people are now taxed more lightly in most Canadian provinces than in most US states.

US governments tax corporate incomes much more heavily than do Canadian governments.

The lighter tax treatment on both capital gains and on dividends is an advantage for Canada. Were the federal government to cut federal income tax rates and the provincial governments to cut provincial rates by just a few percentage points each, Canada would be in serious competition for the most productive Americans.

One aspect of the US tax system where for just one year Americans had a clear advantage over Canadians was the euphemistically named "estate tax." For 2010 only, the US estate tax was zero. The tax is not on estates per se: someone who remains alive does not pay it. Instead, it really is a "death tax," as many of its critics have named it. Under the bill passed to avert the "fiscal cliff," estates over $5 million are taxed at a rate of 40 percent. Canada, meanwhile, abolished the estate tax in 1972, though it does have something akin to an estate tax. When a person dies in Canada, the federal government deems the person's assets to be sold and levies taxes on the estate's income and capital gains.

On corporate income, the roles are reversed. US governments tax corporate incomes much more heavily than do Canadian governments. The US federal tax rate is 35 percent, compared to only 15 percent in Canada. State and local governments add an average of 7.5 percent on corporate income, but because these taxes are deductible against taxable income at the federal level, the net corporate income tax rate is about 40 percent. In Canada, when provincial corporate taxes are added in, taxes on corporations are a much lower 27 percent.

Canadian governments are saying to Americans, in effect, "Send me your huddled corporations yearning to keep more of their earnings; I lift my lamp beside Vancouver, Calgary, and Toronto."

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4 Canada's Challenges in the Face of US Monetary Policy

Jerry Jordan, Former President, Clevland Federal Reserve Bank and President, Pacific Academy for Advanced Studies

Like other major central banks, the US Federal Reserve has a stated objective of assuring a low, maximum rate of inflation. Unlike other central banks, the Federal Reserve also has been assigned by Congress the simultaneous task of achieving and maintaining a low level of unemployment. Not surprisingly, these two objectives often seem to be opposite ends of a teeter-totter—pushing down on one raises the other, and vice versa.

For at least the next couple of years, the Federal Funds rate will be largely irrelevant.

For the past few years the inflation rate has been at or below the acceptable upper limit, while the unemployment rate has been considerably above the acceptable limit. The natural consequence has been much attention to central bank statements and actions that are focused on reducing unemployment. An obvious question is: what actions are being taken by the central bank that are intended to lower unemployment? And, what are the likely effects of those actions on the other objective of maintaining an acceptably low rate of inflation?

Progress towards achieving the objectives of monetary policies is usually gauged by various targets and indicators of policy actions—the level of interest rates, growth of bank reserves, expansion of the nation's money supply, or the availability of bank credit. Historically, the US central bank set a short-term target for the overnight interbank rate—known as the Federal funds rate (FF)—and announced changes in the level of this target as necessary to achieve the desired intermediate objectives in terms of longer-term interest rates, or the growth rates of the various measures of reserves, money, and credit that were monitored by the policymakers. Daily actions to inject or drain funds from the interbank market were the critical actions of monetary policy—if the target level of the FF was set appropriately, the inflation rate would not rise above the desired level and the unemployment rate would be at an acceptably low level.

The central bank's balance sheet... has ballooned to almost three times its size before the global financial crisis.

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During the Great Moderation of the latter part of the 20th century and the early years of the new millennium, this approach of setting and hitting an overnight interest rate in order to achieve ultimate objectives of inflation and employment worked very well. As necessary, policymakers would raise the FF target to slow the growth of reserves, money, and credit to lean against emerging inflationary pressures. At other times, they would reduce the target to counter economic weakness and rising unemployment. All that ended with the global financial crisis of 2008 and the subsequent Great Recession.

For at least the next couple of years, the FF will be largely irrelevant. It's highly unlikely that there will be an announced change in the FF, and it wouldn't affect anything if there were such an announcement. The central bank is taking no daily action to maintain the announced rate—no purchases or sales of short-term Treasury bills, no repurchase agreements, and no domestic reverse-repurchase agreements. In fact, the Federal Reserve no longer owns any Treasury bills and has been aggressively selling the remaining one- to five-year securities.

What's left? The central bank's balance sheet—the monetary base—has ballooned to almost three times its size before the global financial crisis. On the asset side, it is mostly long-term US Treasury debt and mortgage-backed securities. The liabilities now include over \$1 trillion of currency outstanding and almost \$1.5 trillion of commercial bank deposits at the central bank that are classified as "excess reserves." Little is known for certain about the motivations of bankers (mostly foreign banks and US affiliates of foreign banks) holding these enormous balances that are earning only ¼ percentage point interest. They may be meeting demands of foreign bank supervisors for greater liquidity, they may be serving as collateral for other transactions or even debt capital issued by the banks, or in some other way represent reserve balances required by foreign supervisors. The essential point is, not much can be certain about the ultimate disposition of these balances. As long as they exist, the overnight interbank rate is useless as either a target or an indicator of central bank intentions.

The spectre of sharply higher inflation looms in the future.

Nevertheless, the sheer magnitude of central bank balance sheets (including those of the European Central Bank, the Bank of England, and the Bank of Japan) raises the spectre of sharply higher inflation in the future. Some forecasters assume that it is only a matter of a bit more time before the inherent resiliency of a market economy takes hold, animal spirits to create wealth will drive up loan demand, banks will respond to the higher, risk-adjusted rates of returns on commercial loans and rapidly reduce holdings of "idle" excess reserves. The monetary base cannot shrink unless central banks sell assets from their portfolios, so the monetary multiplier must rise as excess reserves fall and required reserves rise, and the consequent explosion of stocks of money and bank credit will be inflationary.

The response to this scenario by some skeptics is that even if real wealth-creating activity starts to increase and loan demand faced by banks starts to increase, the central bank will raise the interest rate paid to banks for their idle balances so the banks will continue to find it more profitable to hold excess reserves rather than make loans. This sanguine view imagines that central banks are sufficiently independent of political oversight that the monetary policymakers will explain to the people's elected representatives that there were private-sector firms that saw opportunities to create wealth and employment and the central bank is determined to put a stop to such anti-social behavior. Of course, as long as the unemployment rate remains elevated, the central bank will neither seek to raise interest rates nor sell assets to shrink excess reserve balances.

One can easily find reasons to agree or disagree that there is significant risk of sharply higher inflation in the near term. Longer-term, however, monetary policy is a fiscal instrument—a way of financing government. Fiscal dominance means the unlegislated tax of inflation is a serious risk if spending by governments is not constrained. Ultimately, a society that is unwilling or unable to control spending by government within the limits of explicit taxation will choose the "lesser-evil" of debasing the currency.

Canada and other smaller open economies such as Australia, New Zealand, and Switzerland will face difficult policy choices as the large, debt-and-deficit economies of the US, Europe, and Japan become more tolerant of rising inflation. Currencies of inflation-prone countries are weak in foreign exchange markets versus the currencies of countries that seek stable purchasing power of their national currencies. Persistent appreciation of the Canadian dollar against the US dollar (and the euro, yen, and British pound) will mean increasing competitive pressures on both Canadian industries and firms that seek to export, and on Canadian companies that must compete with foreign imports.

Historically, policymakers in open economies where some industries experience lost international competitiveness feel domestic political pressures to: (a) intervene in financial markets to weaken the currency; (b) adopt trade barriers to rising imports; and/or (c) provide subsidies to favoured firms and industries adversely affected by foreign competition. It is likely that political leaders at both the provincial and federal level in Canada will be challenged to make difficult policy choices as a result of the debt and deficit and monetary problems of the US, Europe, and Japan.

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5 Energy Policy in Obama's Second Term

Kenneth P. Green, Senior Director, Energy and Natural Resource Policy Studies, Fraser Institute.

The best predictor of what President Obama's energy policy will be in his second term is, naturally, his track record on the issue in his first term. Several trends were clearly visible during the Obama Administration's first term: a distinct antipathy for fossil fuels (especially high-carbon forms such as coal), an equally distinct antipathy for the producers of fossil fuels (especially oil companies); and a belief in the "green dream," wherein government picks which fuels, which sources of energy, and which devices belong in the future, and which do not. Throughout his first term, there's no doubt that the President's rhetoric was anti-coal and anti-oil. In particular, President Obama has shown little love for Canadian oil, refusing to approve the Keystone XL pipeline that would bring oil from Canada's oil-sands to refineries in the US Gulf Coast.

In his first term, President Obama put forth extremely bold goals for America's energy economy, pledging that America will generate 80% of its electricity using "renewables" by 2035, and that it will sharply increase the fuel economy of its vehicle fleets as well. The administration did make some strides toward those goals: in 2012 it implemented new vehicle fuel economy standards that call for a near doubling of vehicle mileage by 2025.

In the main, however, the first Obama administration was not particularly effective at implementing policies that reflected its expressed anti-fossil-fuel preferences. Other than throwing a great deal of so-called "stimulus" money at an array of questionable green energy and green job initiatives, President Obama's first term saw stupendous growth in oil and gas production, while coal's declining consumption rate is primarily attributed to the low price of natural gas. A quick snapshot of US energy policy is in order.

> Oil production on federally controlled lands slowed during Obama's first term; production on privately-owned and state-controlled lands rose sharply.

As the United States Energy Information Administration (EIA) observes, while coal consumption in the United States has declined due to very low


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natural gas prices, coal production and exports are strong, and consumption is expected to rebound as natural gas prices rise to more sustainable levels. The EIA projects an 8% increase in market share for coal-fired electricity production in the US (EIA, 2012a). The record for exports was set in 1981, when the US produced 113 million short tons of coal, a record that EIA predicts will fall in 2012 when US coal production will reach 125 million short tons (EIA, 2012b).

Oil production was a key element of discussion in several presidential debates, and in innumerable speeches leading up to the election. It is clear that while oil production on federally controlled lands slowed during Obama's first term, production on privately-owned and state-controlled lands rose sharply. The slowdown on federally-controlled lands was primarily due to a moratorium and permitting changes that took place in the aftermath of the Deepwater Horizon oil spill in 2008. Nationally, oil production rose 14% from 2008 to 2011, and the trend shows no sign of slowing (EIA, 2012c). The EIA predicts annual growth in oil production of 234,000 barrels per day, reaching a level of 7.5 million barrels per day by the end of the decade (EIA, 2012d).

The big story in US energy production is, of course, the stupendous growth of shale-gas production. Like oil production, US gas production also rose by 14% from 2008 to 2011, a trend the EIA expects to continue. Its newest forecast suggests that US dry gas production will outpace consumption by 2020, leading to net exports of natural gas. And that's despite increasing domestic consumption, which the EIA also expects to continue as natural gas displaces coal in the US industrial and power sectors (EIA, 2012d).

Renewable energy generation in the US is also expected to grow, though it will remain a relatively small contributor to US energy production. The EIA forecasts that renewable energy generation will rise by 3% over the next 30 years (EIA, 2012d). Most of this increase is expected to come from solar power; the EIA's latest forecast is more pessimistic about biofuels than were previous forecasts (EIA, 2012d).

Barring some major new energy disaster that triggers additional drilling moratoria, US energy production and consumption trends are likely to continue as they have—there is just too much at stake economically for the president or his Democrat allies to endanger this overwhelming bright spot in America's economy. Pending regulations in the United States, as discussed elsewhere, have the potential to accelerate some trends (such as the switch from coal to natural gas for power generation and industrial use), though the extended implementation schedules for such rules are unlikely to cause rapid change or significantly disrupt US energy markets in the near term.

The biggest implication for Canada is that our southern neighbour will soon need to buy less of our oil and gas, and will become more of a competitor and less of a customer.

Questions to be answered in the second Obama term are whether or not the administration will accomplish its oft-stated goal of removing "subsidies" from US oil and gas producers; whether the administration can persuade a debt-leery 113th Congress to perpetuate subsidies to renewable energy and electric vehicle technology; whether or not a re-routed Keystone XL pipeline will be given the green light; and most importantly, whether or not the US federal government will implement regulations for hydraulic fracturing, the critical technology behind the boom in US shale-gas and liquids production. The United States Environmental Protection Agency introduced regulations to control air-pollution emissions from hydraulic fracturing in April 2012, and environmentalists are pressing the agency to implement tighter federal controls on water use and disposal, and to require the disclosure of proprietary information about the chemicals used in hydraulic fracturing. Piling additional levels of federal regulation on hydraulic fracturing could slow the growth of this increasingly important component of US energy markets.

Another issue that could potentially alter the trajectory of energy consumption in the United States (and possibly force a similar policy in Canada) is a potential carbon tax. While the President has stated that his administration will not propose such a tax, others, such as anti-tax crusader Grover Norquist, believe that such a tax is an inevitable component of any large-scale "deal" to address America's debt and deficit issues.

The Obama administration has proposed and pursued an anti-fossil-fuel agenda, but has had limited success in implementing that agenda. With rare successes, such as tightened vehicle fuel economy standards, private-sector energy interests have ensured that US energy production and exports have increased significantly. The administration's own Energy Information Administration expects these trends to continue for decades to come. The biggest implication for Canada is that our southern neighbour will soon need to buy less of our oil and gas, and will become more of a competitor and less of a customer of Canadian oil over time. Unless Canada takes step to ensure it has access to markets outside of the United States, Canada's own energy boom could be threatened, along with the great economic benefits it provides to all Canadians.

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6 US Energy and Environment Policymaking in Obama's Second Term

Chris Horner, Senior Fellow, Competitive Enterprise Institute

Second presidential terms typically see fewer major legislative proposals and greater focus on implementing first-term legislative accomplishments. President Obama's second presidential term should be no different.

After an early effort to impose greenhouse gas controls via cap-and-trade legislation failed (felled by his own party in the Senate they controlled) President Obama has sought to use existing laws and his executive ability to achieve initiatives otherwise properly reserved for Congress beginning by clamping down on carbon dioxide emissions under the 1990 Clean Air Act Amendments. Another example was the negotiation of aggressive fuel economy standards for vehicles that Canada recently agreed to adopt as well.

The greenhouse gas regulations now blossoming are among an expected deluge of second-term regulations to be imposed in the name of clean energy and/or saving the environment. They reflect a balancing act that pits ideological desires for higher energy prices against the political imperative of not increasing them too quickly for the public's comfort or the functioning of the economy.

A major test of Obama's agenda will be his management of that tension and how it plays out politically. We are only three years removed from the 2009-2010 popular uprising that propelled a wave of Republicans with "Tea Party" leanings into the US House of Representatives. That furore was spurred in appreciable part by energy and environment issues (recall "green jobs," Solyndra and allegations of crony green capitalism, and cap-and-trade). That being said, the electorate gave Mr. Obama a second term, one that is expected to continue with the same priorities.

> President Obama has sought to use existing laws and his executive ability to achieve initiatives otherwise properly reserved for Congress.

Even though it is major legislative initiatives more than regulations that motivate voters into the streets, Congress will become sensitive to all concerns as thoughts soon turn to the 2014 elections. A second-term president's party historically loses over 30 seats in Congress at the mid-term. This is of less

concern to a re-elected President Obama than to his congressional allies, further suggesting that energy and environmental initiatives will not come from Congress, which may instead be willing to exert strong oversight.

Congress's willingness to flex its few muscles will be dictated by how voters react to Obama's regulatory push, which in turn will depend upon how aggressive he is. Oversight steps include hearings and Congressional program reviews, votes to disapprove new regulations under the Congressional Review Act, or even the amendment of underlying statutes to halt perceived overreach and abuse if members of Congress feel enough public pressure.

> Expect a deluge of second-term regulations to be imposed in the name of clean energy and/or saving the environment.

Expected areas of conflict in the second Obama term include the otherwise sleepy topic of energy-related permitting, whether it relates to onshore production, offshore production, or pipeline construction. The administration is likely to continue its unprecedented bias toward fast-tracking renewable energy projects on federal lands, including offshore, coupled with holding up and scaling back hydrocarbon projects. Signs are that this hostility will extend to exports, e.g., liquefied natural gas, and of course imports with the Keystone XL pipeline being the marquee permitting issue. The State Department's continuing struggle to resolve the Keystone XL pipeline's application should extend at least to the end of the first quarter of 2013. Resolution of this issue likely will frame the rest of the energy debate.

Permitting also implicates the growing battle over the nation's natural gas boom, one of the economy's few bright spots. There is a pending Bureau of Land Management (BLM) rule to require disclosure of chemicals used in hydraulic fracturing ("fracking") fluid and establish well-integrity standards on federal and Indian lands. The rule was expected to be finalized at the end of 2012. It is now under review and is likely the preamble to an attempt by the Environmental Protection Agency to regulate all fracking under the Safe Drinking Water Act. This is considered part of the Obama administration's larger intention to centralize oversight of the oil and natural gas extraction process from the states to the federal government.

Opponents fear that the effort to seize jurisdiction is simply a move to discourage exploration and production of a process that has been safely regulated for decades by the states. To the extent that hydraulic fracturing does pose risks, it seems to be the drilling of wells, rather than the hydraulic fracturing itself that needs improvement (Gold, 2012).

> The intention is to centralize oversight of the oil and natural gas extraction process from the states to the federal government.

With Americans focused tightly on the economy, the BLM rule was unlikely to gain traction as a campaign issue, so its delay likely signals recognition of the perils of taking on one of the few industries spurring growth in the US economy, tapping the vast supplies, and benefitting from the subsequent lowered price, of natural gas.


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The administration has no such qualms about debilitating the domestic coal industry, not only by making it more difficult to burn coal but also using the Clean Water Act to hobble new and even existing permits to produce it.

Among other expensive EPA regulations expected in 2013 and listed in a report by Senator James Inhofe of Oklahoma are: regulation declaring coal ash to be a hazardous substance, “Tier III gas regulations” reducing the sulfur content in gasoline from 30 parts per million to 10 ppm (US Senate Committee on Environment and Public Works, 2012). In late December, the EPA finally issued two delayed regulations, National Emission Standard for Hazardous Air Pollutants for industrial, commercial, and institutional boilers and for cement kilns. These are widely expected to force the shutdown of massive numbers of boilers and dramatically increase the cost of producing cement domestically.

These are mere examples of an expected “regulatory cliff” because the Obama administration had held up many regulations for final approval, citing the need to balance economic costs of regulations with their benefits. Some would argue that this was more a fig leaf than a rationale, as all signs in 2011 pointed to a very tight election, and “kicking the can down the road” is a well-known American political pastime.

But President Obama’s last election is behind him, and the regulatory spigot is opening. The Keystone decision and issues relating to the natural gas boom reflect the dominant tension President Obama faces: how to pursue an anti-hydrocarbon energy agenda he shares with his environmentalist allies while maintaining political capital, which can only come by ensuring some positive level of economic growth. That growth, while anaemic, is in large part due to a hydrocarbon boom. In the end, expect a straddle, if one that has a clear bias toward controlling resource production, consumption and trade.

The primary implications for Canada rest on the fact that Canada has long held a policy of harmonizing environmental regulations with those of the United States, at least the major ones such as National Ambient Air Quality standards. Part of this is due to the North American Free Trade Agreement which urges harmonization of rules as they tighten, but not if they loosen (Bedros, 2009). If the US is particularly aggressive in tightening such environmental standards at high cost, Canadians could soon see their own economy affected through the harmonization process.

If the US is aggressive in tightening environmental standards at high cost, Canadians could soon see their own economy affected through the harmonization process.

The ultimate question for President Obama, to the extent he remains undecided, is whether to follow Canada’s turn to resource development as a desired, not merely tolerated and temporary, component of a

growth plan. Were he to do so, he could go a long way to ensuring that the US economy begins a long-awaited return to a sound footing which would benefit Canada as well—a healthy trading partner is better than one slogging through lost-decades of lackluster economic performance.

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7 Washington's Inadvertent Message to Canada: Diversify

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Canadian-American economic cooperation is in a period of decline. The problem is not ideological conflict or trade disputes. Rather, the root cause is American economic and fiscal vulnerability magnified by political weakness. Unlike previous occasions when Washington did not pay enough attention to Canada's key interests and thus provoked more frantic attempts by Ottawa to regain the attention of its giant friend and trading partner, this time Ottawa is determined to look elsewhere in order to reduce its overall economic dependency on the United States. At the same time, the economic and fiscal disarray in Washington, which will continue after the January 1, 2013, deal to avert a fiscal cliff, is making the Obama administration even more protectionist and oblivious to its North American partners. Rather than bringing Canada and Mexico along to present a single North American approach in the Trans Pacific Partnership talks with the large economies of Japan and South Korea, Washington has sought to keep them out. Even though Canada has been negotiating with the European Union on a comprehensive trade agreement, it is not clear where Canada will stand if the United States should engage the EU in similar talks this year.

Diversification is currently much touted in Canada. Canadian economic and political leaders feel confident about how Canada has weathered the financial and economic storms that have raged in the United States and are ongoing in Europe. They now see growth options for Canada mainly outside of North America. Selling oil and natural gas to Asia is the new priority.

The resulting drift in political relations is likely to worsen in the next two years because Canada is not likely to feature significantly in President Obama's foreign relations or trade agendas. Surprisingly, the drift has occurred at a time when the Canadian government was well prepared and motivated to avoid it and to deepen its ties with the United States.

> Canada is not likely to feature prominently in President Obama's foreign relations or trade agendas.

From the beginning of his term in 2006, Prime Minister Stephen Harper has pursued a pragmatic, issues-based relationship with his counterparts in Washington. He has side-stepped the political liability that hampered Prime Minister Mulroney for being seen as too friendly with America's leaders while also avoiding the loss of credibility in Washington that beset earlier Canadian governments who tried to score political points at home by blaming the United States or belittling its policies. Though the Obama administration came in with a very different agenda in both domestic and foreign policy, the Canadian government had no partisan or ideological liabilities to overcome to continue constructive cooperation.

The first point of major tension between President Obama and Prime Minister Harper arose regarding the 2009 US stimulus bill. The new president did not expend any political capital in Congress to push back the insertion of a "Buy America" provision in the infrastructure and public works procurement parts of the bill, and thereby did nothing to ensure that Canadian suppliers and materials would have access to US government stimulus spending. In keeping with its motivation to work constructively with the US, the Canadian government negotiated skilfully behind the scenes until a compromise was found.

Realizing that Canada faces a long-term economic vulnerability from so-called "border thickening," Prime Minister Harper gradually won the US over to the idea of changing the recent pattern of layer-upon-layer of additional security regulations at the border. The main lure for Washington in coming to an agreement was to expand US exports to Canada, while for Canada it was to reduce the impact of security regulations on trade and travel. The new vision has two themes: perimeter security and regulatory harmonization. The new measures will take effect gradually.

Because Canada's energy trade and most of its manufacturing trade is with the United States, it is prudent for Canadian regulations in these sectors to be compatible with those in the US. Avoiding policies regarding so-called greenhouse gas (GHG) emissions that are either evidently more onerous or liberal than American policies creates a unilateral risk. Thus, the Canadian government carefully

The main lure for Washington was to expand US exports to Canada, while for Canada it was to reduce the impact of security regulations on trade and travel.

avoided pronouncing on the policy debate regarding cap-and-trade that waged during the President's first year.

Despite the sound management of bilateral relations as well as considerable Canadian assistance in Afghanistan and Libya, the Obama administration chose easy, immediate, and relative gain over absolute gain when it refused to expend any political capital on permitting the Keystone XL expansion. In fact, the White House overrode the recommendation of the Department of State. The Canada-US bilateral relationship is based on the premise that only the president can wield enough political capital in the divided structure of US government when narrow lobbies seek to do harm to the overall and long-term benefits of cooperation between our two countries. When he chooses not to do so—repeatedly in the XL case—Canadian interests do not stand a chance. Naturally, when Ottawa feels it is treated as blatantly expendable, it begins to look with new fervour for diversification away from the American economy.

Barring any crisis that brings the two capitals together, the next three years will see further political diversification between Ottawa and Washington. The harsh reality for Canada about the newly emerging international system is that the United States will not be willing to deal with Canada on trade and investment in a strategic manner until it needs cooperation with Canada (and Mexico) because of its own relative weakness vis-à-vis the rest of the world, and that will still be another decade or so in my estimation.

Canada must be in a much stronger bargaining position by then. Diversification requires more than foreign trade and investment deals. The Canadian legal and regulatory framework needs to find a way to to overcome aboriginal and environmental headlocks on energy, mineral, and infrastructure developments.

Canada's first 100 years of economic development and trade was based on a dominant relationship with the United Kingdom. The second 100 years of growth has taken place during a period of close partnership with the United States. The next phase of Canada's economic development will likely take place in a political constellation of several world powers. Canada's well-being will depend on a combination of competitive market factors at home, and specific deals with multiple trading partners abroad, among which the United States will likely still be the largest.

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8 One Part Proximity, Nine Parts Good Will: The Canada-US Trade and Border Challenge

Laura Dawson, President of Dawson Strategic

In April 1813, the Toronto Library was looted by American troops during the occupation of York. Six months later, Isaac Chauncey, the commander of the US fleet, returned two cases of library books with a note of apology (Toronto Public Library, 2012). This act is emblematic of a Canada-US relationship that is extraordinarily close, but never easy.

Presidential references to Canada include blandishments about friendship and alliances forged by geography and culture,[1] but in a 1947 speech to Parliament, President Harry S. Truman recognized that the Canada-US relationship demands effort:

> The example of accord provided by our two countries did not come about merely through the happy circumstance of geography. It is compounded of one part proximity and nine parts good will and common sense. (Truman, 1947)

We have paid little attention to Truman's advice in recent years. Since the 1989 Canada-US Free Trade Agreement and the 1994 North American Free Trade Agreement, bilateral economic relations have been on autopilot. Our trade agreements helped to reduce barriers, but they lacked the institutional mechanisms to sustain future progress. Globalization transformed the way we make things, the rise of the BRICs recast our customers and competitors, and 9/11 changed our paradigms of border security, but NAFTA remains the same—a postcard from a bygone economic era. Moreover, since disgruntled factions blame NAFTA for all the ills of globalization, governments are loath to discuss improvements to this sclerotic agreement.

1 In a 1961 address to the Canadian Parliament, President John F. Kennedy stated, "Geography has made us neighbors. History has made us friends. Economics has made us partners. And necessity has made us allies. Those whom nature hath so joined together, let no man put asunder. What unites us is far greater than what divides us" (Kennedy, 1961).

How much good will and common sense have Prime Minister Harper and President Obama shown in their attempts to shore up world's largest bilateral trade and investment relationship? Recent efforts warrant a "B" with lots of room for improvement.

President Kennedy noted that necessity makes us allies. True. And it was the necessity of recovery from the global economic crisis that launched the recent surge of bilateral cooperation. The 2009 US housing and banking crises caused bilateral trade and investment flows to plummet and the Canadian dollar to soar, making our exports more expensive just as US consumer demand stagnated. The US economy caught the flu and Canada ended up sneezing.

> The Canada–US relationship is extraordinarily close, but never easy.

The United States' first response to the crisis was knee-jerk protectionism including "Buy American" and "Country-of-Origin" labeling. But US policymakers recognized that lasting recovery required that the US strengthen its capacity to compete globally, and the global economy begins on the southern shore of the Detroit River.[2] The United States exports more to Canada than to the entire European Union, or to China, Japan, Brazil, and South Korea combined.[3]

Nearly 400,000 people cross the border every day and the value of cross-border trade is about a million dollars a minute. Since so much Canada-US trade is already duty-free, non-tariff barriers are the biggest drag on goods and services trade. They are also the most difficult to eliminate. It is estimated that border inefficiencies cost the Canadian economy 1% of GDP, or $16 billion a year—roughly $500 for each Canadian.[4]

In 2011, Canada and the United States launched two initiatives: Beyond the Border (BTB) to speed the movement of cargo and people across the border and the Regulatory Cooperation Council (RCC) to align bilateral product standards, testing, and certification methods.

BTB and RCC seek to eliminate unnecessary duplication of efforts, to unclog the border by moving inspection and pre-clearance activities to ports and factories, and to institutionalize the principle of "checked once, cleared twice," so that an inspection in either country is recognized as valid in both.

> Our trade agreements helped to reduce barriers, but they lacked the institutional mechanisms to sustain future progress.

The ideas are simple, the economic effects are huge, and the implementation details are staggering. For example, a joint customs inspection facility is more efficient than separate facilities located a kilometer apart. But what are the legal rights and obligations of the US officer questioning a Canadian traveler on Canadian soil and vice versa? Officials on both sides are making good-faith efforts to meet the commitments set out in the BTB declaration but each step unearths systemic frictions that must be worked out before further progress is possible.

2 Windsor, Ontario is south of Detroit, Michigan.

3 US Department of Commerce, 2011 figures.

4 Government of Canada, Canada's Economic Action Plan: Beyond the Border Action Plan and Examples of Action Plan Benefits.

In December 2012, the two governments released the year-one BTB and RCC progress reports. The results are generally very good, but they have fallen short of promised deliverables such as a plan for a comprehensive pre-clearance system for land, rail and marine cargo. More time and sustained political and bureaucratic attention is essential to finish the job. In the end, it is quite likely that the process will yield a handful of pretty good results; the critical question is whether these outcomes can be leveraged into a comprehensive set of principles and processes that will sustain future cooperation.

Canada's ranking on President Obama's second-term economic agenda will not be high. The Americans face daunting domestic challenges, a gridlocked Congress, and have a congenitally short attention span.

If Canadians are clever, we will use the US desire for free trade agreements in Asia and Europe to bolster our mechanisms for cooperation at home. Want to achieve access for US suppliers in China's sub-federal procurement market? Get rid of Buy Local programs at home and insist that the Chinese (and others) do so as well. Want to eliminate regulatory barriers that hamper American trade with the European Union? Use the successful US-Canada regulatory cooperation plan as the template for reducing barriers in worldwide. We benefit from this strategy in two ways. First, the lure of global markets increases the US's perceived value of completing agreements with Canada. Second, if the standards and processes that we adopt with the U.S. are used in new markets, then Canadian manufacturers have fewer adjustment costs and a de facto competitive advantage in these markets as well.[5]

If Canadians are clever, we will use the US desire for free trade agreements in Asia and Europe to bolster our mechanisms for cooperation at home.

Even if we can sustain US political attention long enough to deliver the promises made on BTB and RCC, a number of important issues remain untouched.

Areas for further work include a meaningful dialogue on energy (including supply, regulation, transportation, marketing, and investment), an agreement on labour mobility that deals effectively with skills shortages in trades and technology, and a joint approach to cyber-threats and economic espionage that mirrors NORAD's cooperative approach to military threats.

5 If Canada and the US have agreed to a common standard on organic produce, for example, and the US reaches agreement with the EU on organic produce, then by default, the Canadian standard would be acceptable to the EU, even if Canada had not negotiated with the EU directly.

Whether Commander Chauncey returned the books to the Toronto Library as an act of good will or just to avoid hefty fines, it is certain that as a naval officer he would have recognized that the United States is not an island but is inextricably linked to its neighbours. As Obama pursues his second-term agenda let's hope he has the common sense to recognize that expanding economic cooperation with Canada strengthens the competitiveness of our two nations in the world.

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9 The Effect of US Financial Market Regulation on Canada

Moin Yahya, Associate Professor of Law, University of Alberta

No legislation concerning the financial markets is expected to be proposed by the Obama administration or to be passed by Congress in 2013. There are, however, many ongoing regulatory developments taking shape. Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) in 2010, but left much of the heavy lifting with respect to regulation writing and implementation to the Securities and Exchange Commission (SEC) and other agencies. Dodd-Frank required the SEC to promulgate hundreds of rules and conduct numerous studies. To date, the SEC has completed about half the required rules. Indeed, there are still a few outstanding studies that the SEC needs to conduct and report back on to Congress, the results of which, undoubtedly, will be further rule-making.

The SEC has completed about half the required rules.

Rule-making by the SEC can be long and arduous. The SEC must first draft a set of proposed rules, which are then published for public commentary. The SEC must then comprehensively review the comments and respond to them in a meaningful manner. This takes time and resources to complete, which explains why rules are still being enacted two years after the Act's passage. Consider for example, the simple question of whether uniform fiduciary duties should be imposed upon investment advisers and broker-dealers. Dodd-Frank did not answer this question, but gave the SEC the task of conducting a study into whether such a duty should be imposed. The SEC solicited comments prior to conducting the study, and received over 3,500 letters, many of which were lengthy and detailed. After receiving the comments, the SEC issued a 166-page study with over 700 footnotes and two appendices, recommending that the answer be yes. At present, the SEC is examining the question of how to implement this simple answer with enforceable rules.

Rule-making by the SEC can be long and arduous.

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The impact of Dodd-Frank and its accompanying regulations on the American financial system is highly uncertain, and in fact, uncertainty seems to be the only certain impact. The impact of Dodd-Frank on Canada's financial system is even more uncertain. The reason is twofold. First, some specific provisions of Dodd-Frank deal with foreign banks, but many of the rules have yet to be developed by the Federal Reserve Board. Second, there are other rules that may apply inadvertently to Canadian companies that happen to be doing business in the United States, such as brokerage firms that trade American stocks for clients either in the United States or Canada.

Canadian companies cross-listed on American stock exchanges will be subject to the Dodd-Frank panoply of regulations. Canadian companies engaging in brokerage or investment activities could find themselves subject to new uncertain requirements, such as limits on interchange fees and new regulations of derivatives. The Volcker rule, which prohibits banks from proprietary trading, i.e., engaging in investments and financial trading using their own money, will affect any Canadian bank that owns an American subsidiary. Although it probably will not apply to the parent Canadian bank, such a rule may require massive paperwork to keep the parent's accounts separate from the subsidiary. Canadian mining and energy companies could face the prospect of having to publicly report any payments to foreign governments. The impact of these new rules on Canada's economic health is yet uncertain, and may not become clear for many years to come.

The impact of Dodd-Frank and its accompanying regulations on the American financial system is uncertain.

Dodd-Frank also set out a series of capital requirements for financial institutions. In addition to these requirements, the Federal Reserve is moving ahead to implement many of the measures recommended by the Basel Committee on Banking Supervision known as Basel III. The Basel Committee is an organization to which both the United States and Canada belong. Many of the Dodd-Frank capital requirements, however, are more stringent than Basel III. The impact of these new capital requirements on American institutions is also unclear, but whether the more stringent Dodd-Frank requirements will affect Canadian banks rather than just the Basel III is also not obvious. Regardless of what happens in the United States, Canada is also adopting Basel III as mandated by Canada's Office of the *Superintendent of Financial Institutions* (OSFI).

The impact of new financial rules on Canada's economic health is uncertain, and may not become clear for many years to come.

Basel III increases the Capital Adequacy Ratios (CAR) that banks and financial institutions will be required to maintain. These CAR requirements will

begin as soon as 2013 and will be phased in over the next five to eight years. The measures came about in the wake of the last financial meltdown in the United States and Europe. The measures will arguably shore up capital reserves for banks in order to cut down on high-risk lending and investing in order to ensure that the banks are financially stable and have more liquidity and less leverage.

Basel III requirements could lower the profitability of Canada's banks while adversely affecting the economy.

Basel III has two main objectives. The first is to raise the required capital reserve requirements, while the second is to lower the overall risk of the assets banks hold. Banks have always been required to maintain minimum reserves, typically a percentage of total assets. Basel III will raise these minimum percentages over the next five years from what can be currently as low as 3% to as high as 10.5%. Banks will have to find extra capital either by raising borrowing rates, lending or investing less money, or raising extra equity from shareholders. The type of capital acceptable to meet the CAR will also change. Banks will now have to maintain minimum amounts of shareholder equity, Tier 1 capital (high-quality assets such as cash, common equity, and preferred equity), and total capital. Certain types of capital once acceptable for the CAR will now not be accepted.

The Basel III requirements could lower the profitability of Canada's banks while adversely affecting the economy. By having to curtail loans or raise lending rates in order to maintain the higher reserve ratios, the macroeconomic impacts could be negative. In addition, because government bonds usually are rated less risky than corporate bonds (or commercial loans), the new rules gives banks the incentive to lend less to the private sector and more to the public sector.

The implication of both US domestic financial regulation, like Dodd-Frank, which affects Canadian banks directly and indirectly, as well as the international regulations being implemented under Basel III is that they may, and likely will, reduce the efficiency and profitability of Canadian financial institutions. Such an impact on our banking system will have clear, negative consequences for the broader Canadian economy given the central importance financial institutions play in a modern economy.

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10 Obamacare and Canadian Health Care

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The re-election of President Barack Obama ensures the enactment of the Patient Protection and Affordable Care Act (ACA). While specific implementation details remain to be worked out, the ACA will profoundly affect the US health care sector. It might also affect the health care sectors of other countries, including Canada's. Perhaps most important is the access that Canada enjoys to US health care technology. The ACA will likely reduce rates of technological change in the US sector which, in turn, will reduce availability of new technology to Canada. This outcome would oblige Canada to devote more resources to health care innovation to compensate for slower technological change in the United States.

Employer-sponsored insurance covers the majority of non-elderly workers in the United States. Medicare is the universal government-funded insurance program for the elderly, while Medicaid is the government-funded insurance program for many of the poor. The ACA addresses the health insurance needs of the "working poor," i.e., those who are too young for Medicare, make too much money to qualify for Medicaid, and who do not receive insurance through their employment.

The ACA reforms the non-group private insurance market ostensibly so that the working poor can acquire health insurance. To ensure widespread coverage, private insurers cannot exclude buyers on the basis of pre-existing conditions. Nor can they charge differential prices based on the health status of applicants. To ensure comprehensive coverage, minimum standards are established for non-group and small group insurance markets, including mandatory coverage benefits.

> The ACA will likely reduce rates of technological change... in the US sector which, in turn, will reduce availability of new technology to Canada.

To obviate the problem of the uninsured waiting until they are sick to buy insurance at prices "appropriate" for a healthier cohort of customers, most uninsured individuals are required to have insurance coverage or pay a penalty. Government subsidies

are provided to low income families, either as expanded eligibility for Medicaid or tax credits to offset the cost of private insurance.

Expanded insurance coverage and increased use of health care services are to be funded in several ways. One is a reduction in reimbursements paid to health providers for Medicare services. New excise taxes will be imposed on medical equipment manufacturers and other businesses expected to benefit from expanded insurance coverage. An excise tax will also be imposed on "expensive" private insurance policies. The Medicare payroll tax will be increased, and a tax will be imposed on capital income. Other revenue sources include penalty payments by individuals and employers who do not buy required coverage and taxes on higher wages resulting from reduced employer spending on insurance. Finally, an Independent Payment Advisory Board will redesign reimbursement of providers, and a new research institute will identify cost-effective medical treatments.

Expanded insurance coverage will contribute to increased scarcity, and possibly shortages, of health care services...

The ACA will profoundly change the US health care system. Specifically, expanded insurance coverage will contribute to increased scarcity, and possibly shortages, of health care services in the US over the foreseeable future. Shortages will be exacerbated by contemplated lower payments for Medicare services which would reduce the quantity of services supplied. Since many private insurers tie their reimbursement rates to Medicare rates, reduced availability of health care services might be widespread. Waiting times for health care services, familiar to Canadians, could increasingly characterize the US health care system.

Lower payments by government and private insurers to service providers could encourage consolidation of the health care sector, whereby most physicians will work for hospital-based provider networks, with fewer and larger hospitals than currently exist. This is because small physician practice groups and hospitals lack the resources and capabilities to implement electronic medical records and to adopt "integrated" patient care models that are increasingly favoured by government insurers. Also, large size is an advantage for hospitals and service providers when negotiating reimbursement schedules. Increased ownership concentration in the sector will reduce competition and, consequently, reduce pressure on providers to innovate in order to improve patient satisfaction and the quality of health care. The excise tax on manufacturers of medical equipment and supplies could also reduce

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competition, as some manufacturers may be unable to pass the tax onto customers. The result might be slower innovation by those manufacturers. Finally, innovation might be stifled by efforts to control costs through a tight application of cost-effectiveness criteria.

These anticipated changes have implications for Canada. The United States is the leading source of new health care products and services, including medical equipment, pharmaceuticals, and surgical and clinical techniques. Other countries, including Canada, benefit by importing products developed in the United States, often at marginal cost. Canadian health care providers also benefit by waiting until new procedures and techniques are proven effective in the United States before adopting them in Canada. The ability of the Canadian sector to acquire technology and knowledge from the United States reduces required Canadian investment in expensive research and development, clinical testing, and the like, thereby making state-of-the-art health care services less expensive for Canadians. If the ACA reduces innovation in the United States, other countries will presumably need to spend more on health care innovation.

If the ACA reduces innovation in the United States, other countries will presumably need to spend more on health care innovation.

The emergence of rationing and waiting times in the US might also increase the costs of Canadian health care by constraining provincial governments from using spare capacity in the US as a buffer against "excessive" waiting times in Canada. Rather than relying upon sending Canadian patients to the United States to deal with excessive wait times, provincial governments will presumably need to add domestic capacity or else increase waiting times for Canadians to receive medical treatment. The demand for procedures such as CT scans that some Canadians acquire outside of provincial insurance plans could increase in Canada if those procedures become less readily available through US clinics. This development would intensify concerns about "two-tier" Canadian health care.

Many observers expect the US health care system to increasingly resemble the Canadian system after the implementation of the ACA, even ultimately leading to a single-payer system. If so, several advantages that the Canadian health care system enjoys, partly at the expense of public and private US insurers, may decrease or disappear completely. This will oblige Canadian governments to spend more on health care or accept a slower rate of technological change in the Canadian sector.

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