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If Taxes Fall, Does Health Care Suffer?

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During the current federal election campaign, politicians are debating whether Canada could maintain its current health-care system if Ottawa cut taxes to the level of U.S. federal rates. It is an issue less for the ages than for the sages, and even their heads are spinning.

No wonder. All of the parties and their leaders are framing the question in a way that does not encourage constructive debate and is certainly of little help to Canadians in deciding who to vote for on June 28. The issue that political leaders are squabbling over is whether federal taxes could fall to U.S. levels without endangering health care or using deficit financing. There are no easy answers. To lower taxes significantly and maintain the health care system, a government would have to cut spending or improve efficiencies, or both. It is those hard choices that political leaders should be detailing to give meaning to this debate. However, as a former prime minister, Kim Campbell, once said — rightly, but to her swift regret — a campaign is no time to resolve complicated issues. One way to approach the subject, however, is to examine the relationship between government spending on health care and that government's tax revenue.

We looked at the relationship for OECD countries.

In fact, governments with higher revenues do tend to spend more on health care, though the relationship is a weak one, with many exceptions. Austria, Belgium, Finland, Greece, Italy, Luxembourg, the Netherlands, and the Slovak Republic, for example, raise more revenue than Canadian governments, while spending less per capita on health care than Canada does. By contrast, Iceland spends more on health care, while its tax level is somewhat lower than Canada's.

The relationship is illustrated in Figure 1. It shows public health care spending compared to total government revenue, both as a percentage of GDP, in 2001, the latest year for which comparison figures are available. Each percentage point increase in the revenue-to-GDP ratio is associated with a rise in public health care spending of 0.06 percentage points of GDP, or 6 cents on each additional tax dollar, not very much. Stated differently, an increase in government revenues of $100 per person in 2001 translates to only a $6 per capita increase in public health care spending across industrialized countries.

Many factors affect the connection between revenues and health care spending, so there is no easy answer as to whether a country can afford the same health care with lower taxes or more health care with the same tax dollars. For one thing, health care spending is a significant — but not the only — expenditure of governments. Canadian federal, provincial and municipal governments spent 16 cents of each dollar on health care in 2001. The provinces spent the most, with health care accounting for about a third of their budgets, while federal and local governments spent much less.

Some countries might afford more health care at lower tax levels if a greater share of health expenditure is covered privately. Proportions of total health expenditures (both public and private) covered by governments vary quite widely across countries. For example, the U.S. has the most expensive health care system, with total costs equal to 13.9 percent of GDP in 2001. However, U.S. governments cover only about 45 percent of those costs. By contrast, Sweden, which has a two-tier health care system, covers about 85 percent of total costs — 8.7 percent of GDP in 2001. Similarly, governments in Denmark, Iceland, Norway and Britain all cover more than 80 percent of total health expenditures publicly. Canadian governments were on the low side among OECD countries, covering 70 percent of total public and private health care costs, or 9.7 percent of GDP in 2001.

At the same time, as citizens retire, their sources of income decline, leaving less money for governments to collect. As a result, countries with older populations have a higher share of health care spending to revenues. Only 12.6 percent of Canada’s population was over the age of 65 in 2001, which compared favourably to Japan (18 percent), Italy (18 percent), Sweden (17.7 percent) and Germany (17.2 percent). Germany spends more on health care than Canada, partly because of population aging, though Japan, Italy and Sweden have lower public and private health care expenditures as a share of GDP than Canada, despite their older populations. Clearly, other factors besides aging strongly influence the relationship between health spending and revenues.

In particular, some governments may simply spend less because they run a more efficient health care system. This seems to be the case in Sweden, for example, which achieves better health status results than Canada at lower total private-public cost. Denmark, with the same per capita GDP as Canada in 2001 and a somewhat older population, spends about 11 percent less on public and private health care than Canada, and the government covers over four-fifths of the cost. A recent study (OECD 2003. Health at a Glance – OECD Indicators 2003. Paris: OECD) showed, for example, that Canada achieves mediocre health status results, although it is one of the highest spenders in that area.

Coming back to the original issue, it appears that Canada could afford its public health care system at lower levels of taxation by running the system more efficiently and by shifting resources away from other public services that are inefficient or of lower priority. It would certainly be hard to cut taxes and spend more on health care if such efficiencies in public services cannot be achieved. From Figure 1, it is clear that several countries spend, like Canada, between 6 and 7 percent of GDP on their public health care systems, but at lower levels of taxation. Such is the case with Japan, the U.S., Australia, the U.K., Portugal and the Czech Republic. Moreover, among countries that raise about the same amount of revenue as a share of GDP as Canada, only two spend more public funds on health care, Germany and Iceland. Most other countries spend far less than Canada, including Austria, Finland, Luxembourg and the Netherlands.

For Canada to maintain the same system with lower taxes, Ottawa would have to reduce spending in other areas, and the choices would not be easy. But those decisions are what politicians on both sides of the debate should now be laying out for Canadians.

Figure 1: *Government Revenue and Public Health Expenditure in 2001*