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Chair

Mr. Massimo Pacetti

Standing Committee on Finance

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● (1110)

[*English*]

The Chair (Mr. Massimo Pacetti (Saint-Léonard—Saint-Michel, Lib.)): Good morning, everybody. Thank you for appearing before the committee.

This is a new exercise for everybody who is here today; it's pretty well a new concept. This is in order to study the fiscal forecasting or projections that the finance department has been providing us with the last couple of years. There was a motion filed before the committee, and we met last week regarding some of the issues that you guys are going to work under.

So if we can go directly to the reports, I will allow 10 minutes for opening remarks for the three groups, the Conference Board of Canada, the Canadian Centre for Policy Alternatives, and Global Insight, and then we'll allow the members to ask questions.

I think all members have copies of the report in both languages.

So if we can, we'll go in the order I have here, the Conference Board first, and then the Canadian Centre for Policy Alternatives, and then Global Insight.

Mr. Darby.

Mr. Paul Darby (Deputy Chief Economist, The Conference Board of Canada): Thank you very much, Mr. Chair.

Good morning, everyone. At the risk of eating into my precious 10 minutes, let me begin by saying how delighted, how honoured, we are to be here as part of this process. We trust that this process will indeed help to shed some clarity, some transparency, and lead to a more efficient and a better budget-making process as we go into the future.

At the Conference Board of Canada, we have worked very hard, as I know my other colleagues here today have, to provide this committee with the best estimates of the fiscal surplus of the federal government going forward over the next two to three years. In the case of the Conference Board of Canada, I would like to spend about four or five minutes just briefly describing our macroeconomic outlook, which serves as the basis for the fiscal outlook presented in the report.

The macroeconomic outlook for Canada in 2005 is in fact relatively weak. We're looking at real GDP growth of only 2.5%. The main reason for this relative weakness in the outlook this year is the high level of the Canadian dollar, which as you know is now trading just above 80¢ U.S. This has quite a negative impact on our export performance, and it drags down the overall real GDP numbers.

The 2.5% growth that we're forecasting for Canada this year obviously will have an impact on the expected fiscal revenues of the federal government, which can be expected not to grow at the same pace we've seen over the last couple of years. In that forecast, we're also looking for commodity prices to come down from their recent peak levels, with oil prices getting down to roughly $40 a barrel as we get into 2005 and 2006, and other commodity prices also weakening from their current record levels. As a result, as we look at the forecast for corporate profits going forward.... Let me remind you that corporate profits are now at record levels as a share of GDP, but we also see some very weak growth in corporate profits in Canada, which will have a negative impact on the growth of the corporate income tax revenues of the federal government. So again, this is not a source of strength, at least in 2005-06, for federal government revenues.

Another interesting development for the economy, as we think about the main drivers of the fiscal outlook, is that for the next six months or so, we see no increase in Canadian interest rates. The Bank of Canada has recognized the fact that the Canadian economy has slowed. However, we do see interest rates increasing near the end of this year in the final quarter of 2005 and rising through 2006. This will have an impact upon the debt charges of the federal government. So we are looking at increasing pressure, if you like, on debt charges as we go into fiscal years 2005-06, but particularly in fiscal years 2006-07.

So if you like, there are some forces that will be operating to put some restraint upon the federal fiscal situation over the next couple of fiscal years. These are relatively slower economic growth, particularly in 2005; higher interest rates, especially in 2006; and falling levels of commodity prices, which will have a negative impact on corporate profits and, as a result, on federal corporate income tax collections.

That having been said, Mr. Chair, I think it's also important to recognize that the domestic economy will in fact show some good strength in both 2005 and 2006. Indeed, as we get into 2006, with the Canadian dollar having eased back to some slightly lower levels, the export side of the economy will also perform better, and we are looking for economic growth that gets into the 3% range as we get to 2006.

A relatively strong domestic economy, with better growth in 2006, does bode well for the general revenue collections of the federal government. As a result, in spite of some of these negative pressures, we are still looking for the federal government to post some rather healthy surpluses as we look at the next two fiscal years. Indeed, we have a surplus in fiscal year 2005-06 that stands at $7.6 billion and a forecast surplus for fiscal year 2006-07 that is slightly better, at $8.8 billion.

It's also important to state that these estimates of the fiscal surplus are on a status quo basis. They assume no new tax initiatives and no new spending initiatives beyond those that have already been announced by the federal government. Recognize, however, that the roughly $2.8 billion in equalization payments going to Newfoundland and Nova Scotia have been used to draw down the surplus in fiscal year 2004-05, and they are in our numbers. They are not pulling down the surplus in 2005-06. That's the main one-time adjustment to the surplus numbers we need to keep in mind.

Mr. Chair, with those opening remarks, and knowing my colleagues will be expanding on this and giving their own comments, I'll close for the moment.

Thank you.

The Chair: Thank you.

Just before I go to Mr. Stanford, I want this for the record. You were basing your projections on the third-quarter numbers, correct?

Mr. Paul Darby: That's correct, Mr. Chair.

● (1115)

The Chair: Mr. Stanford.

Mr. Jim Stanford (Research Associate, Economist, Canadian Auto Workers, Canadian Centre for Policy Alternatives): Mr. Chair and members of the committee, like Paul, I feel very privileged to be part of this exercise. You're charting some new ground in terms of democracy, transparency, and accountability in the budget-making process in Canada, and the committee is to be commended for taking those steps.

I submitted my report yesterday in two files. One was the charts and tables and one was the text, but I believe that only the tables have been distributed to the committee members. I have some extra copies that include the commentary that goes with it and I will pass that around. That will provide some additional insight in terms of the methodology I followed and the results I came up with.

I'll just use PowerPoint to summarize some of the main points with tables that are also contained in the report, and if we could, we'll have the first slide.

I just want to take a quick moment to say this. I'm sure this is a question many of us ask ourselves every day: why are we here? More specifically, why are we here engaged in this particular process? Well, it's because the federal government has exceeded its official budget forecast every year for 10 consecutive years. In other words, for 10 years in a row the federal budget's bottom line at the end of the fiscal year was better than had been forecast, and in many years those differences were large.

Over those last 10 years the average positive “surprise”, if you like, or positive error amounted to $8.5 billion per fiscal year. Table 1 in the package covers that history of overperformed budgets and disaggregates the source of the positive error into its main components. The majority of the error was enjoyed on the revenue side, that is, in a typical year the budget underestimated federal revenues by close to 4%, and that is worth about $8 billion in today's tax take. The typical budget also overestimated debt service charges by about 3%, which is worth about $1 billion at today's levels. Those two factors together account for the $8.5 billion average error on the upside in terms of the budget.

Now, it's obviously better to have an error on the upside than on the downside. However, I would point out that in the private sector, if a chief executive or a chief financial officer was consistently off the mark even in a positive direction, he or she would come under fierce criticism from shareholders, analysts, and financial market players in terms of his or her inability to correctly signal where the ship was headed.

There are two sources of potential error in developing a federal fiscal forecast, and I think it's important for us to be aware of the distinction between them. The federal government's budget balance is a function of macroeconomic conditions in the Canadian economy. The budget balance depends on the state of growth, the level of nominal GDP, the rate of employment creation, and whether those variables affect both the revenue side and the spending side, so the state of the economy is going to impact on the federal budget's balance.

There are two ways we can come to an error in terms of our expectations in the budget balance. The first would be to misforecast the actual state of macroeconomic conditions. If you have a forecast error in your actual macroeconomic forecast in terms of where you think GDP is going to be, or inflation or job creation, that will then, obviously, be a source of budget error.

But a second source of error is to then misanalyze the relationship between the macroeconomic conditions and the federal budget balance. That is, given a certain assumption about macroeconomic conditions, would your fiscal forecast on the basis of that macroeconomic forecast have been correct if the macro-forecast had been realized?

So those are two distinct sources of error. It's important for us to keep in mind those two sources because when we look back over history, we will see that during that 10-year period the vast majority of the error was not the result of errors in the actual macroeconomic forecast.

There were errors in the macroeconomic forecast, of course; economists do not have crystal balls and their forecasts are seldom accurate. On the other hand, the average error in the macroeconomic forecast, the consensus forecast that underwrote those budgets over the 10 years, was relatively mild. Table 2 in the package shows that on average the consensus forecast underestimated actual real GDP growth by about half a point, it underestimated GDP inflation by about half a point, and it overestimated interest rates by 20 basis points. Those are significant errors but not huge ones, and they do not account for the majority of the average $8.5 billion error in federal budgets that was experienced over that period. In fact, they only account for about a quarter of that error.

● (1120)

Using the Department of Finance's own estimates about the sensitivity of the budget balance to macroeconomic conditions, the federal government should have exceeded its targets by about $2 billion a year on average as a result of the fact that growth was stronger than expected and interest rates were slightly lower than expected. In fact, they outperformed their budget targets by $8.5 billion a year on average, and the rest of that error, in excess of $6 billion a year, is due to mis-specification of the budgetary variables, given a certain macroeconomic assumption.

The conclusion I take from this is that our attention in this exercise should not be focused on trying to invent a better macroeconomic forecast. On average, the macroeconomic forecasts that have been used over the last decade have not been bad. I think the process the Department of Finance follows in terms of basing its budget on a consensus macroeconomic view is a good one. We should focus our attention, once we have that forecast in hand, on being more accurate in forecasting the fiscal variables for revenues, expenses, and budgetary balances that come out of the macroeconomic forecast. That's one major point.

Another context point that I want to make is on the general pattern in recent years of a very healthy stability in the federal government's fiscal base. It's discussed in the paper on some of the figures. This figure shows the overall tax revenues that the federal government takes in as a share of Canadian GDP. You'll see that it declined significantly in 2001 with the major tax cuts that were implemented in that period. Since then it has been rock solid, and in fact that's true essentially on a public accounts basis as well as on a national accounts basis. If you look at the individual components of federal revenues for personal income taxes, GST, employment insurance revenues, revenues from excise taxes and import duties, and so on, they have also been very stable as a share of GDP.

This gives me, again, some skepticism as to why it has been so difficult for the Department of Finance to forecast its revenues accurately and why it has consistently underestimated its true revenues, given the historical stability in the relationship between federal revenues and the macroeconomic variables on which they're based.

The one exception to that is corporate income taxes, as discussed in the paper. Corporate income tax revenues are much harder to pin down relative to the state of the economy than any of the other components. There is a certain uncertainty in terms of corporate income taxes.

Other than that, given a certain macroeconomic forecast, it should be relatively easy to then accurately predict federal revenues on the basis of that forecast.

With those notes, I'll quickly summarize the methodology that I followed in my submission to this exercise. I did not develop my own macroeconomic forecast. That's partly because I don't have a macroeconomic model, but in my judgment, it's also because errors in those forecasts have not been the main source of our problem. I think we should focus our attention on what comes after making the forecast.

All I've done is look at the forecasts that other Canadian economists have developed and compiled on the basis of those forecasts, all of which were issued since December. It's something that I call a consensus macroeconomic view. It's a slimmed-down version of what the Department of Finance does anyway. Then, on the basis of that consensus macroeconomic forecast, I developed my own independent fiscal forecast.

I want to stress to the committee and to the taxpayers of Canada that since I did not conduct my own elaborate macroeconomic forecasting model, my invoice for this exercise will be downsized appropriately. I do forecast large surpluses, as you'll see. I'm going to do my bit to help the government realize those surpluses by submitting an invoice that reflects the fact that I conducted a smaller exercise than my colleagues here.

As did my colleagues, I adopted a best guess for a status quo fiscal balance, assuming no additional changes in tax policy or spending programs other than what have already been announced, including new spending since the November economic and fiscal update. In the spirit of transparency, again, this is a genuine, clear and transparent best guess. There are no prudence cushions and there are no contingency funds. I am simply telling you my best guess of what I think the federal budget balance is going to be.

On that basis, here are the highlights of the consensus macroeconomic forecast that I have compiled.

● (1125)

As Paul said earlier, we're seeing GDP growth in real terms as somewhat slower, at least in the next year or two, than was expected last fall. That is offset somewhat by higher GDP inflation than had originally been expected for the fiscal year just ending, but next year, even nominal GDP will be lower than had been expected last fall. Employment growth—1.3% this year, 1.5% next year—is, again, somewhat slower than had been expected last fall, and inflation and bond rates move accordingly.

This consensus you see here, which I've compiled on the basis of forecasts published by other economists, is somewhat more optimistic than the forecasts generated independently by the Conference Board of Canada and Global Insight. That may be because the consensus is a moving target, and the economists are adjusting their views over time. Paul and Dale have performed their forecasts right here and now, and it could be the consensus has become somewhat more pessimistic than some of the ones I looked at in December and January.

On the other hand, keep in mind that it doesn't make much difference. I have performed my fiscal simulations on the basis of Paul's and Dale's macroeconomic forecasts, and it only reduces my expected surplus in 2005 and in 2006 by between $1 billion and $1.5 billion; so even here, most of the action is on the second of those two links I specified earlier. Even if I use the exact macroeconomic forecasts my colleagues have developed independently, rather than this consensus view I've compiled, it doesn't make a lot of difference to my fiscal forecast, and I think that's consistent with the argument I laid out earlier—that the main source of error has been in the fiscal projections, not in the macroeconomic view of things.

The next slide shows you the fiscal projections resulting, in my fiscal model, from that current macroeconomic consensus view, in terms of revenue, program spending, debt service, and the bottom line of budget balance. I would forecast a budget balance. That is, again, on a status quo basis. We don't know what is going to be announced tomorrow, but on the basis of tax and spending decisions already announced, I would see a budgetary balance for the current fiscal year of $8.7 billion. Remember, that is after the $3 billion in new spending—for the Atlantic equalization deal, the tsunami aid, and so on—that's been announced since the economic and fiscal update. Strip that $3 billion in new spending out and you're looking at a surplus of $11.7 billion, as compared to the much smaller surplus indicated by the finance minister in his November update.

That surplus grows over the next two years to $11 billion and then $13 billion. Even though growth is somewhat slower than expected in November, interest rates are going to be somewhat lower than expected, and the growth in nominal GDP is not that much slower than had been expected initially. On that basis, we are expecting the surplus to grow over the next two years, and that is quite different from the projection of a U-shaped budget surplus suggested by some observers.

This is a familiar story, quite consistent with the experience over the last 10 years. I believe the current fiscal projections underestimate the federal government's revenue, overestimate the federal government's debt service charges, and are more or less accurate in terms of the federal government's program spending. That is why I end up with a surplus that's larger than is indicated.

In terms of expressing those relative to Canada's GDP, we see a relative stability in the revenue side, shrinking slightly as a result of some of the tax policy changes in the pipeline, including two years of EI premium rate reductions, the last stage of the corporate income tax reduction, and the gradual phase-out of the corporate capital tax. Those are policy reasons for you to expect some decline—not very much, but some decline—in the government's revenues as a share of GDP. This is much more moderate, however, than the federal government's own forecast, which sees quite a sharp decline projected, between 2003 and 2005, of almost a full point of GDP in terms of the erosion of federal revenues. Unless you have a convincing story to explain why that happened—some kind of a hidden tax cut or some kind of structural change in the makeup of the economy undermining federal revenues—there's no particular reason to believe federal revenues, as a share of GDP, should shrink.

Program spending stays constant as a share of GDP—in fact, declining slightly in 2005 and 2006—so recent spending announcements, even though they are significant in dollar terms, have only stabilized federal program spending as a share of GDP—and then debt service continues to erode as a share of GDP. This shows the surplus forecast is driven by an underlying, very fundamental, dynamic.

● (1130)

Our debt is shrinking dramatically as a share of our GDP. That means debt service charges are shrinking dramatically as a share of both GDP and federal revenues, which opens up significant new fiscal room year after year. If program spending is stable as a share of GDP, which it is, and if revenues are stable as a share of GDP, which they seem to be as well, then you should expect the surplus to get larger, in the absence of other policy announcements, year after year.

For several years the federal government has suggested that its large surplus is going to quickly disappear, and for several years the federal government has been wrong in that projection. I submit that I think that projection is still wrong.

I'll leave it at that, Mr. Chair, and look forward to the discussion.

The Chair: Thank you, Mr. Stanford.

Briefly, on the fiscal projection sheet, where you have the program spending and debt service, again, just to clear up matters, you have no amount for prudence, whether it be a contingency reserve or economic prudence. Is that correct?

Mr. Jim Stanford: That's my approach. To be transparent here, I will tell you what I think the surplus is going to be. If the members of Parliament decide they would like to set aside a $3 billion reserve, that's fine. That will be their choice as a policy matter, but my exercise, as a forecaster, is to give you my best guess of where it should be.

The Chair: Thank you.

Mr. Szadurski.

Mr. Wojciech Szadurski (Senior Economist, Global Insight Canada Ltd.): Mr. Chairman, ladies and gentlemen, thank you very much for inviting me today to your proceedings. I'm Wojciech Szadurski, senior economist from Global Insight. Together with Dale Orr, we prepared an economic and fiscal update as of February 2005, and Global Insight is privileged to be part of the process.

I hope everyone has a copy of our report. I will take you through this report. On the third page you have an executive summary, which is basically our findings in a nutshell. Then on page 7 there is a table with economic assumptions. The table has almost the same format as the table of economic assumptions produced in the November 2004 economic and fiscal update by the Government of Canada. On page 9, table 2, we replicate the average of private sector fiscal projections that was included in the November economic and fiscal update.

On page 10 you find the same table as table 2, but with Global Insight's fiscal update as of February 2005, and on page 11 is table 4, where we basically look at the difference between Global Insight's fiscal projection as of February and the average of private sector forecasts in November 2004.

Let me start by outlining our methodology in this exercise. We used the November economic and fiscal update as the starting point. We participated in this update, and based on our analysis, we developed so-called fiscal parameters. They include, for example, the ratio of personal income tax revenues to personal incomes, corporate tax revenues to corporate income, and so on. We then took the average forecaster's projection for Canada that the Department of Finance developed and used those parameters to come up with our own projection of fiscal balances.

In February, we used our own economic forecast for Canada, and you see the difference between the two forecasts in table 1. Based on the new economic data, including the third-quarter national accounts, we updated our view on the fiscal parameters, such as the ratio of personal income taxes to personal income, and we updated our projection for the fiscal balance.

Now, we maintained some of the assumptions in February that we made in November, and those assumptions relate to areas of government spending such as goods and services expenditures, federal transfers to persons, transfers to non-residents, business subsidies, and transfers to other levels of government that were provided to us by the Department of Finance as the status quo assumptions.

The only adjustment we made to program spending was the introduction of increased transfer payments to Newfoundland and Labrador and Nova Scotia, recently announced—altogether $2.8 billion—for the fiscal year 2004-05 and the $200 million matchup to private contributions for tsunami relief, which amounts to $3 billion for the fiscal year 2004-05.

● (1135)

As well, we used our own economic model to derive the forecast for old age security, employment insurance benefits, and interest on the public debt, because they critically depend on the economic outlook.

Let me take you to table 1 and highlight the difference between Global Insight's forecast as of February 2005 and what was assumed in November 2004.

In terms of real GDP growth, we see weaker growth throughout the forecast horizon. In terms of GDP inflation, we see slightly higher GDP inflation in calendar year 2004, much weaker inflation in 2005, and slightly stronger inflation in 2006. In terms of nominal GDP, which can be considered as a tax base for the federal government, we basically see nominal GDP levels the same as assumed in November 2004 and slightly more than $20 billion lower in 2005 and 2006.

Because we see the economy growing at a weaker pace than what was assumed in November, coming with that is the fact that we also see lower interest rates, both at the short end and at the long end, and a higher unemployment rate. The reason for our relative pessimism, compared with the November outlook, is our outlook for the Canadian dollar. We see the Canadian dollar continuing to be pressured upwards for reasons that are independent from Canadian developments and have more to do with the balance of payments issue in the United States. This is the main factor for the difference in economic outlook between our February forecast and what was assumed in the November economic and fiscal outlook.

Let me take you to table 3, on page 10, which is a summary of our fiscal projections. On page 11, you can also look at table 4. Let me start with budgetary revenues. Even though we are forecasting the same level of nominal GDP in 2004 as in November, we see higher budgetary revenues in 2004-05 by around $1.7 billion. You may ask why that is. Over the past year we've been consistently surprised by the ratio of personal income taxes to personal income. In the November exercise, Global Insight had a relatively optimistic fiscal outlook based on the fact that we assumed a relatively high ratio. Well, when national accounts numbers for the third quarter came out, even we were surprised by the high ratio, and therefore we assumed that this ratio would be a little higher going forward. This basically is what generates a higher forecast of budgetary revenues in 2004-05.

In terms of program expenses, the main factor for why our program expenses are $2.8 billion higher in 2004-05 is the transfers to Newfoundland and Labrador and to Nova Scotia that the federal government promised to make and will likely account for in this passing fiscal year. This is partly offset by lower public debt charges because of a slightly lower interest rate profile for the rest of the current fiscal year.

On balance, in terms of the budgetary surplus, we are looking for a surplus of $8.1 billion in 2004-05, which compares to a $8.9 billion budgetary surplus assumed in the November update.

● (1140)

Going to the year 2005-06, because of the weaker economy as summarized by the lower nominal GDP, we have lower budgetary revenues by around $700 million. Because of the higher unemployment rate, we have higher benefits being sent to unemployed individuals, which raises program expenses by $1.1 billion, with a partial offset coming from the fact that we have lower interest rates in our forecast, which lowers public debt charges by $1.5 billion. Net, we are forecasting a budgetary surplus of $4.1 billion, which compares with the November forecast of $4.5 billion.

In 2006-07 it is again the same story for budgetary revenues. Because of a lower tax base for the economy, we have budgetary revenues lower by around $600 million. Because of higher unemployment, we have program expenses higher by around $1.4 billion. And because of much lower interest rates assumed in our forecast, we have an offset coming from lower public debt charges, with the difference being $2.7 billion weaker than was assumed in the November update. On net, we are forecasting the budgetary surplus in 2006-07 to come in at $6.6 billion, which compares to the $5.9 billion forecast by private sector forecasters in November 2004.

Thank you very much.

The Chair: Thank you. Let me just make a comment. After the conference call we had, I was kind of skeptical; I thought we'd have the same report, just on three different letterheads. But I see there's been a bit of thought put behind it, so it's going to give us a good opportunity to ask some questions.

[*Translation*]

I will give you five minutes because we do not have too much time. I will let the witnesses decide among themselves if they want to participate: it's a new format.

Mr. Penson, you have seven minutes.

[*English*]

Mr. Charlie Penson (Peace River, CPC): Thank you, Mr. Chair.

I'd like to welcome the fiscal forecasters to this committee. I think this is a very historic, important occasion for this country, that we as a committee have the ability to have updated fiscal forecasts to help us, as parliamentarians, make important policy decisions that are necessary for the country. I think we see the benefit, even at this late date, in the third-quarter results, showing roughly a $3 billion higher figure over the fiscal forecast in November, and that's taking into account the spending that was done on the equalization and the tsunami relief.

If we could have had this earlier, in January, it would have been helpful; unfortunately, there were some delays. But this is an important process. I want to have it continue. I think it's a credible process, and unlike the chair, I didn't expect to see three reports that were Xeroxed and all the same.

I want to explore some of the differences here today. I think that's our job, and it's a responsible way to look at this.

I want first to turn to Mr. Szadurski. Mr. Szadurski, I want you to turn to your 2005-06 projections, because yours is the lowest of the three at $4.1 billion in surplus. You had national account estimates of $11.3 billion in the fiscal update just in November.

I want to ask you, when did you do this estimate? What was your timeframe for this estimate?

● (1145)

Mr. Wojciech Szadurski: For the current estimate? Our economic forecast underlying this estimate was done in early February.

Mr. Charlie Penson: No, I mean for the fiscal update. I'm sorry.

Mr. Wojciech Szadurski: We did it last week.

Mr. Charlie Penson: For the November fiscal update?

Mr. Wojciech Szadurski: Oh, the November fiscal update we did in late October or early November.

Mr. Charlie Penson: I realize there's not a perfect one-on-one correspondence between this and the national public accounts estimates, but tell us, if you would, what the main reasons are that you have for changing your estimates for 2005-06 so dramatically, from $11.3 billion to $4.1 billion on a public accounts basis. That's a huge change. Could you help us through the process of why you would have made that tremendous adjustment?

Mr. Wojciech Szadurski: The key difference is that in November we used an economic forecast that was a consensus forecast, whereas in February—right now—we have used our own forecast. That's the main difference.

Mr. Charlie Penson: What was the first one you used?

Mr. Wojciech Szadurski: In November we used a consensus forecast that was used by every participant in the fiscal update exercise in October and November, whereas currently we use our own forecast.

Mr. Charlie Penson: Oh. So when I see the chart from the fiscal update—page 5, table 3.2—showing a number of different group forecasts.... Just going to 2005-06, they show Global Insight, the University of Toronto, the Conference Board of Canada, the Centre for Spatial Economics, and then they show the average. It looks as if the average of those was $9.5 billion, but you were the highest, at $11.3 billion.

So were you really using the average, or were you using your own forecast?

Mr. Wojciech Szadurski: We were using the consensus forecast for the economy. The way this process works is that the participants would be given the same economic forecast. For example, every participant had the same level of nominal GDP to work with, the same level of employment, the same level of personal income, the same level of corporate profits. Then each participant would form their own view on the fiscal parameters, and they include the ratio of personal income taxes to personal income, the ratio of corporate income tax to corporate profits—

Mr. Charlie Penson: Because we have limited time, I'd like to keep this as crisp as we can.

How confident are you in this latest forecast of $4.1 billion?

Mr. Wojciech Szadurski: I am as confident as I can be.

An hon. member: Good answer.

Mr. Charlie Penson: Okay. I'll ask you another question.

I understand you did some good work fairly recently in a paper on the sources of fiscal forecasting errors. I want to ask you a question in the context of your estimates for 2004-05, our current fiscal year....

Just let me preface the question with this comment. Last year at this time we were told the balance would be $1.9 billion for 2003-04. As we know, it turned out to be $9.1 billion when they finally released the year-end results. My question is, at this point last year would you have forecast $1.9 billion for the 2003 fiscal year that was about to end within weeks?

Mr. Wojciech Szadurski: Because we didn't do the same exercise at this point last year, I cannot answer this question.

Mr. Charlie Penson: Maybe I can ask Mr. Darby the same question then.

Roll this back one year. If we were doing this exercise now, taking the $1.9 billion that was showing as the surplus for 2003-04 and that ended up being $9.1 billion, if you had the ability to look at it on this date, which is near the end of February—and the year-end books close at the end of March—would you have forecast the $1.9 billion, or would you have been closer to the $9.1 billion?

Mr. Paul Darby: We in fact undertook a fiscal prospect study for the federal Department of Finance. It was in the summer actually, but we had numbers that would have been closer to $8.5 billion, as opposed to $1.9 billion at that time. Of course, that number came out after the budget. We were looking at work we had done last September, so we had the benefit definitely of some more months' data.

Going back to an exercise similar to this prior to the $1.9 billion, it's hard to say—and I would have to go back to look at our forecast from that time period—but I think at that point we would have been in the $4.5 billion to $5 billion range, wouldn't we, Matthew?

That's something I would need to check, Mr. Penson.

● (1150)

Mr. Charlie Penson: The year was almost up. At this stage, we are almost finished the current fiscal year. That's the context I'm asking this in.

Mr. Paul Darby: I'm sorry. In that context we were close to $9 billion. We were at $8.8 billion even as early as September.

Mr. Charlie Penson: Thank you.

Maybe I could ask Mr. Stanford the same thing.

Mr. Jim Stanford: I have not been involved in the process on an annual basis as my colleagues have. We did our own fiscal forecast through the Canadian Centre for Policy Alternatives for the alternative federal budget process, and we in fact had anticipated a budget surplus of around $9 billion.

That was not just two months before the fiscal year ended. We had actually projected that a year earlier on the basis of the same kind of analysis I presented today, namely that there is an underlying strength in the federal revenue base such that unless something dramatic happens in tax policy or the economy deteriorates far more than has been the case with the consensus forecast, you should expect a very healthy surplus.

Mr. Charlie Penson: Thanks, Mr. Stanford.

You've had a pretty good record—

The Chair: Sorry, your time is up.

Thank you, Mr. Stanford.

Monsieur Loubier, and then Mr. McKay and Ms. Wasylycia-Leis.

[*Translation*]

Mr. Yvan Loubier (Saint-Hyacinthe—Bagot, BQ): Thank you, Mr. Chairman.

I am very happy to see what's happening today since I've been dreaming about this for the past eight years. It's not the only type of dream I have, of course, but this one could really be a dream come true. We, in the Bloc Québécois, have been the only ones to produce more or less accurate forecasts for eight years, give or take 3 or 4 p. 100, by making use of what Mr. Stanford suggested this morning, that is to say using our intelligence, looking at spending on a quarterly basis and looking at the macroeconomic variables published by the Bank of Canada or other institutions. The only difference is that we were—and still are—a political party.

Today's process completely changes the situation in that we now have forecasts that we can use and which will become an additional tool in our toolbox to compare what the federal government will announce in tomorrow's budget and in future budgets with what it will do in reality. This is new ground, as you said. And as Mr. Darby also said. It is new ground for our democracy and I am quite ready to recognize that. It was high time that we got a true picture of our situation.

What surprises me in those reports is the one from Global Insight. I think that organization is making the very same mistake that the government has made for the past seven or eight years. I was playing around a while ago with a small calculator that I tried to give to Mr. Goodale when he published his last economic update, to help him make more accurate calculations, but he refused my gift. You are making the same mistakes.

I look at your revenue forecasts for 2005-06 compared to 2004-05. If I'm not mistaken, you forecast 1.5 p. 100 growth in government revenues. You say that there is a slowdown in the economy. So be it, but may I remind you that in 2003-04, the worst year for Canada—the year of all our disasters with the SARS crisis, the mad cow disease, forest fires in the Western provinces, the power failure in Ontario, storms in the West—the federal government's revenues increased by 4.8 p. 100. So I think that you make the same mistake as the government last year. You work with the same model and the same assumptions. Perhaps it was not a 1.5 p. 100 increase in revenues that you had in mind but 5.1 p. 100? Last year's forecast surplus was 1.9 p. 100 but the figure was then reversed and became 9.1 p. 100. If I correct your mistake, I end up with a surplus of about 11 billion dollars at the end of fiscal year 2005-06, which is similar to what is being suggested by the Canadian Centre for Policy Alternatives.

That being said, let's ignore my little joke. Tell me if you're not perhaps making the same mistakes which led the government to underestimate the surplus by about 70 billion dollars over seven years, since you're working with the same assumptions which have absolutely no connection with reality?

● (1155)

[*English*]

Mr. Wojciech Szadurski: If I can respond, our forecast is based on the best analysis that we feel we can provide.

As an example, in the November economic and fiscal update, we had the highest forecast for budgetary surpluses among the four participants. In the February update, we used the same fiscal parameters that we used in November. The reason our forecast is relatively low is because our baseline forecast for the economy is much weaker than what the Conference Board or Jim Stanford assumed in their analysis.

[*Translation*]

Mr. Yvan Loubier: Yes but you're not only forecasting the future of our economy. When one compares GDP growth to government revenue, one sees that over the past few years revenue has frequently increased more than GDP.

So, first, you underestimate GDP growth. You also underestimate the relationship between GDP growth and government revenue. With 1.5 p. 100 you are at the lower end of the projections. You are even lower than the government was in last year's economic update.

One the basic lessons of Economics 101 is that, when you have three projections, you take the higher and the lower ones. You also use your intelligence to determine, for example, if there are still some tax cuts to come into effect in 2005-06. We've just reached the end of the five-year plan. You tale into account the Health Accord, equalization payments, etc... All that has been taken into consideration by the Conference Board of Canada and the Canadian Centre for Policy Alternatives.

When all that is done, you come to the conclusion that the surplus, based on the forecasts of the Conference Board of Canada and the Canadian Centre for Policy Alternatives, will be between 8 and 11 billion dollars in 2005-06, and between 9 and 13 billion dollars in 2006-07, which is far from the average of the two other forecasts.

Once again, this is what one should normally do when faced with differing projections from different forecasters. One considers the highest one and the lowest one, ie the best and worst case scenarios. There are two scenarios in front of us giving us results that are more than double your own. Don't you think that this should lead you to have another look at your assumptions?

Shouldn't the Department of Finance also wonder about the quality of the assumptions it has been using year after year with the same model as yours?

[*English*]

Mr. Wojciech Szadurski: Again, I'd like to reiterate that the main difference between the November update and our February forecast is the forecast for the economy. That's the main difference. We are not putting any prudence factors into our forecast here, and we are standing by our forecast.

[*Translation*]

Mr. Yvan Loubier: Yes but I go back to the statements of Mr. Stanford and Mr. Darby. If one has to be excessively cautious in economic forecasting, what is the usefulness of economists? We're asking you to give us a plausible scenario. We've received two, at both ends of the scale. When we get wildly different results such as yours, they are not useful. You have the same attitude that Mr. Martin demonstrated during many years and that Mr. Goodale continues to demonstrate. You show such extreme caution about your fiscal variables, GDP growth and revenue growth, that you don't provide us with anything useful. Yours is close to an anxiety forecasting model. That's not what we need. We need credible forecasts based on assumptions that are no less credible. Your growth assumptions are just not credible.

[*English*]

The Chair: No, I know. That's fine.

[*Translation*]

Thank you, Mr. Loubier.

[*English*]

Mr. McKay, and then Ms. Wasylycia-Leis.

Hon. John McKay (Scarborough—Guildwood, Lib.): Thank you, Mr. Chair.

Thank you, witnesses.

I can't imagine how battling economists make riveting television. Nevertheless....

First of all, I want to address a couple of questions to Mr. Stanford. On table 6, in your balances for 2005-06 and 2006-07, I think you've possibly underestimated your balances. When I do the math, the totals appear to be $11.7 billion for 2005-06 and $13.9 billion for 2006-07. Am I correct or am I incorrect in that?

● (1200)

Mr. Jim Stanford: I'll double-check the math on that, sir. I just pulled these straight off my spreadsheet.

Hon. John McKay: All right. They were just fairly significant numbers.

The second question I had is in regard to note 4 for your table 6. You seem to assume a $4 billion debt reduction, yet in your balances you don't assume any debt reduction at all. Again, I can't quite reconcile the balance line with the note.

Mr. Jim Stanford: The purpose of note 4 was that I would be consistent with my colleagues at the Conference Board and at Global Insight. In the approach they take when they're simulating the simultaneous economic and fiscal model, they have to break the link in how they model the debt reduction as a result of the federal surplus. If they don't break the link, then it's very hard for the model to mathematically solve.

You'll see in their reports that they have limited the maximum amount of debt repayment to $3 billion or $4 billion in each of those years. To be consistent with them, as we discussed last week, I limited the debt repayment to $4 billion per year. If you look at table 6 and the line that says “Closing Debt”, in 2004-05 and in 2006 that debt is reduced by $4 billion per year, and that feeds through into the reduction in debt service charges in each of those years.

Hon. John McKay: That was my question, because I wasn't sure whether you were in fact calculating that in.

Mr. Jim Stanford: No, it does feed through, so you do get the debt reduction and the debt service savings. If anything, that's conservative. I'm projecting surpluses much larger than $4 billion, but my forecast at this point does not capture the interest cost savings for the debt reduction in excess of the $4 billion, and that was solely to be consistent with the other two forecasters.

Hon. John McKay: The interest rate you've chosen appears to be at the low end, at 4.5%, which I think is the bond rate. It doesn't seem to calculate that the sum of the debt is in fact paid in excess of that rate. Indeed, for some of the debt there's no rate at all because really it's just contingent liabilities. I'm querying why you would choose the lower of the rates as opposed to the effective rate.

Mr. Jim Stanford: This forecast of debt service is based on the average effective interest rate. That would be the debt service charges as a ratio of the total outstanding debt. What this model assumes is that there's no change in the average effective interest rate over the three-year horizon. That's consistent with what I view as the consensus view that there won't be much change in interest rates over the next two years.

That's conservative, in fact, because of something that's happening at the same time. The government is still rolling over debt that was issued at very high interest rates in the eighties and early nineties. Some of that is being rolled over and renewed at current lower rates, so I would actually expect some gradual decline in the average effective interest rate over the next couple of years.

Hon. John McKay: I wouldn't disagree with you, but you seem to have been very aggressive in your debt servicing charges. You seem to be quite considerably lower than the others. The others seem to have...well, even the Conference Board of Canada says the debt is going to cost us $36 billion in 2006-07, while you say it's $33.3 billion. That's a considerable variation.

I just ask the Conference Board, what's your justification for saying the cost of debt is going to be that high going forward?

Mr. Paul Darby: I would suggest that the main difference would come from the fact that we do assume interest rates rise rather significantly through the course of 2006, beginning in the last quarter of 2005, in fact. I haven't done the math, but I would imagine the increases in interest rates that take place at that time would explain much of the difference between our projection on debt charges and the projection of—

Hon. John McKay: Essentially, it's an underlying assumption on your part.

Mr. Paul Darby: On the interest rates, yes.

● (1205)

Hon. John McKay: My next question is just out of interest in your comment on Mr. Stanford's analysis. If I understood it in lay terms, his analysis was that the errors in projections over the last number of years are not so much errors in macroeconomics as they are more in the microeconomic application of that macroeconomic picture, like recognition of revenues, for instance, and things of that nature. I'd be interested in your commentary on whether you see the so-called happy errors as methodological errors on the part of the department.

Mr. Paul Darby: We haven't in fact undertaken the analysis that Mr. Stanford has undertaken. Without doing that, I would be hesitant to make a statement regarding that issue. We have, of course, noticed that as the actual numbers presented themselves, the fiscal surpluses did indeed tend to be generally higher than the fiscal surpluses initially estimated by the Department of Finance in their budgets.

Certainly we would be careful in terms of ascribing any consistent hidden agenda to the Department of Finance. That's certainly something I would not want to do. There are—

Hon. John McKay: Again, for people watching on television, shouldn't this just be a matter of math?

Mr. Paul Darby: The relationships between the macroeconomic drivers and the fiscal revenue and expenditure results are not, I would say, so robust, tight, or one to one—without error—that one could argue that it's just a question of math. Nevertheless, they are still amongst the more robust relationships that we see in economics and statistics; hence, I have some sympathy with Mr. Stanford's argument that, at least for a number of these revenue items, we could expect to see a fairly close relationship between revenue growth and nominal GDP growth.

So without having done the analysis, as I say—

The Chair: Just wrap it up, because I have Ms. Wasylycia-Leis....

Thank you, Mr. McKay.

I have Ms. Wasylycia-Leis, then I have Mr. Solberg, Monsieur Côté, and Mr. Hubbard.

Ms. Judy Wasylycia-Leis (Winnipeg North, NDP): Thank you, Mr. Chairperson.

I'd also like to thank all of the independent forecasters with us today.

I'd just comment on how important this day is for Parliament. It represents a real breakthrough in terms of getting some real numbers before us and some way to in fact hold the government to account with its projections, which have been so wrong for so long. I think, actually, that Canadians will find this riveting TV, because in fact they're as curious as anyone as to why the government could have been out by so much for such a long period of time. I think this helps all of us get to the bottom of this.

My first question is for Jim Stanford, who I think has given us a clear breakdown of where these errors have occurred. There seems to be, as has been reinforced today, some broad agreement around macroeconomic indicators. But as you've pointed out, Mr. Stanford, the real problem is with respect to errors in fiscal forecasting based on the macro data—all that information of which the government has, and which these 19 so-called independent forecasters have had, and yet no one has come close to your projections or those of the alternative federal budget, which have been accurate over all these years.

So why have these errors been made? I'm trying to get an understanding of why the government keeps doing this, so we can get to the bottom of this. Is it deliberate? Is it for accomplishing another agenda, and what would be the reason? How do we actually then apply that to the fact that the finance minister currently is prepared to perpetuate another hoax on Canadians by suggesting that the numbers are going to drop again way to the bottom, that we're going to have this u-turn over the next two years, contrary to everything you're predicting, the Conference Board is predicting, and the alternative federal budget is predicting?

● (1210)

Mr. Jim Stanford: Well, there's one part of the forecasting exercise that does have an explicit agenda. I wouldn't call it a hidden agenda; it's an explicit agenda to point the budget forecasts to the conservative side of the target, that is, by the introduction of the contingency funds and this growing wedge for economic prudence in their forecasts. These are justified explicitly by the government saying, "We want to make absolutely sure that the government never falls into deficit again". So that's an explicit agenda to shift the targeting exercise deliberately off centre, if you like. I have my own doubts—which I've expressed to Mr. Tim O'Neill, who's conducting his review of the whole process—about the wisdom of doing this at this particular point in our fiscal history, and those are explicit.

On top of that, there is another pattern of systematic error in addition to those explicit reserves. Now, like Mr. Darby, I would be very, very careful to ascribe a particular motive to the officials at the Department of Finance. I think they are civil servants who are doing the best job they can. On the other hand, the political parameters for the exercise have been made clear by the government's leadership. So I tend to think that what happens is that in addition to the contingency reserve and the reserve for prudence, you get people at every step of the way making the most conservative assumptions possible—probably influenced one way or another by this mantra that the government can never fall into deficit again, that if we're going to have an error, it has to be on that side, not this side.

Again, without ascribing a nefarious motive to it, I think the way the budget forecasting process has been structured, dating back to 1994 when we had a serious deficit problem and a serious credibility problem, has in fact created another credibility problem: people still don't believe the budget forecasts. I mean, when the finance minister stands up and says, as he did in November, there will be a surplus of all of $500 million next year, if there's anybody in Canada who believes that, I've got some shares in Nortel Networks I'd like to share with them. That's the credibility problem today. That's why I think we have to reform how we do this process.

Ms. Judy Wasylycia-Leis: I appreciate that response.

I don't want to necessarily ascribe motives, or nefarious motives, to what's happening in the Department of Finance, but the outcome is clear and it is questionable, and that is that when you're out some $80 billion or $90 billion over the last decade, because of lowballing the surplus for whatever reason, that is money that is lost to Parliament in terms of decision-making. It's lost to Canadians in terms of their pressing needs, and it is money that automatically goes against the debt.

So my questions are twofold. One is—and you hinted at this earlier—what's the rationale for a $3 billion contingency fund and a $1 billion prudence fund? Have we ever relied on those funds for emergencies, or has it always gone against the debt? Number two, shouldn't we, as a matter of principle, be putting this before Parliament and having a real debate on what should be set aside and what should go against the debt?

Finally, if you could, comment on what happens to the debt-to-GDP ratio with this kind of massive injection of funds, and what could have happened if those dollars had been spent to grow the economy and to deal with some pretty critical issues before us today?

Mr. Jim Stanford: In terms of the rationale for the contingency fund and the prudence fund, I think this does date back to 1994 and the situation that was faced at that point. I think the effort was probably to try to rebuild some credibility with financial markets and with the independent analysts, to say we're not going to be wishfully thinking here about how the deficit is going to disappear; we're actually going to make sure it disappears and give ourselves some extra room.

That thinking today has no relevance, I believe, for Canada's actual economic and fiscal performance or credibility. Our debt burden, as a share of GDP, is the lowest of any major industrialized country, and is continuing to fall rapidly, and it would continue to fall rapidly even if we just balanced the budget, instead of having the contingency reserve. I think today the contingency reserve and the prudence cushion do more harm than good in terms of the credibility and transparency of the process.

My recommendations that I made to Mr. O'Neil's exercise are that the federal budgeting process should be guided by an independent, arm's-length fiscal projection, something similar to the exercise that you folks are trying to conduct here, but more systematic and more well-resourced. That projection should be a neutral projection. That is, it should simply project a best guess of where we think the fiscal situation will be this year, next year, and the year after, absent major tax or spending policy changes.

Then it will be up to Parliament to make the policy decisions coming out of that. A policy decision coming out of that may indeed be that we're going to set aside $3 billion, or $5 billion, or whatever, but at least you're making it an explicit policy decision, instead of trying to pretend that it's part of the forecast, which it clearly isn't. To build it into the forecast, as they've done today, is to impart a deliberate, off-centre bias to the whole forecasting exercise, which I think now does more harm than good.

● (1215)

The Chair: Thank you, Mr. Stanford.

Mr. Solberg, five minutes, and then Monsieur Côté and Mr. Hubbard.

Mr. Monte Solberg (Medicine Hat, CPC): Thank you very much, Mr. Chairman.

Thank you to all of you for being here today.

This is an important day. I don't know if it's gripping TV. Maybe it's *Crime Scene Investigation* Ottawa, I'm not sure, but at any rate it's great to have you here.

I have a question for Mr. Szadurski. In your presentation you make reference to the fact that the finance department did not provide numbers and did not cooperate. Can you elaborate on that? What do you mean by that? Did you seek their help and did they say they were not going to participate, or how did that work?

Mr. Wojciech Szadurski: As far as I know, at the start of the process that brought us here, there was an issue raised. To what extent would you get cooperation from the finance department for this round of the exercise? The answer was that you wouldn't get any cooperation for this round.

Mr. Monte Solberg: Is it important to get some cooperation, though? I mean, there are numbers, for instance, I always think, on the spending side, but there may be other numbers that it would be helpful to have, numbers that maybe they would have exclusive knowledge about that you don't necessarily have. Would it make sense that your forecasts could be more accurate if you had that kind of cooperation?

Mr. Wojciech Szadurski: It would make a lot of sense, as you mentioned, in terms of the status quo forecast for many of the government program expenditure areas, to get a consensus on that from the finance department. Also, in terms of helping us to monitor demands to the fiscal figures as they come out in the *Fiscal Monitor*, it would be very helpful.

Mr. Monte Solberg: Do you have a sense of whether or not the finance department would be prepared to offer those numbers going into the next quarter?

Mr. Wojciech Szadurski: I cannot comment on this.

Mr. Monte Solberg: Okay. I have a question for all three of the forecasters.

I'm curious about the likely direction of revisions going forward. You have all given us your best estimate on where things are going to end up in the next three years, but knowing that you can be fallible, as we go forward, I'd be curious to know if you have a sense of the direction your revisions might go based on maybe your own built-in bias.

Mr. Darby, why don't we start with you? Where do you think things will go?

Mr. Paul Darby: There are two main risk elements to the outlook, as we've presented it.

I would argue, to begin with, that it's on the future direction of the Canadian dollar. In our outlook, we actually have the Canadian dollar falling slightly to about 78¢ U.S. on average in 2006. That provides some small stimulus to economic growth, particularly in 2006.

The Canadian dollar is trading higher than that. There are some fundamental forces operating against the U.S. dollar worldwide. It is certainly possible that the Canadian dollar could be stronger, significantly stronger than what we have in our outlook, particularly in 2005-06. The impact would be weaker economic growth in Canada and the result would be some smaller surpluses than what we are projecting.

At the same time, another key risk element in our outlook is the outlook for oil prices and commodity prices in general. In fact, we're very conservative in terms of our outlook for oil prices and commodity prices. We have them falling back rather strongly through 2005-06. That has a negative impact on the corporate profits and corporate income tax collections of the federal government.

In a sense, then, I have two offsetting risks as we go forward and, frankly, as a result, I feel fairly comfortable that the surpluses I'm projecting are reasonable even with risks taken into account.

● (1220)

Mr. Monte Solberg: Mr. Szadurski.

Mr. Wojciech Szadurski: There are actually three main areas of risk to our fiscal outlook; two of them relate to the economy and the third one relates to the fiscal drivers.

Let me talk about the risk factors relating to the economy first. The first one has to do with real GDP growth. As we monitor the economy, we feel that growth late last year and early this year could be a little bit weaker than we forecasted and assumed for this exercise. For later this year, and for 2006 and 2007, we are fairly comfortable with our forecast.

The second economic risk is the forecast for GDP inflation. We are currently assuming a moderation in commodity prices, but we've been surprised so far by the fact that commodity prices remained at fairly high levels, including oil prices. This upside risk of GDP inflation provides an offset to the downside risk to real GDP growth for late last year and early this year.

I also think that every forecaster would agree that the main wild card in the economy for Canada is the future of the Canadian dollar. At Global Insight, we are forecasting the economies of close to 200 countries. We try to balance everything together on a global basis.

From our U.S. economists, I can tell you that there is a continued pressure to drive up currencies against the U.S. dollar because they have difficulty in bringing down the U.S. current account deficit to manageable levels. We forecast a continued appreciation of the Canadian dollar, reaching 86¢ at the end of 2006. It's much higher than the other two forecasters forecast. However, I must tell you that this is still less than what our U.S. economists would like the Canadian dollar to be.

In a sense, our risk to the economy from the Canadian dollar perspective also happens to be well-balanced. In a nutshell, we are comfortable with our economic forecast.

Now, there is the third risk element, which has to do with the fiscal drivers. I already mentioned the ratio of personal income tax revenues to personal income.

The Chair: Excuse me, Mr. Szadurski. Just go quickly, please.

Mr. Wojciech Szadurski: There's some uncertainty related to it. In the third calendar quarter last year it was higher than we thought. However, when we look at the *Fiscal Monitor* numbers for October to December, it seems that this ratio may have come down, and that's a source of risk to our forecast.

The Chair: Thank you.

Monsieur Côté, and then Mr. Hubbard.

Ms. Judy Wasylycia-Leis: Excuse me, Mr. Chairman. Can the last witness answer?

The Chair: I'm way over on time. I just want to give all the members a chance. We'll come back to it.

Monsieur Côté.

[*Translation*]

Mr. Guy Côté (Portneuf—Jacques-Cartier, BQ): Thank you, Mr. Chairman.

Thank you for your presentations. This is indeed a momentous occasion since we now have the opportunity to look at independent economic forecasts.

Like some of my colleagues, I must admit that I was rather astonished by Mr. Szadurski's results. I was astonished by the various tables you put before us. If I understand correctly, you revised your figures in February. Your results for 2004 are very similar to those of the November economic update, with a difference of only 1.1 p. 100. They are very similar. I take it that the assumptions are similar in both models.

However, I find it more difficult to understand why there are wide differences in some cases, and I'm going to give you a few examples. Looking at the rate of exchange with the US dollar in 2004, there is a 1¢ difference, which is acceptable in a forecast. But the more we move into the future, the wider the spread becomes. It is 4 ¢ in 2005, then 6.9 ¢, and finally 7.5 ¢. And we find the same thing for GDP. In 2004, the difference is 1 billion dollars, becoming 22 billion the very next year, and then 23 and 26 billion dollars in later years.

Don't you think that you are in a way playing the same game as the government which has been crying wolf year after year by painting an always alarming situation in order to be able to end up with unforeseen surpluses?

It would seem to me that the point of this exercise would be precisely to make more accurate forecasts and avoid a situation where the Minister of Finance—Mr. Martin did that and Mr. Goodale is doing the same—plays penny pincher and keeps counting his gold coins to make sure that, even if his treasure chest is overflowing, he will always have some spare coins and will use them all to pay down his debts instead of answering the real needs of Canadians?

We keep hearing about fiscal imbalance. This may be a somewhat abstract concept for most people but it does mean that there is underfunding of education, employment-insurance, help to farmers and social housing.

Don't you think that you are playing the same game as the government which tries to hide the true state of our finances?

● (1225)

[*English*]

Mr. Wojciech Szadurski: Again, I would like to reiterate that there are two main areas that generate our fiscal forecast. One is our forecast for the economy; the other is our forecast for fiscal drivers, which determine, for example, the ratio of revenues to GDP. In terms of the latter, when I look at CCPA's forecast for 2006-07—this is table 6—the ratio of revenues to GDP is 14.9%. That's the same as our ratio, 14.9%, so nobody can say we are playing some game in terms of the fiscal drivers.

In terms of the economic forecast, the forecast we assumed in this exercise is the same forecast we give to our clients. This is not some special forecast that we've done just for this exercise. It's a very similar forecast to what we have in January. So I think I can defend ourselves against an accusation that we are playing some sort of game here. This is the best forecast we can give, looking at the data and based on our best analysis of the data.

[*Translation*]

Mr. Guy Côté: It is still very strange to see that. As was mentioned a while ago, it is important to look at both extremes. Unfortunately, one gets the feeling, looking at your figures, that your forecast is far more cautious than would seem to be justified by today's reality.

I go back to the year 2004 which, whatever one's criteria, was the year of all our disasters. Everything that could go bad did go bad: SARS, the power failure in Ontario, etc... I don't need to remind you of all those events. Despite all that, we had good economic growth and the government revenues increased significantly. I find it hard to understand why suddenly, after all those events and considering that there are no specific policies that could lead to a dramatic reduction in the government's take, you project only 1.5 p. 100 growth in government revenues. That doesn't make sense, unless you believe that it's important to lower the figures to make sure that we all live in a very conservative economic environment where everyone just wants to *playsafe*, as we say in Quebec. Then, of course, we'll once again end up with unforeseen surpluses and the Minister of Finance will be able to apply them to paying down the debt or do whatever it wants with the money, perhaps shovelling it to some foundation or other.

[*English*]

Mr. Wojciech Szadurski: Thank you for your comments. Again, our fiscal update is based on the best analysis we can give, considering the numbers we have to work with.

The Chair: Thank you.

Monsieur Hubbard. Then I have Ms. Ambrose, Ms. Minna, Mr. Pallister, and Mr. Bell.

Mr. Charles Hubbard (Miramichi, Lib.): Thank you, Mr. Chair.

It certainly is a historic day when we have these groups coming to us to explain their forecasting. Forecasting, of course, is always a difficult job. It's like listening to the weather forecast the night before about whether it's going to be a good weekend, whether we might enjoy Friday and Saturday and Sunday of the coming week.

Mr. Chair, I'm disappointed by some of the statements that are being made to our experts, statements that they're playing the government's game. We've had a very dedicated government for the past number of years. We have had very dedicated ministers of finance. When the projections we look at forecast a very healthy future for the next two or three years, a lot of it is as a result of good management. We have to recognize that we're not sitting here today worrying about a forecast that's going to say we're going to have $10 billion added to our debt in the year 2006 or 2007.

Mr. Chairman, we have to look at the parameters here, and there are a few little points here that I am “twirking” on. We talk about oil prices affecting the future of our economy. We talk about weak growth in certain sectors that I guess the Conference Board has referred to. We talk about international markets and we talk about the fact that we hope there will be some consistency in the approach we see.

I think every viewer.... We've talked about people being riveted to their televisions. I doubt if they are, but if they are, I think all of us have to recognize that Mr. Greenspan in one minute can change the entire forecast of this budget by changing United States interest rates, or the United States can change a lot our outcomes by affecting the value of the Canadian dollar, which is a major factor in our trading relationships here.

Maybe one of our witnesses might want to comment on what a 1% change in interest rates would do to the forecast they're projecting here, if suddenly in the next six months interest rates increased by 1%.

On the other hand, Mr. Chair, if employment rates changed by 1%, how would that affect these forecasts?

We have to realize, Mr. Chair, we're dealing with a whole balancing act of a great number of different factors. Some of them we can control within our own Parliament, but more importantly, many of them are controlled today by international corporations, by foreign governments, and—very importantly—by the productivity of our workforce in this nation.

How, then, would those two elements—a 1% change in either employment or interest rates—affect, in terms of billions of dollars, the forecasts they're presenting here to our committee today?

● (1230)

The Chair: Do you want to ask someone in particular?

Mr. Charles Hubbard: I think Mr. Darby is perfect for this.

The Chair: He's ready and primed, I think, to answer it.

Mr. Charles Hubbard: So a 1% change in interest rates on that $500-and-some billion debt....

Mr. Paul Darby: The finance department publishes some rules of thumb in that regard. I don't have those numbers in front of me, but if my memory serves me well, a 1% change in interest rates would lead to a roughly $1 billion impact, in the first year, on the level of the deficit, rising to roughly $2 billion in the second year as more interest-bearing debt is rolled over. It's certainly not a catastrophic impact. We would be looking for something much more important if we had 300 or 400 basis point increases that could also cause recessions in the Canadian economy. Then I think we would see something more substantial. Frankly, a 1% increase in interest rates, in our view, is not something that would substantially undermine the fiscal projection.

A change in the unemployment rate of 1%, again, frankly, is not something that we sense would have a major impact on the budgetary projection. I don't have the rule of thumb in front of me. There is an impact on the unemployment insurance payments that would result. There would also be a relationship between that change in the unemployment rate and GDP. Again, my sense would be that something in the order of perhaps $1 billion might even be on the high side of the estimate.

So there is some robustness, in fact, to the federal government surplus projections with respect to some of these economic drivers. It's important to recognize that part of the deficit reduction strategy that the current Prime Minister and the finance department put in place in the middle of the 1990s involved, to some extent, decoupling federal revenue and expenditure projections from the economy. Certainly they're not as closely related as they would have been in the 1970s and 1980s. This probably reflects what they've adopted in terms of the unemployment insurance program and how that's now assumed to balance over the course of the cycle. Their current financing relationships with the provinces have also, to some extent, cut the link.

I know this is a bit of a long argument, but I think it's important to recognize that the impact of a 1% change in interest rates or a 1% change in unemployment rate on the federal surplus position, in my view, would not be dramatic. You would need impacts much stronger than that, I think, to substantially undermine a fiscal projection.

● (1235)

Mr. Charles Hubbard: Mr. Chair, just for a minute...?

The Chair: Five seconds.

Mr. Charles Hubbard: Well, only in terms of employment is it a big factor on both ends.

But also, Mr. Chair, I was indeed a bit taken aback by the variation in the value of the Canadian dollar, which seems to have quite a spread between our different groups in terms of what is safe in terms of having a continued surplus. I've heard figures as high as 86¢ and others who've talked in the high seventies. I'm not an economist by any measure, but I would think that would be a major factor in our trading relationships. I think an 86¢ dollar would really cause a major, major problem.

Thanks, Mr. Chair.

The Chair: Thank you.

Ms. Ambrose, Ms. Minna, Mr. Pallister, and Mr. Bell.

Ms. Rona Ambrose (Edmonton—Spruce Grove, CPC): Thank you.

I wanted to go back to the beginning of where this process began, and that would be when the leader of the opposition introduced the amendments to the Speech From the Throne, those that included not only tax cuts for low- and middle-income Canadians, but a call for something just like this. So I wanted to reiterate the importance of that, and how fortunate we are to be here today taking part in this process.

I want to thank each of you today for all of the hard work you've done in the past several weeks to prepare these estimates for the committee. I also want to congratulate Monte Solberg, our finance critic, for putting this motion forward so that we could do this, and also working with the opposition parties.

As you know, the motion we passed on December 1 was aimed at having all parties involved in this forecasting process. We are disappointed that the Liberal Party and the Liberals have not participated in this process to date, and we hope their participation will occur when you do your update in March.

We do think this is a very important process because we want Parliament to have a greater understanding of how the finances of the Government of Canada are unfolding during the year, and we've always been on the outside of this process. By doing this and being here today, I feel we're engaged in the discussion on behalf of Canadians, and that is in the public interest. That will empower not only the opposition parties but the backbenchers to have a more effective opportunity to direct the financial affairs of Canada.

This is happening now only for the reason that we, the Conservative Party, the Bloc Québécois, and the New Democratic Party, are working so hard to make sure this process moves forward. Again, we hope the Liberal Party will see the wisdom in the committee's initiative and participate and join in.

Again, this is a huge gain, not only for public transparency and accountability, but having the quarterly basis numbers available to us—which is the best information and snapshot of our fiscal situation in Canada—opens up the process, and parliamentarians finally have the tools to participate in this discussion.

One of my major concerns, though, is that we hope the finance department will also participate so that the information on departmental spending and other initiatives, which the budget experts need in order to do most of your accurate forecasts, are available in a timely manner. As you know, the finance department did not participate in this first forecast, despite the intent of the motion that was passed on December 1 that they would participate and help out.

I have a question for Mr. Darby. In your opinion, is it necessary and helpful that the finance department participate actively in the work you are doing? Specifically in what areas would they be able to be most helpful to you in terms of accuracy for your forecasting process?

Mr. Paul Darby: That's a fundamental question to the process, and one that we need to think about very carefully and potentially debate.

Certainly, the finance department is extremely helpful to us in terms of the most recent historical estimates of federal government spending and revenues. The most recent official estimates that we have are based on the November statement. It would be useful for this process to have more recent historical information. It is potentially also useful for us to have information on unanticipated or unintended expenditure or revenue items. For example, it's very important for us to know that the payments on the equalization to Nova Scotia and Newfoundland are being taken from the 2004-05 fiscal year. That's something we actually saw from the newspaper. The amount of Tsunami relief, for example, would be a good number to have.

At the same time, I think, going forward, we do want to preserve independence, and we're always going to be walking a fine line in that regard, to answer your question. Whereas I feel it is important for us doing our best work to have the most recent historical information and data on anticipated policy moves, I'm actually quite interested in maintaining a certain independence from the Department of Finance. This always opens up the risk that they may know things we don't know, but I can adjust and deal with that after the fact. We do the best job we can with the information we have. So I'm not actually terribly uncomfortable with trying to continue the sense of independence as we go forward.

● (1240)

Ms. Rona Ambrose: Thank you, Mr. Darby.

I'd ask the same question to Mr. Szadurski.

Mr. Wojciech Szadurski: I agree with the Conference Board of Canada that definitely for historical numbers it would be extremely useful to have the Department of Finance help us to understand the data as they come out, and also to help us in timing some of the initiatives that have been announced, or are about to be announced, in a given fiscal year.

From the point of view of comparison, you could argue that it would be useful to have the same status quo projection for some of the expenditure areas. There are many expenditure areas that are not driven by the business cycle. It would be useful to have some agreement among forecasters on those expenditure areas so that the differences in program spending would reflect both the different economic outlooks that forecasters use.

Ms. Rona Ambrose: Mr. Szadurski, could you give an example of an expenditure?

The Chair: Your time is up.

Quickly, please.

Mr. Wojciech Szadurski: For example, in the current exercise we used the status quo assumptions from November for other federal transfers to persons, including child benefits. On the other hand, for interest on public debt, we used our own model because we have a different forecast for interest rates, and therefore we will have a different forecast of this expenditure area.

The Chair: Can you just repeat, for some of the members, the example?

Mr. Wojciech Szadurski: There are some areas of program spending that are not as susceptible to business cycle fluctuations as other areas. For example—

The Chair: No. Just repeat what you just said. Some of the members didn't hear. Was it child care, or interest, child benefits, interest on debt?

Mr. Wojciech Szadurski: Interest on public debt.

The Chair: Thank you.

Ms. Minna, Mr. Pallister, and Mr. Bell.

Hon. Maria Minna (Beaches—East York, Lib.): Thank you, Mr. Chairman.

I wanted to reconcile some of these figures. I'm trying to see....

For Mr. Stanford first, in table 6 where you talk about “for consistency”, with a reference to forecast, you have “$4 billion in debt reduction”. Is that your combined $3 billion and $1 billion prudence and contingency funds? Have you taken that out of your figures already? Have you taken that into consideration or not?

I'm trying to understand how figures line up.

Mr. Jim Stanford: This is something I did precisely so that I would be comparable to the other two you have. What we do in all three years is we limit the amount of debt repayment. Even if the surplus is bigger than $4 billion, we assume internally that only $4 billion, or I think it's $3 billion in the case of Global Insight, is actually paid off. That is note 4 on table 6 of mine, which explains why the closing debt only falls by $4 billion a year, even though the balance is actually much larger than that.

If I might take a moment, this actually is the source of the error that the member has pointed out. I do remember Mr. Solberg mentioned economists are fallible, and I suppose I'm living proof of that.

While you're on table 6, if you look at the debt service line—that's the third line—the last two years of that line on my table 6, which currently reads "34.1" and "33.3," that was from a line in my model that did not sterilize that extra debt. That was the interest payments assuming that the full surplus was used. Those numbers should read "34.4" in 2005-06 and "34.1" in 2006-07. Those are the numbers that are actually on table 7, which is the detailed breakdown. Those are the correct numbers on table 7. That is the source of the error. I do apologize for that. The surplus numbers in my projection are not changed by that.

● (1245)

Hon. Maria Minna: I wondered about that. So the 11.4 for 2005-06 includes a $4 billion debt—

Mr. Jim Stanford: If you want to call $4 billion of that the contingency, whatever, yes.

Hon. Maria Minna: Is that the same as the contingency of $3 billion—

Mr. Jim Stanford: Plus the $1 billion in prudence, three plus one. That's why you have economists here—three plus one.

Hon. Maria Minna: Right.

If you were to add the three plus one to 11.4, you're looking at a much higher number.

Mr. Jim Stanford: No, the $3 billion and the $1 billion are included within the $11 billion. The total surplus is $11 billion, but someone at Finance might say the actual surplus is $7 billion.

Hon. Maria Minna: That's what I wanted to make sure of. I was reading your note and it wasn't too clear to me.

Mr. Szadurski, your figures are the lowest. I can't remember exactly whether you said the $3 billion contingency and the $1 billion prudence is taken off. Is that why they're lower, or not? Or have you not taken that into consideration?

Mr. Wojciech Szadurski: I reported a budgetary surplus that does not net out contingency reserve or economic prudence numbers.

Hon. Maria Minna: So that's not included in your numbers. You haven't already set it aside. That's what I'm saying.

Mr. Wojciech Szadurski: It is not set aside, no. It is included in the numbers.

Hon. Maria Minna: Okay. So you're also the same as Mr. Stanford.

Mr. Wojciech Szadurski: That means, for example, that in 2004-05 we report a budgetary surplus at $8.1 billion. The so-called planning surplus, which is $8.1 billion minus $3 billion, is $5.1 billion.

Hon. Maria Minna: Right. So you're considerably lower. I was going to add the $3 billion, but you've left it in. That's quite a difference. I was trying to understand that.

The Conference Board has already put aside the contingency, so if you were to add the contingency plus the prudence to your figures, you're closer to Mr. Stanford's numbers, are you not?

Mr. Paul Darby: No, we're all on the same basis. The budgetary surplus lines that you see, $7.6 billion for 2005-06 and $8.8 billion for 2006-07, are comparable to Mr. Stanford's numbers. They include the contingency.

Hon. Maria Minna: That's what I thought, but I just wanted to make sure. Actually those two projections are quite comparable.

Do I have time for one last comment to Mr. Stanford, Mr. Chairman? Thank you.

In your table 1, you have the government underestimating its revenues by 3.7% and overestimating its debt services by minus 3%, and that 4% equals to $8 billion, although this is not quite 4%.

This is a question to ask because this has been consistent for 10 years now. I've been one of the ones who has criticized the government, so I need to just ask you a question. How easy or difficult is it for the government or for any forecaster to be off by two or three percentage points? One of the things I keep hearing from some forecasters is that if you're off by two or three percentage points you could be into deficit or into surplus by $2 billion to $3 billion. So how easy is it to be off by that much in this particular exercise? Or is it not easy? I just need to understand.

Mr. Jim Stanford: Madam, there's a very important principle in economics called the rational expectations hypothesis, which I subscribe to even though I'm a left winger. The essence of that hypothesis is that people learn from their errors and that it is not realistic to assume that people will be systematically wrong.

Certainly there is error in any forecast, both in the macroeconomic forecast and in the fiscal projections based on that macroeconomic forecast. It wouldn't be difficult in any one year, for one reason or another, to be 1%, 2%, or even 3% off that forecast, even though the fiscal drivers on the revenue side, as I think all of the experts have indicated, have been very stable, with the exception of the corporate income tax side, which is more cyclical. However, to be systematically wrong for several years consistently on one particular side of the ledger is very difficult to reconcile with the notion that human beings do learn from their errors.

● (1250)

Hon. Maria Minna: Thank you, Mr. Chair.

The Chair: Thank you.

I'll just allow Mr. Darby ten seconds.

Mr. Paul Darby: I just have two brief comments. One, it's true that if you look back historically, we certainly had some difficulty picking turning points and forecasting severe recessions, which is clearly one of the worries of the Department of Finance.

Hon. Maria Minna: That was my point. We previously used to be in deficit all the time.

Mr. Paul Darby: I think it is important to recognize that under the circumstances, if Canada was to go into a severe recession, or even a recession, you may want to be in a situation where a deficit in fact arises, from a standard fiscal policy framework. That is obviously a policy decision that will have to be made by the finance officials of Parliament, but I think it's a good point to raise.

Another quick point I wanted to raise, if I could indulge, Mr. Chair, is the issue around the amount of surplus available, given whatever you decide in terms of debt repayment. It's not a simple issue of subtracting surplus and then taking your debt repayment off the bottom. There is also the consideration of how much spending the economy can absorb. We have a notion of potential output that is driving fiscal and monetary policy through most developed countries in the world. It's not always the case that just because you have a very large surplus, all of those funds are necessarily wisely dumped into the Canadian economy. Often, the result is just more inflation, and I think that's something we need to always keep in mind as we think about what we might want to do with discretionary surpluses.

The Chair: Thank you, Mr. Darby.

Mr. Pallister and Mr. Bell.

Mr. Brian Pallister (Portage—Lisgar, CPC): I'll add my thanks to you, gentlemen, for your presentations today. The work that went into them is appreciated.

Further to Mr. Standford's comments about the rational expectations hypothesis, I think your assumption, sir, is that people would learn from their mistakes. I think what's missing from that hypothesis, and we can discuss it further later, is the strategic advantage that's derived by being wrong repeatedly. That would defeat that hypothesis. People would therefore behave irrationally on a repeated basis, and that's what the government has done over the last decade. It has behaved irrationally, in the sense that by over-projecting surpluses, it has deprived Canadians of a debate about what should happen to their money—this is their money, after all. So by design, they've behaved irrationally, although rationally if you were a government supporter, I suppose.

My concern here is that, and others have questioned the accuracy of your comments, the accuracy of your projections.... I would think this debate, and the vagaries, the difficulties of what we're asking you to do, should reinforce the need for this discussion to take place. So I am very supportive of this exercise and of your work, and I thank my colleagues, although I must note that we have not had support from the government side on this issue. And that flies in the face of these continued buzzwords that I hear associated with this government, at least by their communications people, which is that they believe in transparency and they believe in accountability. If they did, they shouldn't be blocking this process.

I only have two questions for you. The first one relates to the degree to which the government could potentially sabotage this exercise by refusing—or by directing finance officials not to be open—access to information they may have that would pertain to your projections. I'm very concerned that this not be something that could happen. And I hope we would all agree it should certainly be something that should not and must not happen here.

You alluded earlier, Mr. Darby, to the need for some kind of independence from finance officials, but I would assume that would not include independence from the knowledge and information that might benefit you in this exercise. Am I right in that assumption?

● (1255)

Mr. Paul Darby: You are indeed, and as I emphasized, we originally felt that was especially true with respect to historical information. We had the most recent historical information. Also, if they plan to bring in new policy initiatives, new spending initiatives, with timing that would be useful to know, such as Newfoundland and Labrador's and Nova Scotia's equalization payments....

Mr. Brian Pallister: And various other ad hoc promises—

Mr. Paul Darby: And various other ad hoc promises.

At the same time, recognize that to the extent that the finance department does publish unintended or surprise announcements, they'll be well-known to us, their magnitudes will be well-known, and after the fact, it should not be too difficult to do the math.

Mr. Brian Pallister: Given the fact that there are going to be these proposals for change, throwing, I'm sure, numerous dollars around in a politically advantageous way tomorrow, and given the fact that we are going to have another public accounts report, it would seem to me.... I'll ask you this, Mr. Standford. Do you agree that it's essential that you have the cooperation of the finance department in terms of accessing the figures and the updates that are associated with all these various initiatives the government is going to enter into tomorrow?

Mr. Jim Stanford: I think the three of us are on the same footing in the sense that the one area of our forecast that is the most dependent on information from Finance Canada—other than seniors' benefits and EI benefits, which we can all independently forecast on macroeconomic variables—is the information on program spending. So I think that having year-to-date, ongoing updates about the status of program spending above or below budget would be the most useful additional information we could receive from Finance.

This also touches on the question from Mr. Solberg, which I didn't get to answer, on what the emerging risks or sources of error are likely to be. I tend to think one of them may be on the program spending side. If you look at the monthly *Fiscal Monitor* publication, it's very hard to extrapolate on the basis of that, because they always make year-end adjustments and so on, but it does seem to indicate that the government is under-spending its program budget in the current fiscal year.

So if there is a surprise tomorrow, in addition to what we forecast, my guess is that it will come from a certain margin of error on that side. But we don't have the information independently to judge that or not. So outside of the seniors' benefits and the EI benefits, all three of us are basically having to take the federal government's budgeted numbers as given. So that could be an additional source of error once we see the numbers tomorrow.

Mr. Brian Pallister: Thank you.

The Chair: Thank you.

Mr. Bell.

Mr. Don Bell (North Vancouver, Lib.): One of the issues that came up during the hearings at the pre-budget consultations we had, which I heard Mr. Darby, and I think all of you, touch on is this issue of spending versus paying down the debt. The suggestion was made during those discussions—I think by Judy—that one alternative to what has been happening in terms of paying down the debt from those surpluses was that by greater spending, you would still end up with the debt-to-GDP ratio being kept down, because in effect what you're doing is by spending more, and if you then lower...the rate will go down as a result. That sounds as though one is saying that the ratio of your personal debt to your overall salary would change if you just increased your spending and didn't put money into, let's say, a savings account for a contingency.

Mr. Darby, I heard you say for the first time that it could add to inflation, if I understood your comment right.

I thank all three of you for your reports, and I am curious about the comments of all three of you on this issue. We haven't really talked about inflation, and I can remember when inflation was a huge factor in the economy, a double-digit issue. I'm just wondering how important you feel that is.

Mr. Paul Darby: Well, I think from my perspective, as I've looked at policy initiatives over the last 20 to 30 years, it's extremely important; it's crucial.

Certainly one has to make a political choice in terms of debt versus spending versus revenue, and it's obviously not up to this panel here to make those choices. That's for Parliament; the people will decide. I agree with Mr. Stanford that we are certainly not in a situation now where the levels of debt threaten the fiscal situation. The progress we have made in terms of debt repayment and publishing surpluses has taken us away from a rather dangerous situation in the early 1990s to one where I now feel there's no burning platform, in a sense, in terms of debt repayment.

That having been said, and I repeat my remarks, it is not necessarily the case that one could automatically assume that all of the surplus available should necessarily be spent or be put towards tax reduction, because there's a limited capacity for the economy to absorb such spending. We went through two decades in the 1960s and 1970s and, possibly, one could argue, even the early 1980s, when that was not necessarily recognized by policy-makers. It's not clear that we achieved substantially higher real GDP growth; it is clear that we achieved substantially higher inflation.

The Bank of Canada will put strict limits on the amount of spending that we could in fact expect to see translate into real GDP growth. They will warn the Department of Finance, if it intends to spend enormous amounts of funds, that the result could simply be higher interest rates and higher debt charges. These are serious considerations and constraints on the ability of the body politic to employ large surpluses for program spending or revenue reduction. How much of those funds are available will be something that will be determined through fiscal and economic analysis. The composition of the disposition of those funds is a political decision made by policy-makers and Parliament, but I think it is important to warn that a large surplus need not necessarily wisely translate into large amounts of spending or substantial tax reductions.

● (1300)

Mr. Don Bell: May I just ask the gentleman to comment on that briefly?

Mr. Wojciech Szadurski: You can look at the issue of fiscal policy from the following perspective. There is this big pie, and you can make a decision about whether a bigger or smaller share of the pie should belong to the government, or you can make a decision on whether you want to grow the pie so that every participant in the economy can have more.

That's my comment on fiscal policy.

Mr. Jim Stanford: In terms of the evolution of the debt burden, the way to measure it appropriately is not relative to spending but relative to our income, and our income as a country is our GDP. If you look at the end of the forecast period we're considering, all of us agree the debt burden is going to be half the share of GDP that it was a decade ago, which is a stunning turnaround and is the source of the happy problem we have about how to spend the surplus.

And 85% of that debt reduction has been due to the growing of the pie. Only 15% of it has been due to actually repaying debt. So you don't have to repay debt in order to capture the lion's share of the gains of debt reduction.

The Chair: Thank you, Mr. Bell.

I think it was a very interesting exercise. I want to thank everybody. I know there was a lot of last-minute...a lot of hard work involved. As I said, I was present at the conference call, and I'm pleasantly surprised. I'm looking forward to the fourth-quarter estimates in the fourth-quarter report. So we'll get ready for that.

Once again, thank you for being here.

Mr. Brian Pallister: On this issue of the applicant, this form, the deadline is not....

The Chair: Whenever we decide. I just want some input from you. I got it on Thursday, so as soon as possible.

The meeting is adjourned.

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