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Mr. Massimo Pacetti

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• (1110)

[English]

The Chair (Mr. Massimo Pacetti (Saint-Léonard—Saint-Michel, Lib.)): Let's begin, please. Good morning, everybody.

[Translation]

I want to thank the witnesses for being with us today. We are meeting to pursue our study on federal fiscal forecasting. We generally provide approximately ten minutes for witnesses' opening statements.

[English]

There will be ten minutes for each of the witnesses' opening statements. Is that okay? I don't see any nodding heads. Is it okay—yes, no?

Mr. Don Drummond (Chief Economist, TD Bank Financial Group, As an individual): I don't have an opening statement. I would just be pleased to answer any questions I can.

The Chair: Okay.

Mr. Orr, do you have an opening statement you'd like to make?

Dr. Dale Orr (Managing Director, Canadian Macroeconomic Services, Global Insight Canada Ltd.): Yes, I could make a few comments.

The Chair: Okay.

Ms. Russell, will you have an opening statement?

Ms. Ellen Russell (Senior Research Economist, Canadian Centre for Policy Alternatives): Sure.

The Chair: Yes, okay.

We'll start ladies first. We'll have Ms. Russell's statement and allow up to 10 minutes for it, and then we'll go to Mr. Orr. Then we'll allow the members to ask questions.

Thank you.

Ms. Ellen Russell: Good morning, everyone.

I did not receive any questions that I was specifically to address, so I thought I would give you a few comments to give you a sense of what my thoughts are at the moment.

My broad understanding is that this process you've initiated here has two broad objectives: first, to assess the need for independent fiscal forecasting advice to Parliament; and second, to consider how to construct an institutional mechanism that would provide this advice.

The first question is, do you need independent fiscal advice? Certainly any attempt to craft good public policy must be informed by the best economic forecasting information available and the most accurate possible projections about the state of federal finances. You can't possibly have a sensible debate about proposed new developments in public policy if you don't have a good grip on the budgetary context in which these decisions are considered. I think here particularly of new spending and taxation measures. How can we possibly debate the merits of these initiatives if we are uncertain about the government's ability to afford them? We need reliable projections of upcoming budget surpluses so at least there is the possibility of meaningful democratic debate about the use of these surpluses.

The practice of disclosing surpluses after fiscal year-end is a critical issue here. Since the practice of the government is to use these funds to pay down debt, any opportunity to consider other alternative uses of this money is foreclosed.

I readily concede that the economy is fraught with uncertainties. Forecasts change, the assumptions that inform projections are modified, and I would expect to see a constant process of revisions to the official estimates of budget surpluses. But the problem, of course, is that this government has a history of making the same error every time. Ever since there has been a federal surplus, the government has lowballed its surplus estimates.

If the government's projections were in error only because of the inherently changeable nature of the economy and the other uncertainties that afflict budgeting, then we would expect that sometimes there would be a lowball error and sometimes there would be a highball. But the government always lowballs its projections, which suggests to me that something more is at work here than the inherent perils of forecasting.

At the Canadian Centre for Policy Alternatives, we have been able to predict the budget surplus much more accurately than has the government, which suggests to me that there is room for improvement in the information available to parliamentarians. Moreover, at the Canadian Centre for Policy Alternatives we create our projections in a fairly low-tech way. We do not have access to any of the internal information available to Finance Canada. We are not privy to any of the meetings attended by the private forecasters who advise Finance Canada, nor do we have any sophisticated in-house economic model. Basically, we only have access to whatever documents Finance Canada puts on their website and our own critical faculties, with which we examine the plausibility of government projections.

So the good news in all of this is that if a few economists at Canadian Centre for Policy Alternatives, with a computer and an Internet connection, can outperform Finance Canada in terms of the accuracy of the surplus estimates, it should not be an insurmountable task to provide parliamentarians with improved fiscal forecasting advice.

In the absence of independent information about federal finances, there will always be the risk, regardless of the political party at the helm, that the government will be enticed to shape its financial disclosures to suit its political agenda.

Consider this year's federal budget. As of the economic and fiscal update in November, the government had a so-called planning surplus of about \$29.5 billion for the period between 2004-05 and 2009-10. As a reminder, the planning surplus strips out contingency reserves and economic prudence, which is a total of over \$30 billion of foreseeable budget surpluses that are off the table.

This means that as of last November we might have expected about \$29.5 billion over six fiscal years in new measures announced in this current budget. What we actually got in the 2005 budget was \$41.8 billion in new measures over the next six years. That is net of the spending cuts implemented by the expenditure review process.

So between November 2004 and February 2005, Finance Canada came up with a little more than \$12 billion extra dollars to make use of. This is an increase in the cumulative surplus over this period of something around 40%, so one naturally asks, what happened to create an extra \$12 billion to work with over the next several years?

One of the curious things about the interim between November and February is that the economic outlook of Finance Canada worsened. The forecast for real GDP growth was adjusted downwards slightly, except for the very distant future, where it remained constant. You have a situation in which the economy is seen as worsening somewhat in the near term, yet the cumulative budget surplus they are working with is growing. So why does the budget surplus grow? Part of the reason was that debt service charges were adjusted downwards, which seems to me entirely appropriate. Most of it was that projected revenues improved. Almost \$10 billion of the extra \$12 billion was found via this enhanced revenue outlook. I just don't know what to make of this.

I either cynically conclude that the finance minister intentionally lowballed revenue projections in November, in which case he misled the public about the genuine state of federal finances. Or, alternatively, the finance minister genuinely didn't foresee that within four months the cumulative projected budget surpluses over the next six years would change by \$12 billion. If it is the latter case, then projections about federal finances years down the road could change very dramatically in quite a short time. How can I then give credence to a budget that claims to assess the affordability of measures several years hence? For example, how can I believe that by 2009-10 the government can afford to slash government revenues by close to \$7 billion via tax cuts.

I'm just not sure which of these two scenarios causes me the greatest concern. If you accept, as I do, that the present state of federal fiscal forecasting justifies having an independent source of fiscal advice, the question is then how to create this. I must confess, I

have no particular expertise in the design of an institutional structure that would accomplish this goal. It seems to me that you have both a short-term and a long-term project. In the short term, you have initiated a process of receiving independent forecasting advice, which seems to me a step forward in terms of having greater scrutiny of the plausibility of projections produced at Finance Canada. In the longer term, you are evidently pursuing discussions about what type of permanent mechanism could be put in place.

I think that both short- and long-term approaches have considerable validity as well as important challenges. I believe it is critical for you to keep this public debate going, to insist that democratic debate about budgetary choices be built on reliable information.

Thank you.

•(1115)

The Chair: Thank you, Ms. Russell.

Just to clear up, at the beginning of your opening remarks, you said the government or the finance minister has to disclose his surplus. At what point? Because I think he is disclosing the surpluses. You were just saying he wasn't disclosing the surplus.

Ms. Ellen Russell: Perhaps I should say what I intended to say. I don't know quite what words I used.

The Chair: I think you said the finance minister should disclose the surplus, but at what point do you believe he should be disclosing the surplus? I think he is disclosing a surplus, but maybe it's too far down the line. Is that the point?

Ms. Ellen Russell: Perhaps what you're referring to is that I made the point that if they're disclosed after the fiscal year ends, the practice is to use them to repay debt. My preference would be to have a sense of coming surpluses as early as possible so we can have debate about what we could do with those funds.

The Chair: As early as possible being when? What would your timeline be? He's disclosing it now, so it's just a question... I'm just trying to clarify this.

Ms. Ellen Russell: Now is a couple of weeks until the fiscal year ends.

The Chair: So you would prefer that it be prior to the fiscal year-end?

Ms. Ellen Russell: I'm only pointing out that between November and February there was a kind of re-evaluation of what the state of finances was. I am wondering if it is not possible that we could be getting that information in a more timely manner than we do, so we could have the option of debating this more fully.

The Chair: Thank you.

Mr. Orr.

Dr. Dale Orr: Thank you.

Good morning. I have just seven brief points I'd like to make by way of introduction.

First, I'm completely supportive of and sympathetic to the desire of the committee to have a reliable forecast of fiscal surpluses. The fiscal surplus for planning is very important to know in advance, so you can participate better than you have in the past in the discussions and decision-making on tax reductions and/or program spending increases.

Second, I have just a couple of comments on my background that might help you anticipate some of the questions. I have monitored, evaluated, and commented on federal budgets every year since 1985. I have participated in the exercise with the finance department since 1999, being one of the 20 economic forecasters who provide the forecast from which the economic consensus for the forecast is derived. I am also one of the four forecasters who have an economic model of Canada, where we take that consensus economic forecast and produce forecasts for the fiscal surplus. So I have a bit of experience, but I must say I have a lot more questions than answers. I don't come to you with a magic-bullet solution to the serious problem we're all having.

Third, by way of context, I think we can reasonably expect the forecast of the surplus to be within about \$4 billion. I'm not sure whether that's your view or not, but if you think there's a reasonable chance of getting much closer than that, I would disillusion you on that. I tabled a paper that explains why I'm saying \$4 billion rather than \$1 billion or \$10 billion as a reasonable range for the forecast of the surplus. This has to do with how close the actual data get sometimes, and in forecasting a surplus we're forecasting the residual from two very large numbers, both of which are about \$180 billion.

It is quite important for you to have a context within which to put how accurate the forecast is. You certainly can expect the forecast to be an over-forecast as often as an under-forecast. That's the nature of the problem, and as Ellen said, every year since 1995 the fiscal balance has been larger than forecast. That's the problem.

Fourth, the paper I've tabled with you focuses entirely on an evaluation of the fiscal forecast since 1995. As I phrased it in the conclusion, there's a lot of smoke but there's no smoking gun. It's really important to understand that while there has been a reasonable amount of error—more than there should have been, more than what we'd like to see, and certainly all on one side—if you look at fiscal forecasting since 1995, the errors have been all over the place. They've sometimes been on revenues—sometimes on one component of revenue and sometimes on another—they've been on program spending, and they've been on debt charges. There has been no one particular source of error in the fiscal forecasting, which could be discouraging when we're trying to find solutions. But there

has been no one significant and consistent source. It's been a little bit of everything, as you go over the last nine years.

Fifth, the weakness in the fiscal forecasting process in the recent years has in fact been in the updating of the forecast. In my view, that's what's got the Department of Finance into trouble. That's why their credibility is up in the air, and that's one reason why we are here today. Had they done a better job of updating, probably the other problems would not have caught people's attention.

• (1120)

To give you some numbers on why I say that, over the last five years, two of the last five updates have moved in the wrong direction. One of them didn't move when it certainly should have. We might have been almost better off not to listen when they updated the fiscal forecast. Only in two of the last five years has the update of the fiscal forecast been helpful. That, I would say, is a major area we should try to improve.

Sixth, as long as it's a very high priority for the government of the day to have no deficit, then the fiscal surplus is going to come in close to forecast or above. I can go into more detail on why that could be, but that's just the nature of the beast. That's why it's not so difficult to forecast that the fiscal surplus will be as forecast or above. That's what you can expect when the political master, the Minister of Finance, says, don't come and tell me that we've had a deficit, especially when that happens over the summer after the fiscal year is finished.

Seventh, one of the reasons I don't have a strong recommendation for what you should do is that, as we sit here, the government has a task force in play, with Tim O'Neill looking into this process. I'm trying to keep an open mind. Let's see what he comes up with. Let's see what those recommendations are. I have an open mind at looking at those to decide where we should go.

Those are my seven points. Thanks.

• (1125)

The Chair: Thank you, Mr. Orr.

We'll allow the members to ask their questions. I'm going to tolerate a little bit of interaction between the witnesses so that we can get a better idea of some of the questions. If the members want to ask questions to one or more of the witnesses, they may do so.

So we have Mr. Penson, then Mr. Loubier, and then Mr. McKay.

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

I'd like to welcome the panel here today. I believe most Canadians think the process we are embarking upon to see if we can have a better understanding of the finances of the country on a more timely basis would be a good one, so we can more accurately predict what surpluses or deficits may be in store for us so we can make those kinds of decisions they want us to make.

I think the fact that Mr. O'Neill has been tasked with that from the government side is a reflection that they're getting the same message from Canadians, that although there may have been surpluses for the last seven years or eight years, they are all one way. We want to know if there's some fundamental problem with the predictions.

I'd like to direct my questions to Mr. Drummond, in spite of what the chair has said, and maybe if we have a second round I'd like to talk to the other two witnesses here.

Mr. Drummond, perhaps we can keep our questions and answers short. We only have seven minutes, so I'd appreciate getting as many responses as I can.

You have worked with the finance department. Can you first tell us how long you worked at finance and how many budgets you helped to work on? This would help us, I think, as background.

Mr. Don Drummond: I started at the Department of Finance in September 1977. I've been involved with the budgets all that time. As punishment for having presided over the increase in the deficit, I was forced to stay until 2000 until the deficit was eliminated, so 23 years in total.

Mr. Charlie Penson: So you've seen it from both sides. I think because you have that type of background and knowledge, Mr. Drummond, you can be helpful to the committee.

Maybe you could tell us, how often is the minister briefed in regard to what the fiscal situation would be in the country?

Mr. Don Drummond: It would certainly vary. As you can tell from my duration, I've worked under a lot of different finance ministers, and each would be quite different. Certainly the last seven years of my experience were with the current Prime Minister. He was briefed about every 10 minutes, as far as I can recall. I certainly don't remember any gaps, going even into several days, where there wouldn't have been some discussion or some updating.

Mr. Wilson and Mr. Mazankowski were very similar. There were constant briefings on the economic and fiscal situation.

Mr. Charlie Penson: I'm sure that would be very helpful for the finance minister and he would need that. The finance minister would be fully engaged in the fiscal program, then.

Mr. Don Drummond: Again, it would depend on what year you're talking about, because it totally transformed over the 23 years I was there. When I started in 1978, the budgets were literally a two-month or three-month event. You did other things for eight months or nine months of the year, and then you concentrated on presenting a budget. If you look back at the documents, they tended to be quite focused and quite thin.

Mr. Charlie Penson: When you were there, Mr. Drummond, briefing the finance minister, would the content of those briefings deal with the revenue, the spending, interest costs, the year-end adjustments, that kind of thing?

Mr. Don Drummond: The starting point was always the status quo fiscal. That was your starting point.

I'm glad you brought up the question of the year-end adjustments, because just looking at the previous testimony and what we discussed, that's something that seems to be missing from the discussion of the committee. In fact, there seems to be an implicit view that if you get the economy right, you'll get the fiscal forecast right; and unfortunately, getting the economy right helps, but it's by no means the end of the story. If you look at some of these errors that Dale and Ellen referred to, they weren't coming from the economy; they were coming from things like the adjustment to accrual accounting, the provincial tax collection adjustment—a whole host of these measures—the lapses in departmental spending. And of course, the economists and the economic forecast don't help you with those. Those collectively could swing you billions of dollars, as in fact they did in closing off the books in 2003-04.

• (1130)

Mr. Charlie Penson: But if it weren't for the year where there was a change in accounting practices, about how long after the end of the fiscal year would the finance minister or department officials have fairly solid numbers to look at?

Mr. Don Drummond: The sad part is that if we take 2003-04—let's take an example—the year ends off on March 31, 2004. Some of those adjustments and some of those billions of dollars of adjustments would not be known until August and potentially even September.

One of the last ones every single year would be the provincial tax collection account. The federal government collects the taxes for most of the provinces. You do an estimate of how much money should be passed to them. The Auditor General doesn't give you an audited number until August and sometimes even September, and it could easily be that either the provinces owe you \$1 billion or you owe them \$1 billion, and you don't know.

Now, of course, we have one additional wrinkle in that we have switched to a full accrual accounting, so there's a revenue adjustment that also doesn't come until the summer months. And it's not reflected in the monthly numbers.

Mr. Charlie Penson: But if you had been looking back last year at the numbers, if you had been at the finance department after March 31, when they were projecting a \$1.9 billion budget surplus in the budget that had been brought down shortly before that, a week before that, and March 31 came—or even six weeks later, a reasonable amount of time later—where would you have been, closer to the \$1.9 billion or the \$9.1 billion that ended up at the end of August?

Mr. Don Drummond: In the context of a budget that was later than usual, so there was only one week to go in the fiscal year, and as I look back at the reconciliation between the budget and what actually happened, there are two items that catch my eye. And I would have thought there would be better information available at the time of the budget. Again, these aren't items that have been talked about at all in the committee.

One is the profits of the crown corporations. The major crown corporations, the CDIC, EDC, came in with profits over \$1 billion higher than had been forecasted. Again, you would think the people running those corporations would have known roughly what state they were in with that week to go.

Then there is the lapse of the departmental spending. Again, you would think there would be a system whereby the information from departments... They must have known, with one week to go, that they were going to underspend their budget.

Mr. Charlie Penson: You monitor this as well, I'm sure, as a former finance official. Let's say six weeks after the close of the books on March 31, what degree of confidence would you have had in that \$1.9-billion surplus number that was still being projected?

Mr. Don Drummond: The first thing we have to realize...and it's interesting to hear this, because it's almost like a charge that systematically the actual outcome is better than the budget plan, but we've got to recognize that this is by design. That is supposed to happen that way, and that is part of the answer to your question. There is a \$3-billion contingency reserve, and so as late as with one week to go, that contingency reserve is sitting there. Obviously you know that with a week to go, nothing is going to tap that. So right off the bat, you're looking at \$4.9 billion. You wouldn't be looking at \$1.9 billion.

You say that people like me would monitor, but the truth is that people like me, who are not privy to... I would have absolutely no idea, even six weeks after the end of the year, in my position at the Toronto-Dominion Bank, where the departments would be on their spending lapses. I would have no idea, because there is no regular reporting on it, what the profits were of Canada Post until they were reported, way after the fact, to the public accounts—

Mr. Charlie Penson: Mr. Drummond, I'm sure you're aware that the committee has engaged some fiscal forecasters—in fact, your colleague Mr. Orr's group is among them—to help our committee try to understand what the balances may be on a more timely basis, and I'd like your comments on that. Would it be helpful if the finance department and the crown corporations could keep us more updated, through the people we've employed, to help parliamentarians understand the current situation of the finances so we can make better decisions?

Mr. Don Drummond: Yes, I think some of that information would help. In some respects, since I left the department in 2000, this forecasting exercise has become infinitely more difficult, and that is the switch to full accrual accounting on revenues. That's another adjustment that doesn't come until way after the end of the year.

I'll be very blunt about that. I have stopped monitoring the monthly results. I don't have the capacity to really understand what they mean anymore. That's pretty discouraging, really, because if we

want scrutiny of what the government's accounts are going to say, you presumably want people in my position to do it.

But the monthly results are released on a cashflow basis, and then at the end of the year—long after the end of the year—they're adjusted to accrual basis. That was over a \$3-billion adjustment. Again, with all respect to Dale and his colleagues who are doing that exercise from an economic perspective, they wouldn't have had a clue what that adjustment was going to be. Of course, that was early on in the process, so you don't really have a historical perspective.

I guess the point I'm trying to make to you is that it's so much more than just getting the growth in the economy or the interest rates right. Obviously that's important, but there are so many other adjustments. Those adjustments would be very difficult for your committee to track. They're even more difficult for people such as me, in the private sector, to find out.

• (1135)

The Chair: Thank you, Mr. Penson.

Mr. Loubier, then Mr. Hubbard or Mr. McKay.

[*Translation*]

Mr. Yvan Loubier (Saint-Hyacinthe—Bagot, BQ): Thank you, Mr. Chairman. I intend to continue Mr. Penson's line of questioning and pursue the discussion with Mr. Drummond.

Mr. Drummond, I'm having a hard time distinguishing you from Mr. Dodge, because you were both Deputy Minister and Assistant Deputy Minister at the Finance Department. Indeed, I have occasionally called Mr. Dodge Mr. Drummond.

I have followed your career, Mr. Drummond, because you took malicious pleasure, every time Mr. Martin, when he was Minister of Finance, announced a surplus or an exceedingly high deficit, in commenting publicly to the newspapers, taking advantage of your title as Chief Economist for the Toronto-Dominion Bank, to let every one know the Minister was right. In those circumstances, you weren't the slightest bit shy about providing your own assessment. Earlier, however, you said there was a need for prudence, that we needed to be careful, and yet you certainly were not shy about commenting publicly.

I have been following your career on a daily basis; in fact, I want to commend you. I didn't agree with the figures you were using or the attitude you demonstrated at the time. I had the feeling Mr. Martin would pick up the phone and call you, to have you say exactly the same thing as him the following day. You worked very closely with him. That only reinforced my apprehensions with respect to your forecasts.

As a matter of fact, I also following John McCallum's career. I followed it all the way up until he arrived at the House of Commons. He became a good Liberal and began giving the same low-ball estimates of the surpluses as you did.

So, your warnings don't impress me. I am trained as an economist and my area of expertise is forecasting and econometrics. So, your *caveats* are not really that at all, in my opinion. Rather, they are an invitation to avoid in-depth analysis, and thereby prevent people from seeing that they have been duped by the Department's forecasts for the last ten years. Ms. Russell said so earlier: revenue forecasts were grossly underestimated in order to arrive at the numbers we were discussing earlier.

I would like to address a question to Mr. Orr. A little earlier, Mr. Orr, you impressed me, but not in a positive way. You said that forecasts should be within a range of \$4 billion and that you believed that to be a reasonable range. So, we are basically talking about approximately \$4 billion.

There are two things that bother me here. First of all, there is your proposed range of \$4 billion, although you also said there had been no unreasonable errors in terms of surplus forecasts. I want to go back to the 2003-04 fiscal year. The forecast was \$1.9 billion. Based on your premise of a \$4 billion variance, the Department must have been thinking that either there would be a \$3.1 billion deficit, or a \$5.9 billion surplus. However, there was no evidence of a possible \$3.1 billion deficit, and the government's surpluses came in at \$9.1 billion, which is quite a bit higher than the upper limit of the range you have suggested.

As regards unreasonable errors, once again, I would like to return to the 2003-04 fiscal year, although if I had the figures in front of me, I could just as well have gone through the same exercise for all the other years. Forecasting errors were in the order of 125 to 250%. The last time, the forecast of the surplus was off by 379%. If those are not unreasonable errors, then I wonder what is. At some point, somebody is going to have to stop spouting this kind of nonsense and claiming that it is impossible to forecast accurately, even though it is easy enough to keep track of inflows and outflows of revenue, even on a monthly basis. It is even easier for the Department to do this. It is a simple matter to determine when the most significant outflows are occurring in a given month as well as when inflows of revenue will be less significant in a particular month, and to develop quarterly forecasts on that basis. If monthly data are available, it is even easier. So it's about time people stopped exaggerating and claiming that we cannot achieve better results than that, unless we get into politics, something Mr. Drummond has been engaged in for years. I wanted to meet him just to tell him that, because this has been bothering me for a long time.

Mr. Don Drummond: I don't know what answer I could possibly provide, Mr. Chairman. I didn't hear a question; all I heard were comments to the effect that my forecasts are not independent.

• (1140)

Mr. Yvan Loubier: No, they aren't. I have been following what you have been doing on a daily basis. Mr. Martin would make a statement. We would develop forecasts. There were forecasts from the National Bank of Canada, the Mouvement Desjardins or the Conference Board of Canada, and yet you were always in perfect agreement with the Minister of Finance.

Your professional objectivity has probably been tainted by your close working relationship with Mr. Paul Martin over a considerable number of years. I've wanted to tell you that for a long time, but have

never had an opportunity to do so. That was the rule; it was systematic. The next day or the day after that, your forecasts would be in the newspapers.

What were you basing yourself on to make those kinds of forecasts? Were you simply using the same figures Mr. Martin gave you?

[English]

Mr. Charles Hubbard (Miramichi, Lib.): Mr. Chair, I have a point of order.

I think we don't bring witnesses here to deal with them personally. We're dealing with issues; we're not dealing with personalities. This is not fair to witnesses, to bring them here to give them some message that doesn't affect the work of this committee.

The Chair: Mr. Drummond, if you feel you wish to comment, you can comment. I'm not sure there's a direct question. This was just an opinion of one of the members, not necessarily of the committee.

[Translation]

Mr. Yvan Loubier: I have a point of order, Mr. Chairman. This is not a personal attack. For eight years now, experts and the Department of Finance have been pulling the wool over our eyes about the surplus and the surplus forecasts, which are absolutely ridiculous and do not in any reflect reality, and yet what we are being told here today is that it's impossible to do any better. Enough is enough! It is absolutely possible to do better than that. Elsewhere in the world, people manage to do so.

[English]

The Chair: *Merci, Monsieur Loubier.*

Mr. Don Drummond: If the member said I have no credibility, what's the point in my answering any question? My answer would have no credibility.

I would love to address these suggestions, but I don't think that's going to advance the work of your committee. So maybe I should move on.

The Chair: Thank you.

Mr. McKay, please.

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

Thank you, witnesses.

Mr. Charlie Penson: I have a point of order.

The Chair: Mr. McKay, just a second, I didn't hear a point of order. Sorry.

Mr. Charlie Penson: Well, Charles Hubbard ordered—

The Chair: I made a comment. I think the attacks were personal. I think this was the opinion of one of the members. I don't think we brought—

Mr. Charlie Penson: I want to comment on it, Mr. Chair.

It seems to me the witnesses are very able people to handle this area. We're talking about economics, and Mr. Orr... I'd like to hear the response to what Mr. Loubier has said. Would there be any response?

The Chair: There was no question posed by Mr. Loubier, and I ruled on that.

Mr. Charlie Penson: Well, he heard the question and he wants to respond.

The Chair: There was no question. The question was directly—

Mr. Charlie Penson: The witness wants to respond.

[Translation]

The Chair: Mr. Loubier, do you have any questions you want to put directly to one of the witnesses?

Mr. Yvan Loubier: Yes, I have a question for Mr. Orr.

How can you have two premises that did not prove to be accurate in the last fiscal year—in other words, your \$4 billion spread, and that the errors of the past were not unreasonable? Wouldn't you agree that a 379% error is unreasonable? Is a \$4 billion upward swing not unreasonable as well? Is that margin of error really usable? Don't you think there were unreasonable errors made somewhere along the line?

The Chair: That's a question.

[English]

Monsieur Orr, can you answer that question, please?

Dr. Dale Orr: Yes.

If you look at the first conclusion from the paper that I have in front of me, the question is—and it bears on what Mr. Loubier is saying—does the government usually under-forecast the fiscal balance? The answer is, on the basis of this study, yes, they do. The fiscal balance has been under-forecast in seven of the past nine years. It has never been over-forecast. It has been significantly under-forecast—that is, greater than the \$4 billion that I gave you—in six of the past nine years.

If the ramp-up in spending in response to an impending over-forecast of revenues is counted within the under-forecasts of the fiscal balance, as is reasonable, the government has really under-forecast the fiscal balance every year since 1995-96.

The Chair: Okay.

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

Hon. John McKay: Thank you, Chair.

Thank you, witnesses. Indeed, all of you are some of the foremost people in Canada in this field. For my part, I appreciate your contributions, even when I don't necessarily agree with your political spin on things.

I want to direct my questioning to Mr. Orr.

I did go through your paper last night and found it, frankly, kind of confusing for a layperson. So let me just work my way through this paper and ask Ms. Russell and Mr. Drummond to comment as I go through it.

You basically say that if you're within \$4 billion you've done a good job. Is that the nub of the point?

Dr. Dale Orr: I didn't say you'd done a good job, I said what reasonable expectations are. The \$4 billion comes from two perspectives. One, if you're 1% off on revenues, that's \$1.8 billion.

If you're 1% off on spending, that's another \$1.8 billion when we add in both the debt charges and program. That's \$3.6 billion, so you look at it that way.

The other goes back to the point we were talking about just previously. When the data for the fiscal year is finished and reported in *The Fiscal Monitor* in May for the complete fiscal year, as Don was telling you, that data is the first report in the fiscal year. There are a lot of final adjustments that come in. Finally, in late September or October, when the books are closed, you can be up or down \$1 billion or \$2 billion. So you can look at it either way.

I said that to put it into perspective and have reasonable expectations, it's pretty hard to try to expect people to forecast closer than about \$4 billion. Now, that's a judgment call. That's why I said that. You can agree or disagree, but that's where I'm—

• (1145)

Hon. John McKay: Does Mr. Drummond's explanation explain the discrepancy that you've put out in appendix 3, where the update is sometimes more off than on? I would have thought that as you got closer to your final number, you would have a ramping up of your accuracy. He explained it in terms of shifting to accrual accounting versus cash accounting. All of the update information is in cash, and it's almost impossible to convert to accrual. I'm interested in your reaction to that explanation, as well as Ms. Russell's. Is that a reasonable explanation for that kind of update failure, if you will?

Dr. Dale Orr: There are a couple of points.

First, last year was one example of when the update was not helpful, because it moved us in the wrong direction. As I said, in two of the last five years the update moved us in the wrong direction. But I certainly agree with you, and if you look at that chart, in some years the update did exactly what you had hoped it would. In 2000-01 it did, and it did in 2002-03. Those are very good examples of when the update did exactly what you'd want it to do. Last year it didn't. Why was it that we came in with \$9 billion when the update said \$1.9 billion? Well, Don has told you what two of the larger moving parts were. That was that year. In other years there might have been something different.

Hon. John McKay: So proper reporting on the crown corporations...

Why is it that the government continues to report on a monthly basis in cash versus accrual over time? I take it the cash number is essentially out continuously.

Mr. Don Drummond: One of the biggest adjustments, of course, would be on personal income tax. There it's easy to see the reason. You pay your 2003 income taxes and you make your settlement period payment after April 30. The government doesn't get that until 2004, and then it has to figure out what portion of it to push back into 2003. But how would the government know that in January, February, and March 2003? You haven't filed your income tax report yet. They don't know what your settlement period payment will be.

Hon. John McKay: Does that play through to corporate?

Mr. Don Drummond: It's exactly the same thing on the corporate. A corporation could be making its instalment payments on its tax base from the previous year.

Let's just say it's a corporation. Natural resource companies tend to have a December taxation year-end. They would be making their settlement period cheques in March. Until it had those cheques in its hand, the government would have no idea how much money it was going to get, and then it has to decide how to push it back.

Hon. John McKay: So that's the explanation for why the government was surprised by the huge amount of money the banks and particular financial institutions generally made in the last fiscal year-end.

Mr. Don Drummond: Any corporation—and the banks would have been there—has the option of making their instalments on the basis of the previous year, so it makes for a big surge in profits. It holds those back and makes huge payments at the end.

The case of banks is probably not a good example, because they're in October taxation year money, so that money should have been in the government's hands. But the oil companies and natural gas companies, for which there are surging profits, wouldn't have made their settlement period payments until days before the budget was tabled.

Hon. John McKay: Ms. Russell, do you have any comments on those explanations?

Ms. Ellen Russell: Only to pick up on Dale's \$4-billion discrepancy as being a reasonable thing. That should be plus or minus \$4 billion?

• (1150)

Hon. John McKay: No, he's at \$1.8 billion down and \$1.8 billion up and has rounded it to \$2 billion, so it's a swing of revenues and expenditures.

Ms. Ellen Russell: What I'm saying is that whatever you might judge as being a reasonable margin to be off—and I'll take that one to be as good a thing to work with as any—then we should be up or down by whatever that margin would be. If we're always in one direction, that's what's causing me concern.

Hon. John McKay: But when you're up or down, you get into a political conversation. If you're a master, if the finance minister has said you cannot be down because there's no way we're going to go into deficit, the error is always going to be up.

Ms. Ellen Russell: It's a kind of circular conversation.

Hon. John McKay: You're calling it an error. I'm using your word.

Ms. Ellen Russell: My point about Dale's point was that there are any number of things going on in a fiscal year that cause changes.

We don't know ahead of time what all those are going to be. Our best guess at the outset is that we might be high or low. If that margin that Dale or others are going to establish is a reasonable margin to be out, it should be high or low. Your point is that the finance minister says we must always be in one direction. Well, then I start thinking it isn't just this almost infinite number of adjustments occurring in the fiscal year that is causing this problem.

Mr. Don Drummond: I'm sorry to come back to the same point, but there still doesn't seem to be an understanding of the role that the contingency reserve and economic prudence face. Because of these two buffers, the forecast errors can't be symmetrical. They're designed so that they will be asymmetrical. If the world unfolds the way it should, where it's laid out in the forecast, you will always do \$3 billion better in the current year. Look at this budget. By the time you're up into 2008, there are \$7 billion worth of reserves set aside. If the economic forecasts and the fiscal forecast are accurate, you will be \$7 billion better. If people don't like that bias...

It does put in a bias, let's be open and transparent about it. It puts a bias onto the forecasting procedure. To improve the forecast and remove that bias, the simplest thing in the world is to take out the contingency reserve and economic prudence. But that's not a forecast issue, it's a policy issue that should be debated.

Remember the context. The contingency reserves were created at a time when we had 25 consecutive years of deficits and almost every single forecast was biased in the "wrong" way. One of the ways of addressing that was a contingency reserve, but now we've had budget surpluses since 1997-98. The forecasts are more accurate and the debt load is lower, so maybe it's time to reappraise whether those reserves are needed.

Hon. John McKay: Just as one more little question, I want to know whether you're adding them—

The Chair: No, thank you, Mr. McKay. You're way over. You can come back.

Ms. Wasylycia-Leis.

Ms. Judy Wasylycia-Leis (Winnipeg North, NDP): I want to jump in right now, because I'd like to take issue with what Mr. Drummond just said with respect to the prudence and contingency funds.

Notwithstanding the \$3 billion and the \$1 billion set aside and whether we agree or disagree, we are still dealing with big gaps in accuracy between the government and reality, between the Centre for Policy Alternatives and your forecasts, as well as Global Insight's forecasts. The question still is, why there is an error in the fiscal forecasting when we set aside the prudence and contingency and we agree on and we achieve a consensus around macroeconomic forecasting? There are big gaps in the forecasts. That's why we're here, so I think that's the question.

We can talk about whether we agree with the \$3 billion and \$1 billion later, but right now we have to come to grips with why we have this huge discrepancy. That's what needs to be answered. I'm sorry, I missed your opening statement, Mr. Drummond, but I don't think I've heard from anyone how you've always been out and the CCPA has always been accurate.

If you look back over the ten years of forecasting... Okay, I shouldn't say you, I'll say the government and CCPA to start with, but I think your results tend to mirror the government's. For ten years the Centre for Policy Alternatives has done the same thing. It has looked at the consensus macroeconomics, has made some assumptions around fiscal forecasting, and has ended up, before the government numbers are out, being accurate in terms of reality. Why are they accurate and why are you not in terms of your forecasting? That's one question, because that might get at the heart of what is determining this distortion.

• (1155)

Mr. Don Drummond: Again, half of the difference is the treatment of the contingency reserve and economic prudence. They're not all of it—I wasn't suggesting that—but they are half of the difference.

Ms. Judy Wasylycia-Leis: No, no, it's not true. If you leave aside the prudence and contingency reserves and roll it all in, in each case you still have a huge gap of—

Mr. Don Drummond: Yes, I'm saying that you still have half of the difference gone.

Why has it turned out that way? As Dale said, there isn't any systematic error in that; it's not always that revenues came in one way or another or that expenditures each year... The errors tended to be in different directions.

Ms. Judy Wasylycia-Leis: But why is CCPA accurate and the other forecasters not?

The Chair: Ms. Wasylycia-Leis, who is your question for? Let me help you out. Let's have Ms. Russell answer and then I'll have Mr. Orr answer.

Ms. Russell.

Ms. Judy Wasylycia-Leis: How is it that CCPA can generally be on track in terms of proper, accurate forecasting, and the government is always out by billions?

The Chair: If I may, can I ask Mr. Drummond to answer that question?

Ms. Judy Wasylycia-Leis: Well, I tried. He's still giving me this line about the contingency reserves and prudence, and I'm saying put those aside. They're not half of the issue; it's still the same discrepancy if you leave those as a neutral factor.

Mr. Don Drummond: Let's just start with an exercise that was done in the fall update. We had a group of four forecasters, with all of their models, who agreed on a common set of economic numbers. Has anybody on the committee looked at the range of their forecasts? What was published in here was just the average. The range was really illuminating. Using the identical economic numbers, there is billions of dollars worth of a gap between the low and the high.

So again, I come back to my point: the economic numbers are important, but they don't get you very far. There's a huge amount of discretion that goes into that.

Is it possible, from my personal experience, and looking at the uncertainty or range of results, that the Department of Finance would tend to go to a number that was on the conservative side? Absolutely. That was certainly a very strong sentiment in the early 1990s and mid-1990s. Put yourself in the context of a government that had underestimated the strength of the deficit for 25 years and had always made forecast errors in the wrong way.

Where there was uncertainty, did you lean on the cautious side? Absolutely. I know there wouldn't be any point in denying that.

Could I look at those economic projections and look at these ranges from the fall exercise and say that the higher numbers are feasible and possible? Absolutely. There's the confidence—

Ms. Judy Wasylycia-Leis: No, but I'm asking you to look at history and say, yes, there's a range, but that when you look at the track record, the Centre for Policy Alternatives has managed to come within a very small gap in accurately forecasting the reality. You haven't; Global Insight hasn't; the 29, or 39, or 49 economists, or whatever, and the 19 at the Department of Finance haven't; the government hasn't. Why?

Mr. Don Drummond: Well, I'm saying that the Centre for Policy Alternatives... Again, if you look at the range—and they are only four—if we extended it to a larger number of forecasts, we'd be—

Ms. Judy Wasylycia-Leis: No, I'm saying look at the reality over the last 10 years. Here's the fact: the CCPA has been accurate for 10 years; everybody else has been lowballing. Why?

Mr. Don Drummond: First of all, it's not true that everybody else has been different. There are a variety of fiscal forecasts out there. The Canadian Centre for Policy Alternatives is not the only one that has had the more optimistic forecasts; they have been at the more optimistic end of the range, which has turned out to be more accurate over the time. The forecasts in the budget tended to be at the lower end of it.

Certainly, I'll only speak for the ones when I was there until 2000, but again, they were within the range that was out there. It was a more conservative view, if you want, with a small *c* on conservative.

Ms. Judy Wasylycia-Leis: So based on that kind of argument, what you're saying is, we're just going to do more of the same.

Mr. Don Drummond: Well, I can't say what they're going to do; I'm not even in the government.

Ms. Judy Wasylycia-Leis: Well, I'm looking at what the government is forecasting for the next couple of years, at what you're forecasting, and at what Global Insight is forecasting, and comparing these to the CCPA.

What we're getting from the government and the Minister of Finance is that we're going to have this sudden U-turn and we're going to drop off to surpluses of \$4 billion and \$4 billion over the next two years. Global Insights says it will be \$4 billion and \$6 billion. TD says there will a surplus of zero next year and that it will then go back up.

So the government and the banking side, or whoever, have forecast this U-turn. CCPA has not. In fact, CCPA predicts a steady rise in surplus dollars. They've been right all of these years. Why should we believe you over CCPA? Don't we want to get down to realistic forecasting so we can play a meaningful role in Parliament, rather than this kind of guesswork?

Mr. Don Drummond: I think the point Dale was trying to make, and I would reinforce it, is that we're not telling you to believe one group or another. We have to recognize that even if you have a single set of economic assumptions, you have to encompass a wide range of possible fiscal results. You can't call it that closely.

Dale refers to \$4 billion. I think if you came within \$4 billion you'd be doing very well.

• (1200)

Ms. Judy Wasylycia-Leis: So you don't see any...

Ellen, do you want to answer this, and then maybe Mr. Orr?

The Chair: We'll get the input of Ms. Russell and Mr. Orr, but just quickly because of time.

Ms. Judy Wasylycia-Leis: I'm having a hard time with this argumentation. So if anybody could enlighten me...

Ms. Ellen Russell: I'll speak to the CCPA's process a bit.

We see a kind of redundancy about prudence happening. On the one hand, you have the contingency reserves, which are intended to deal with these unforeseen consequences, one would assume, by the name "contingency". But then if on top of that you have cautious assumptions about macroeconomic variables, and on top of that you have cautious assumptions about revenue, expenditure, and debt service charges, if you build in padding all the way along, it doesn't

take long before there's a big discrepancy between what CCPA is doing and what some other folks are doing.

The Chair: Quickly, Mr. Orr, perhaps you'd like to comment.

Dr. Dale Orr: Yes. I have just a couple of points.

First, in the paper I've tabled, this whole issue of reserves is taken out of the question, because what I'm talking about here is forecasts of what we call the "underlying surplus". That's the surplus before any reserves are set aside or how much is set aside for economic prudence in what year. It's all set aside. I'm looking at the underlying surplus, simply revenues minus program spending, minus debt charges, and what do you get? What do you forecast? So that issue of reserves and set-aside should not be a part of this issue.

As to the other point, why there has been error, well, in the paper I did, there's a summary table that shows you very clearly, in each of the last nine years, where the error was. It was a little bit all over the place, with no one significant, consistent source. You have the paper, and there it is.

Revenue was over-forecast twice and under-forecast seven times. Program spending was over-forecast four times and under-forecast four times. Debt charges were pretty consistently over-forecast, seven times versus one under-forecast, and one was just about on. So it's a little bit of a lot of things.

The issue is that it's difficult to forecast closer than \$4 billion, but why should the underlying surplus, before any reserves, be consistently under-forecast? I'm saying that I've looked at it in great detail here, and there is no one significant, consistent reason.

People say that in addition to the reserves, there's prudence built into all the individual judgment calls made in the Department of Finance. I'm saying maybe there is. It certainly would be very understandable that there would be. If I were an official in the Department of Finance and the minister asked me for an estimate of something, I would certainly be on the side of prudence, because in the summer, after *The Fiscal Monitor* had closed, after the fiscal year was over, while all those fiscal adjustments were going on, would you want to be the Department of Finance official to go to the minister and say, "Well, Minister, you know how the final adjustments can be up or down \$1 billion? Sorry about that, but this year they seem to have fallen on the negative side, and it turns out that you're going to have to report that there was a deficit for that fiscal year that finished three months or four months ago". You wouldn't want to be that department official, and neither would I.

So it would be understandable that there be prudence, but when you go through this in a lot of detail, there's no evidence that this is playing a role. That's not to say it isn't or it couldn't; I'm just saying I did not find a smoking gun that there is the sort of evidence there.

Clearly, the big reasons that the forecast is off lie, in some years, in the economic forecast, and in some years, given the economic forecast, the government just didn't get the amount of revenue or they got more revenue, one or the other, out of the economy than what they thought. In some years, program spending lapsed. It's that sort of thing that explains the big misses.

• (1205)

The Chair: Thank you, Mr. Orr.

Next I have Mr. Penson in place of Ms. Yelich, and then Mr. Hubbard, *M. Côté*, and Mr. Bains.

Mr. Charlie Penson: Thank you, Mr. Chairman.

Mr. Orr, we just heard Mr. Drummond tell us a few moments ago that the move to accrual accounting has made a major shift and therefore affects these year-end numbers so dramatically that they could be out by billions of dollars, I gather.

But surely six weeks after the books are closed the finance minister would have a pretty good idea what the solid numbers are for the year-end, wouldn't he? I see Mr. Drummond shaking his head, so I'm going to ask him the same question: how much would you attribute these massive shifts—I'm just thinking through the \$1.9 billion versus \$9.1 billion—to the accrual accounting issue?

Dr. Dale Orr: Let me get to your first question. Is it reasonable to expect the finance minister to have a pretty good idea of what the fiscal balance is for a year six weeks after the close of the year? The year closes March 31, so we're talking about mid-May. About that time the May issue of *The Fiscal Monitor* comes out and reports the end of March results.

Well, I agree with what Don said. Experience has shown that over the course of time, after the results in *The Fiscal Monitor* come out in May, six weeks after the fiscal year, until the final audited numbers come out, the number in *The Fiscal Monitor* could be one or two billion higher or lower than the final audited results. That's the way it has been. More importantly, it's what I'm expecting now.

If you go back to when we had partial accrual, was it the same? I would turn that one over to Don. I've been concerned over the last couple of years over what we are to expect going forward, but that's what I'd expect. I certainly want to reinforce what Don said, that no, it is not reasonable to expect the finance minister to know what those final numbers are going to be. They can be a couple of billion higher or lower than what he sees in *The Fiscal Monitor*, or what his best information is from any other source at that point in time.

Mr. Charlie Penson: And how much of this would you attribute to the accrual accounting explanation?

Mr. Don Drummond: It raised revenues by over \$3 billion. Now, you might have anticipated, the way the economy was shaping up, that there was going to be some positive number. And of course I was not internal at the Department of Finance; I'm sure they were surprised by it.

Mr. Charlie Penson: But, Mr. Drummond, wasn't this just a scenario for that one year?

Mr. Don Drummond: No, and there's the difficulty. Let's just suppose the economy goes in the other direction and in the beginning of 2005 it's a lot stronger than it is at the end of the year. When they do the accrual accounting for 2005-06, the adjustment could easily be \$3 billion in the other direction.

Don't get me wrong; accrual accounting is a positive step forward in the concept, but it's terrible for a forecaster. And I must say from a forecasting perspective, I'm very thankful it wasn't in place when I was doing it.

Mr. Charlie Penson: Let's just pursue that a moment, Mr. Drummond. We're doing it now, so would there not be some reasonable assessment of how it affected the economy in past years so that as we go forward, we could look back at it and say we think there's going to be so much of an adjustment as a result of the year-end forecast?

Mr. Don Drummond: I think at the moment you'd have to say there's a wild card of at least \$3 billion, and you're not even sure what sign it is, and it would depend on where you are in the cycle throughout the year. It was a positive in closing off last fiscal year; it could be a huge negative for next year.

In terms of your question about timing, just think of your own case. If you owe money on personal income tax, when are you going to pay it? You'll probably do it on the last day in April. The government's just barely received your cheque, as Dale mentioned, in time for *The Fiscal Monitor* in May, but you would not get the May issue until the end of July or maybe even August, way outside of that time period.

Mr. Charlie Penson: That's true, Mr. Drummond, but don't most Canadians have deductions coming off their paycheques on a weekly basis or have to make quarterly payments? How much are we talking about? What's at play here?

Mr. Don Drummond: Again, it would be a swing factor of several billions of dollars. As you say, people do have to make quarterly deductions, but a lot of people who have more than one source of income or have made RRSP contributions would be getting refunds, or in some cases they'd be paying. If it's a refund, then yes, they've probably dealt with it earlier in the year, but why would you pay the money earlier than you need to do? So there's a lot of holding back until the end.

• (1210)

Mr. Charlie Penson: But if you looked at it over a number of years on that basis, wouldn't you come up with some kind of a rough idea of how much of a factor this is?

Mr. Don Drummond: First of all, accrual accounting just started, so we don't have a lot of precedents for it. I said that it won't be the same thing every year. It will depend on the shape of the economy during the course of that year.

Mr. Charlie Penson: Companies have used accrual accounting. If we go down this road in six years, would people be able to say that because there will be those kinds of adjustments to accrual accounting, it will make a difference of 10% or something like that?

Mr. Don Drummond: I think the model you need to have in mind is that it's going to exacerbate the fiscal swings in the economy. As I've said, if the economy is doing well in a period and then deteriorates, you're going to get some good fiscal numbers on the monthly collection basis. Then when you align that to the accrual accounting, all of a sudden you're going to get this hit.

If you want the psychology, as Dale was explaining, now you have additional uncertainty. If you're asymmetrical and getting the numbers wrong—in other words, there's more of a punishment for the numbers being worse rather than better—you're going to implicitly carry a number aside, knowing that this accrual accounting can really hit you and you'd better keep something aside for it.

The Chair: Thank you, Mr. Penson.

Mr. Hubbard.

Mr. Charles Hubbard: Thank you, Mr. Chair.

I think all of us recognize that forecasting is a very difficult job. Charlie, you have a lot of experience here, but I'm a little concerned that you seem to think the economists should be very good at forecasting.

I met with a group of farmers from western Canada this morning. These farmers are going to their banks, Mr. Chair. They're predicting that they want to put in a certain crop, and they're asking for loans to put that crop in.

Charlie, in terms of what you've experienced, from the time you put the seed into the ground to the time you get money back from your canola, there are probably a hundred variables that could affect the yield, your income for the year, and how much you're going to repay the bank.

Mr. Charlie Penson: Sometimes it's better, sometimes it's worse.

Mr. Charles Hubbard: Charlie, you're the expert at this. We would like to say that maybe you should be sitting at the end of the table to talk about forecasting.

First of all, in terms of what our government has done, I would certainly think that what you said, Mr. Orr, in terms of trying to predict the best way for the government... because the economy functions on confidence, expectations, and the hope that we're going to have a good year—that companies are going to operate well, they're going to make money, and they're going to pay more money into our governments. But to ask a basis question here, Mr. Chair, the opposition is really concerned that we're forecasting and it's always a little better than they thought. Maybe it's because we have such a good government, I'm not sure. Who was hurt in this economy?

Ms. Judy Wasylcia-Leis: Who was hurt? Let me count the ways. How much time do you have?

Mr. Charles Hubbard: There seems to be a tragedy that happens here because we have a surplus that's bigger than someone thought it might be. We've heard evidence that \$4 billion can be a very satisfactory amount to think about. But what element in our economy, what element in our nation, is hurt by the fact that we have more of a surplus than we predicted? Why is it of concern to some people that when we predict a surplus of \$2 billion, we come up with a surplus of \$8 billion?

Ms. Judy Wasylcia-Leis: Where does the money go?

Mr. Charles Hubbard: What's the problem? Can one of the witnesses tell us what the problem is? In doing better, how would it improve something for us to be more accurate in our predictions?

Mr. Orr is ready to answer.

Dr. Dale Orr: That's what I dealt with in the first paragraph of the paper that I gave you. I may be putting words in the mouths of other members of the committee, but it's certainly my understanding that members of the committee and members of Parliament want to better participate in the decisions that are made with respect to fiscal planning.

If the government were to more accurately forecast the surplus, then there are decisions with respect to what we should do with the surplus. Should we use it for tax cuts or should we use it for program spending? You could participate, give your views, and maybe even have an influence. If the government says there's no surplus, then the money arises at year-end. It automatically falls to debt reduction. Nobody has had an opportunity to weigh in and have the money allocated to tax reduction or program spending, as they would have had that been known sooner.

What's the difference in money going for tax reductions, program spending or debt reduction? Every one of them has their own clientele of social groups, business groups, economic groups, you name it. We're talking about how Canadians' money is distributed. It's pretty fundamental to your role as parliamentarians.

•(1215)

Mr. Charles Hubbard: So, Mr. Orr, what you're saying is that if we knew prior to the budget what was happening, we could make better decisions in terms of spending more money or cutting taxes. That's the thesis.

Dr. Dale Orr: Yes, or you could explicitly say, yes, I know the money is there and I know I want it to go to debt reduction, rather than by default at the end of the year having it automatically go to debt reduction. You could. You have the choice.

Mr. Charles Hubbard: Mr. Drummond, in terms of what you have experienced, and looking at the last 25 years or so in terms of the finance department, the swings before, when Mr. Wilson was finance minister, how much were you out in the forecasts back then as opposed to today? We're out a certain percentage today, but when they came in with these deficits of \$40 billion, I can't recall what the estimates were in terms of forecasts.

It would seem to be very pathetic if our finance department sat around, say, back in 1989 and predicted a deficit of \$25 billion that came in at \$42 billion. What were the effects at that time in terms of planning by governments, and did it actually happen? Were they out by \$10 billion?

Mr. Don Drummond: Yes, if we look at it relative to the size of the economy, the forecasts were just as inaccurate, there again putting aside the contingency reserve. The only difference was that the forecasts were almost uniquely in one direction and the results were always worse. I would argue that it ended up with a very bad set of policies that went on for 25 years.

Mr. Charles Hubbard: To work in the finance department at that time, it must have been a very desolate place, because you looked at it and you said, "It's going to be \$30 billion. Oh God, it's \$42 billion. What's it going to be next year?" It kept growing bigger and bigger. Did people flee from the finance department? Did they want to get out of that job? It must have been a terrible place to work, where you were out so much and things were so drastic in terms of our economy.

Mr. Don Drummond: That's why I bring in, because it's not a science, that there's a psychological element of this as well. In order, I would say, to avoid some of the tough policy decisions, there was certainly a tendency for a long period of time to make the forecasts more favourable and to hope the problem would go away. Obviously it didn't work out very well.

So to a degree, if you've gone through a 25-year experience and you've always made an error in one way and there's uncertainty, you're going to lean in the other direction. That's exactly what happened in the early 1990s to mid-1990s.

There's one other aspect on the inaccuracies of the forecast. I agree with everything Dale said, but they have given birth to this phenomenon of the trust fund. I am very critical of the trust funds. I don't think those should exist at all. You as parliamentarians should be the most upset, because they have incredibly weak accountability to you. But having these surpluses that are not on a planned basis and you don't know what to do with them, literally there seems to be an allergy to putting them straight to debt payments...has created this. I think that's not an appropriate use of the funds.

The Chair: Thank you, Mr. Drummond.

Monsieur Côté.

[*Translation*]

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

Thank you for your presentations. I have a number of comments to make.

Mr. Orr, you thoroughly explained that a margin of error of \$4 billion is, in your opinion, reasonable and that it is possible to forecast a \$4 billion variance. Naturally, on this side of the House, we find it surprising that the \$4 billion discrepancy is always on the positive side, and never on the negative side. That's my first point.

We also talked quite a bit about the budget exercise in the previous year, where the surplus went from \$1.9 million to \$9.1 billion. And yet, it seems to me that last year should have been a catastrophic year in terms of government revenues, as a result of SARS, mad cow, flooding in the East, and forest fires in the West. It seems to me that all the conditions were in place for this to be a catastrophic year, and yet we ended up with surpluses that were much higher than what was forecast. We really are a very long way from the \$4 billion amount that you deem to be reasonable.

Indeed, on page 2 of your document, you explain that:

[...] the government had really under-forecast the fiscal surplus by more than \$4 billion in seven of the past nine years. That is, there has been a significant under-forecast of the fiscal balance in seven of the past nine years.

What you are basically telling us in this paper is that not only is the credibility of the Department of Finance's forecast

• (1220)

[English]

up in the air, but it's below... [Inaudible—Editor]... level, in fact.

[Translation]

This is really incredible.

For quite a few years now, the Canadian Centre for Policy Alternatives and my colleague Yvon Loubier have been developing forecasts that are much closer to reality.

The fact is that no matter how much effort the Finance Department's forecasters make, their results will never be accurate. Ultimately, the Minister of Finance will ensure there is indeed a surplus at the end of the year; he lowers expectations and presents the lowest possible surplus forecast to the House of Commons, knowing full well that the government's surpluses will be much higher.

I want to come back to the \$4 billion margin. Mr. Penson asked earlier whether it was normal that six weeks after the fiscal year-end, an accurate assessment could not be had. Mr. Drummond, you say this is normal and that there can be a difference of several billion dollars. But we're not talking about a difference of several billion dollars; we're talking about a difference of \$7.2 billion.

Is this an indication that the Minister of Finance has a plan to remove parliamentarians' control over the actual results? And we could also talk about foundations.

Mr. Drummond and Mr. Orr, I'd be interested in hearing your comments. Does it not seem as though there is some grand design in place that would explain the fact that from one budget to the next, surpluses are always as low as possible, so that when the end of the fiscal year arrives, that money can be used simply to pay down the debt? Given that forecasting is not an exact science, do you not think it's ridiculous that we are being presented with budgets that forecast spending for the next five years?

[English]

Mr. Don Drummond: Maybe I'll start. Again, back to my favourite theme, the contingency reserve, you say the error in the March 23, 2004, budget was \$7.2 billion, but of course \$3 billion of that was the contingency reserve. Obviously nobody would have anticipated it.

Mr. Guy Côté: Was it accounted for before?

Mr. Don Drummond: No one would have anticipated, with a week to go, that the contingency reserve was going to be needed. If you look at that budget, instantly you'd say the forecast is not \$1.9 billion but it's \$4.9 billion. So how did the \$4.9 billion get to the \$9.1 billion?

Personally, with a week to go, that is outside my range of tolerance. I find that's quite shocking. A good chunk of that would be this new experience with accrual accounting, and one can understand that. But again, I can't help but think there's some kind of weakness in monitoring what was going on with the crown corporations and with the departmental lapses, that they were such a major contributor

to that error. Looking at process changes, that would certainly be something I would keep a close watch on if we couldn't do better than that.

Instinctively, it tells you that you should have expected a larger lapse, because Parliament wasn't sitting for a good part of that time. If you go back to the 2003 budget, there were a whole bunch of new initiatives, and you knew they hadn't really started. For many on the environment, for example, that are still being announced now, the money actually hasn't flowed. I think instinctively one should have expected quite a large lapse, but that didn't appear in the budget forecast.

[Translation]

Mr. Guy Côté: I'll be more specific. The government has tabled a budget where spending is spread out over the next five years. You are telling us that there can be a margin of error of some \$4 billion every year. We know that the government prepares its budget in such a way as to keep its surpluses low. Is it relatively easy to predict that surpluses over the next five years, rather than amounting to \$12 billion, could in fact amount to \$16 billion, or even \$20 billion? Can we give any credibility whatsoever to the Minister's budget forecasts for 2009, for example?

Mr. Don Drummond: First of all, it must be a surplus of \$7 billion in 2009, because there is \$3 billion set aside...

• (1225)

Mr. Guy Côté: But is that credible?

Mr. Don Drummond: The difference between a zero surplus and a surplus of \$7 billion is that a zero surplus is not calculated, because it contains two levels of reserves, whereas the \$7 billion surplus is. Will it actually be \$7 billion? No, because there will be policy changes between now and 2009. But for the time being, I believe that is a realistic figure. It's the type of economic forecast we use for financial planning purposes at my bank. Can there be errors? Yes, absolutely. Based on Dale's presentation, the probability of an error of as much as \$4 billion a year is high. Could the \$7 billion surplus end up being \$11 billion? Of course it could, I certainly can't deny that. It could be...

Mr. Guy Côté: It could be \$11 billion, \$15 billion or \$19 billion.

Le président: Thank you, Mr. Côté.

Mr. Bains.

[English]

Mr. Navdeep Bains (Mississauga—Brampton South, Lib.): Thank you very much, Mr. Chairman.

First of all, thank you very much for coming out today. I'm very interested in this conversation. I know we're here to talk about fiscal forecasting, and that seems to be the premise. I know we've been diverted a bit here and there.

I can speak from my experience. I worked at Ford and helped to prepare two annual budgets for the company. The minute we completed our budget it was not obsolete but it became inaccurate, because new information became available, the environment changed, and so forth. Really the budget was more of a directional feel. So by their sheer nature, the forecasts are meant to be inaccurate. That's the nature of the forecasts. They're never meant to be exact. They don't predict the future with the likelihood that we'd anticipate or that people would desire.

Above and beyond that, I'm glad you mentioned the accrual notion of it versus cash, which does make it very interesting. I'm glad you clarified that, Mr. Drummond.

Above and beyond that, I do acknowledge the bias and the prudence of \$3 billion built into the budget.

But I need your feedback and your experience with respect to this budget—and in relative terms, because when we look at absolute terms we seem to be fairly far off, by billions of dollars, but that's because our base is much higher. So in relative terms, when we talk about being off our forecasts by a certain percentage, how do we compare to, say, *Fortune 500* companies when they forecast? I think the private sector would provide a good benchmark to see how the government forecasts.

Take, for example, the government's ability to forecast. And I would like to take into account the prudence and the contingency, because that's a known fact. That's not a surprise; that's built into it. So how does the portion above and beyond that compare to the private sector?

I would like your thoughts on that, please.

Mr. Don Drummond: Actually, the forecasts of the government are, sad to say, very similar to the private sector experience. Let's just take my own bank, for example. We had a huge loss in 2002 that was totally unpredicted. It all came from the United States and two specific sectors that went under in the space of three months: telecommunications and public utilities. There had been small amounts of revisions, but no one foresaw the extent of it. Now, for the last couple of years, all the banks, including my bank, have made major profits way above their forecasts.

I can tell you that the one thing that is common, I think, to what the government is doing and what we're talking about here is that in the private sector you do a single best-case forecast, your best-guess forecast, and then you look at alternatives. Believe me, you don't spend a lot of time looking at alternatives and more favourable outcomes, because if it's more favourable, you take it and you're happy. You spend all your time looking at less favourable outcomes.

The reason I raise that is that it is something you might want to consider. In the 1980s in a couple of budgets they did exactly that. They did not look at a point forecast; they looked at scenarios. What would happen is that we'd say, okay, here's your base forecast. The economy on average is going to go up 3% a year. But let's suppose it grows at 3.5% and you get this outcome. Or let's suppose we have a

rough ride, interest rates go up, the economy under-performs; you would have this kind of scenario. That kind of range could easily encompass the sorts of numbers that Mr. Côté was talking about by the time you get to 2009.

I think it's a bit delusional to look at one specific set of point numbers and think this is providing a reliable estimate for planning. No private sector company would look at it that way. I'm sure yours didn't. Ours certainly doesn't look at it, and I think the government should not look at it, as being one set of numbers showing the way the world is going to unfold.

Mr. Navdeep Bains: Just as a quick follow-up, how does the forecasting accuracy of Canada compare to that of other countries, specifically the United States?

Mr. Don Drummond: Actually, in relative terms—

Mr. Navdeep Bains: Yes, how does it compare in relative terms?

Mr. Don Drummond: In relative terms we've been doing better. Their turn toward the huge surpluses at the end of Mr. Clinton's administration was way off the map from what they had been expecting, and the deterioration and deficits under Mr. Bush have actually been more inaccurate than what Canada's have been.

Mr. Navdeep Bains: And that's an arm's-length organization that does those forecasts?

Mr. Don Drummond: They have two. No, the ones that are used in the budgets are done by the office in the government. There is a Congressional Budget Office that has a second view, but that does not become the official forecast. If you look at the United Kingdom—well, Mr. O'Neill as part of his job is going around the country. If you look at the OECD countries, they've pretty much all been plagued by these sorts of errors around the same type of relative

Mr. Navdeep Bains: So how does Canada compare to other countries overall—especially European countries, comparable countries, G-7—in terms of its ability to forecast?

Mr. Don Drummond: Certainly in the last 10 years we've been in the ballpark, and it's not a really favourable ballpark to be in. I'm not saying ours looks good, but it doesn't stand out. There are a large number of countries that have not done any better.

Mr. Navdeep Bains: Thank you very much.

The Chair: Thank you, Mr. Bains.

Okay, we have time so we're going to go to Mr. Penson, Ms. Wasylcyia-Leis, and then Mr. Bell, for five minutes each.

•(1230)

Mr. Charlie Penson: Yes, thank you.

It seems to me that Mr. Bains' question was dealing with forecasting one year ahead. What I think our committee is interested in is trying to get more accurate figures during the year. As we get updates, we're able to make decisions based on whether, as was discussed by Mr. Orr, there should be tax cuts, more spending, whatever. So the more accurate information we have at our fingertips, the better decisions we can make. While I agree with Mr. Bains that when you forecast something, a year later it's probably going to be out, and that's why we have contingency reserves. But what we're interested in here is, as we are further along in that process, timely updates to tell us where we're at.

Mr. Orr, your company came before our committee just recently, and in the work you're doing for our committee, you forecast for the 2004-05 year a surplus of \$8.1 billion. My understanding is that didn't take into account... I'm sure you had thought that the equalization for Newfoundland, Labrador, and Nova Scotia of \$2.8 billion was going to be charged to this fiscal year, and we've now found out it is not going to be. If you factor that in, your numbers would have been more like \$11 billion.

What I'm trying to get at is that we've seen the budget come out last week now saying \$3 billion. Where do you stand on what you think is a more accurate number if you don't consider what might be year-end spending that we don't know about?

Dr. Dale Orr: You're right. Our agreement among the forecasters was that we would make the assumption that the money to Newfoundland, Labrador, and Nova Scotia would be paid out of this year. That's because the description of that was always accompanied by cash advance. So it certainly sounded okay to me and others, but it wasn't. By coincidence, a virtually equal \$3 billion that we weren't expecting to be booked into this year was booked in. That was a trust fund on health—waiting times.

So there you go, offsetting errors. The impact of that is nil because it was offset by something of the same size in the budget.

Mr. Charlie Penson: But, Mr. Orr, that still leaves a difference of about \$5 billion from what you had suggested. I think you were the lowest of the three who made presentations to us in February, just recently. Even at yours, that still leaves about a \$5-billion range.

Where are you at today? Are you saying, with your colleague here, it could be out \$4 billion because of...

Dr. Dale Orr: To be fair, Mr. Penson, you're asking me to answer a question that I'm going to be here on April 4 to answer. Where are we today? We're hard at work. Hopefully by then... well, by then we will have an update.

Mr. Charlie Penson: That's true. But, Mr. Orr, while you're telling us that and while we have employed you to do just that along with two other companies, what you're telling us today is that even after you get the fourth-quarter results, year-end, accrual accounting, and all these other things could make it out by \$4 billion. Is that the range we have to expect?

Dr. Dale Orr: My point on the \$4 billion was generic, not relating to any one particular year, and I explained where it came from. There you have it. We're at work. When we've done our work, then we'll

have our answers. I don't have any preliminary answers for you today.

There's one point related to that of which you should be very well aware. Yes, the economic forecast is one of the most important ingredients in the fiscal forecast. As Don has emphasized, there are other quite important moving parts that play a role. Even on the economic forecast, what is not well understood is that the rate of growth of real GDP is important, but so is the movement of nominal GDP. It's the movement of real GDP that gets all of the profile and all of the attention.

For example, in 2004 real GDP came in lower than what was forecast in the economic statement. People ask, then how come there weren't downward revisions of the surplus? One of the reasons was because nominal GDP came in right on the forecast, a very accurate forecast. In fact, at \$1,292 billion, I think it was within \$1 billion, well within a fraction of 1% of what was forecast earlier.

Real GDP is very important in the government's collections of personal income tax, employment, etc., but other forms of taxes such as the corporate income tax or GST depend quite heavily on nominal amounts.

•(1235)

Mr. Charlie Penson: Is that because of the inflationary pressures?

Dr. Dale Orr: Yes, the difference between the real GDP and the nominal GDP is the deflator. As you can see, the amount that the government collects in GST depends on pure nominal dollar amounts. You go out and spend \$1, and they want the GST in a percentage form.

When we're talking, and when you're reading the newspapers, making your assessments, and wondering, I'm just emphasizing to you that while real GDP might be going down, you have to ask what's happening to nominal GDP. In fact, nominal GDP is referred to as the general tax base. For example, last year real GDP was lower than forecast, and nominal GDP was right on the forecast. The reason for that was that the amount of inflation in the economy was greater than what was forecast. That was mainly due to higher commodity prices.

So this gives you a feeling for the sorts of things we have to get our heads around to get these things right. It was actually those oil prices, which are very difficult to forecast, that boomed up the tax base, in spite of the fact that the real economy was shrinking.

The Chair: Thank you, Mr. Penson.

Mr. Charlie Penson: Am I done?

The Chair: Yes, way done.

Ms. Wasylycia-Leis is next, and then I'll pass it over to Mr. Bell.

Ms. Judy Wasylycia-Leis: Thank you, Mr. Chairperson.

First, I agree with Mr. Drummond—and I think this is shared by all of us—that the use of trust funds on the massive basis that is occurring is something we're concerned about vis-à-vis accountability. But the trouble is, if we don't get a better handle on the forecasting, the only other option is for the money to go against the debt. It's not a desirable situation, from my point of view, so it does come back to the question of needing to be accurate in our forecasting.

Never mind the work you're doing right now, Mr. Orr and others, on this last quarter, but looking ahead to next year, the forecast of the government is \$4.5 billion, which includes the \$3 billion and the \$1 billion contingency and prudence. When we look at TD, it is \$0 plus \$4 billion, so that's \$4 billion. When we look at Global it is \$4.1 billion, which includes the \$4 billion for contingency and surplus. Compare that to the forecast of Jim Stanford and the Centre for Policy Alternatives of \$11-plus billion. If the track record of CCPA bears out, we could end up with another huge gap and the same dilemma repeating itself. So how do we avoid that?

On my other related question, why is the government, Global, and TD predicting this U-turn? I haven't heard explanations for the sudden dip and then back up, which is something the CCPA doesn't predict.

Finally, the real work of this committee is to put in place or try to think about putting in place an independent forecasting capacity for Parliament. In fact, our work overrides the work of Tim O'Neill. It came first, as a result of the Speech from the Throne. The government then asked Mr. O'Neill to do some work, but this is the committee that has the mandate to pursue the broader objective. In fact, we have very detailed terms of reference. I'm not sure if you saw the terms of reference for our committee's work.

The real objective here is to come up with a plan so Parliament has its own independent assistance with respect to budget planning and forecasting, so we can do the work Mr. Orr outlined so accurately.

So those are three questions for each of you. Take your pick.

• (1240)

Dr. Dale Orr: Can I ask a question of clarification? You made reference to a U-turn, and I'm not exactly sure what you mean. I know there was certainly a dip in the forecasted surplus going forward in the November economic statement, but there wasn't—

A voice: The surpluses go like that.

Dr. Dale Orr: In the economic update they did, but in budget 2005 the underlying surpluses... As a matter of fact, they go up by \$1

billion each year as we go forward, like \$3 billion for 2004-05, \$4 billion...

So maybe, you know, that's history.

Ms. Judy Wasylycia-Leis: That could be, if we accept that. Up to the day of the budget, our finance minister was publicly talking about a U-turn, in media reports. I haven't heard him since then. He basically suggested we're going to see some drop-off over the next couple of years, and then a big swing up again. Maybe the way the budget is presented doesn't reflect that, but this budget is also curious because it has this elongated process of putting spending over several years. So it might be distorting the actual surplus. I'm not sure.

Ms. Ellen Russell: On that U-shaped point, to have a reasonably low budget surplus in the next two to three coming years and then have it grow over time was definitely the line prior to this last federal budget, and now there are new measures in place that change that to some extent. But really, what you see are measures that gain momentum as the years go by. There are more spending and taxation measures in the latter end of the budget.

It's interesting. All of the conversation we've had this morning has been on the incredible complexity of estimating a surplus even just weeks after the fiscal year is closed, but to consider measures that are coming in 2009-10, you have to be able to assess whether they're affordable years prior to that fiscal year even happening. So it puzzles me in a way that your committee is so concerned about figuring out what's going on just before the fiscal year ends or just after the fiscal year ends. If your purpose is to enhance public debate about what new taxation or spending measures ought to happen, and if these measures are being planned years in advance, really, the whole game is not being played on refining our accuracy on today's information.

Mr. Don Drummond: Let me just address this U shape. It's a very simple phenomenon.

The forecasters who are asked to participate in the fall update make assumptions on revenues and expenditures, and generally they have revenues growing at the pace of the nominal economy, so they grow about 4.5% to 5% a year. Then for a whole host of expenditures, they assume they're going to be constant in real per capita terms, so they'll grow about 3%. You just create this wedge. There's not much of a surplus there in the short term, but the further out you go you get this wedge.

Of course, the wedge is made all that much sharper because while they were anticipating interest rates to go up, they don't go up to a terribly high level. Even in 2008, when some bond from the 1980s is expiring, it's expiring at a lower interest rate, so you'll always get this improvement in the surplus.

Why doesn't it appear in the budget? That's really simple. It's because they filled it up with tax cuts and expenditure increases that are backdated. If you look at the elimination of the corporate surtax and what not, it doesn't even happen until 2008. So that flattened out that U shape.

In terms of the question of an independent capacity, I agree with that. In fact, in a document—and if you haven't looked at it, I suggest you do—from the Department of Finance from the early 1990s we actually suggested something along that line. It had a little bit of a different twist, because we actually suggested that it deal with federal and provincial information.

I think the situation has improved somewhat, but at that time every single province was on a different accounting system; you couldn't compare anything. There's more information now, and it's on a more comparable basis. But I think it's really necessary.

I think one thing you have to think really hard about is that independent part of it, because right now I sense you're placing the officials of the Department of Finance in a very awkward position, because they're on one side of the table serving their minister, but then you're asking them to run around to the other side of the table and be independent for Parliament. I don't think you can do both.

The Chair: Mr. Orr, do you have any comments on this?

Dr. Dale Orr: No.

• (1245)

The Chair: Thank you.

Okay, Mr. Bell.

Mr. Don Bell (North Vancouver, Lib.): I had two questions. My other questions were answered, but there's one related to the issue of the contingency and the reserves.

Going back to Mr. Orr's paper, the \$3 billion and the \$1 billion, do those figures seem reasonable amounts based on what you understand? We have the plus or minus error that you talk about at \$1.8 billion, which is \$3.6 billion, but then you talk about the traditional economic prudence, the sort of planning for those unknowns of \$3 billion and \$1 billion.

Do those seem reasonable amounts based on the size of the budget and your knowledge of government?

Dr. Dale Orr: That's a really good question. I have been thinking about it. Where I'm at is that they're pretty close. I'm comfortable with the idea that the contingency fund, which is there for fiscal emergency, should be an absolute sum each year—it's the \$3 billion; it's the same every year. The idea that the reserve for economic prudence should grow over time certainly makes sense, because as you go further out, the probability of error increases.

So I think it's pretty close. It's one of those things I'm looking forward to in Tim O'Neill's report. He may make points that I haven't thought of that may sway me a little bit, but it's pretty close.

Mr. Don Bell: My colleague Mr. Bains asked one of the questions I was going to ask: how do other governments compare when we talk about forecasting? My other question is, how do other governments compare in terms of prudence?

Dr. Dale Orr: I'm glad you asked that. I've spent a reasonable amount of time hammering on the provincial finance ministers to adopt what the federal government is doing, because I think that way of being prudent is preferable to what most of the provincial governments are doing. It's right there. It's in the budget. It's very explicit. Like it or love it, it's transparent and there it is.

There are quite a few provincial governments that set up fiscal stabilization funds. Money is set aside in good years, and they draw from them in bad. Unless you go to some of the appendices, the text can be very misleading when a provincial government says—and several provincial governments have done this—“We've balanced the budget this year; we have a balanced budget”. Unless you read back into the fine print, you don't realize that they borrowed \$800 million from last year. That's why I don't like those fiscal stabilization funds.

What some other governments do and what the federal government did before this process, which I prefer, is purposely downgrade on the economic forecast. That imparts certain biases. It's much more of a judgment call. It's much less transparent. Some of the provincial governments do this.

So I think this way of dealing with the uncertainty is much better than what most of the provincial governments are doing. It's pretty satisfactory, but it's one of the questions we'll get more information on.

Mr. Don Bell: The reason I ask that question is because in my experience in municipal government, first of all, you're not allowed to have a deficit. So all your budgeting does provide for a surplus, and you have to. The question is, how much of a surplus?

You have to allow for contingency, and we have contingency amounts. One of them was called “council reserve”. One of the criticisms that came, which is the opposite of what's here, is that we had allowed, in our municipality, the contingency reserve to be less than a lot of people thought it should be. We had the experience where it wasn't needed, but the suggestion was that in fact we were keeping taxes or the budget down as a percentage by not having an adequate amount in there.

So it's almost the opposite of what I'm hearing here. It's interesting.

Mr. Don Drummond: Could I address the question about the contingency and economic prudence?

I think I would disagree with Dale, in a sense. I think you can make a very credible argument that they should be eliminated. They have outlived their purpose. They were established at a time when we had a 25-year history of always making errors in the “wrong” direction. I think they were an important part of re-establishing credibility, but that credibility has been re-established, and I think you have to ask yourself the basic question, should the whole process be skewed toward having surpluses, or should it be trying to come to an accurate number, right on that?

Of course, to answer that question you have to address the very point you've made, that in the municipality you weren't allowed to have a deficit. Is there some reason the world would fall apart if we had \$1 of deficit? I think a politician, at the moment, anywhere in Canada would probably answer yes from a political perspective, but from an economic or financial perspective, obviously no. If we're going through a cycle and we have a small amount of deficit, as long as they don't become structural and go on and on forever, there's no particular problem with that.

So with our debt burden down—I would argue that it's still too high—having a track of surpluses since 1997-98, why don't we try to call a forecast dead-on? Don't have any bias in your economic forecast and in your planning surpluses, and try to get the accurate result.

• (1250)

Mr. Don Bell: Well, the reason, from what I've seen as a new member of Parliament, is that there are factors that can come in. You talked about, at one point in here...

I don't know if it was you, Don. I made the notes and I didn't make the distinction between Dale and you. I drew a line after Ellen's comments and after Dale's. No, I guess it was Dale on that point.

You said there was no one consistent source of error. If that's the case, then there are the unknown factors. There's the ice storm. There's BSE. Things like that can happen.

Mr. Don Drummond: But there could be things on the other side as well. That's my point. The contingency reserve is there to handle untoward, unpleasant things.

Mr. Don Bell: Negative ones.

Mr. Don Drummond: Corporate profits have been increasing at over 20% a year for the last three years. There are an awful lot of corporate income taxes coming in that were not envisioned in the

budget. So why set a reserve all for the negative but not counterbalance it with anything positive?

Again, it gets to a fundamental, almost philosophical question: do you want to skew the exercise toward having surpluses? It is skewed that way, and it has been since the early 1990s. Maybe it's not necessary to do that anymore.

Mr. Don Bell: It's like family budgeting; you provide for the rainy day, or the contingency, or the disaster account.

Thank you.

The Chair: Thank you, Mr. Bell.

Just quickly, Mr. McKay.

Hon. John McKay: Personally, I like forced bias, in one way. But maybe you're now improving in the esteem of Mr. Loubier.

I have a clarification question for you, Mr. Orr. Just thinking about the way to do this, are you saying that the contingency money should be your \$3 billion plus \$1 billion, and the \$4 billion, that's your bias, and then after that you should criticize the errors—that is, you really have to get to in effect about \$8 billion worth of “surplus” before there's something seriously wrong with the forecasting here, and the errors should be criticized?

Dr. Dale Orr: Those are separate points.

My point on forecasting the error is on the underlying surplus, the amount before any reserves have been set aside. I think that's the best one to use for making that comment. So I'm saying, you know, we'd all like to do better, but a reasonable expectation is the forecast of the underlying reserve, the underlying fiscal balance, could be up or down by \$4 billion.

Out of the underlying, you set aside various amounts of reserves under current practices, depending on what year it is. Actually, right in the in-year, you'd have nothing. Then you go to \$3 billion. Then the next year it's \$4 billion, because you lay some aside for economic prudence, etc.

So the reserve amounts are separate from that.

Hon. John McKay: But if you've already made your upfront statement, that it's balance plus your contingency, before you really start to talk, your error margin really is on top of the contingency money, though, isn't it? I know you want to talk underlying surplus, and really, the government has already made the decision that there is going to be...

So your swing is essentially \$8 billion from your underlying surplus.

Dr. Dale Orr: Let's take an example. Let's take one year out, where you've laid aside \$3 billion in contingency and \$1 billion in economic prudence. Let's say the underlying balance was \$10 billion. Well, what if everything turned out really nasty that year, and instead of an underlying you had \$6 billion? You've laid aside reserves of \$4 billion, but you'd have a \$2 billion deficit in that case.

• (1255)

Hon. John McKay: Yes. And there you would effectively say that was an intolerable error, because you're beyond your \$4 billion.

Dr. Dale Orr: Well, I didn't use the word "intolerable".

Hon. John McKay: I couldn't think of a better word.

Dr. Dale Orr: I'm just trying to say, here are the moving parts, here are reasonable expectations, or whatever—yes, a reasonable standard that you could set.

The Chair: Thank you, Mr. McKay.

Quickly, Mr. Penson.

Mr. Charlie Penson: Just to follow up on Mr. McKay's line, I understood you to say, Mr. Orr, that the swing you're talking about is \$4 billion, but it could be \$2 billion either way. Is that not correct?

Dr. Dale Orr: No, it could be \$4 billion either way, from the \$10 billion.

Mr. Charlie Penson: So when Mr. McKay says that you have your contingency reserve as \$3 billion plus \$4 billion, you're saying that the \$4 billion could be the other way, just as easily.

Dr. Dale Orr: Let's say the underlying surplus was \$10 billion. I'm saying that if everything turned against you, it could be... \$6 billion would be... you know, that's the \$4 billion; it could be \$14 billion. If it happened to be \$6 billion, then you would have actually \$2 billion in surplus, because you've set aside \$4 billion in your reserves.

Mr. Charlie Penson: Okay, thanks.

The Chair: On that note, I want to thank the witnesses for appearing. Thanks to Mr. Orr, Mr. Drummond, and Ms. Russell.

Thanks to our members. We'll see you guys this afternoon.

The meeting is adjourned.

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