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## Standing Committee on Finance

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**Tuesday, March 8, 2005**

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**Chair**

**Mr. Massimo Pacetti**

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Tuesday, March 8, 2005

• (1540)

[English]

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

This is pursuant to the study we're conducting on federal fiscal forecasting. We'd like to have some input from the witnesses, and I want to thank you for appearing.

We had a session this morning, and not all of the witnesses had opening remarks. Would all four of you like to have opening remarks or make an opening statement? Does anyone want to?

**Mr. William Robson (Senior Vice-President, Director of Research, C.D. Howe Institute):** Sure, I would like to.

**The Chair:** If we can limit it to five to ten minutes, no more than ten minutes, I'll signal you at the five-minute mark.

I have an order here: the Caledon Institute of Social Policy is first, then the Conference Board of Canada, the Canadian Council on Social Development, and the C.D. Howe Institute. Then we'll allow the members to ask questions.

Mr. Mendelson, could you go first, please?

**Mr. Michael Mendelson (Policy Analyst, Caledon Institute of Social Policy):** Thank you, Mr. Chair. We're very pleased to be here and to be able to contribute to your deliberations.

I just want to tell you, before we start, a little bit about my own background. I've done—if I can use that word—three provincial budgets in my career. Before I was with the Caledon Institute I was a long-time public servant in the provinces, and much earlier in the federal government. I did a provincial budget for the Pawley government in Manitoba, and then a budget for the Filmon government, which was their first budget. It was the Pawley government's last budget. I'm not sure if that's much of a recommendation. I also did one budget for the Peterson government in Ontario. So I might be the only person in Canada who has done a provincial budget for a Liberal government, a Conservative government, and an NDP government. It did give me a range of practical experience in budgeting. Of course, none of it is quite at the level of the federal system, but Ontario's begins to approach the federal complexity.

I want to not so much focus on why I think a parliamentary budget office is a good thing, as much as make some points about what is needed technically, what it might be, and what it might not be. I'll try to do that quickly.

The first point I want to make is that from my perspective the issue is not one of economic forecasting. The problem that needs to be addressed or the balance that needs to be achieved is not one of poor economic forecasting. I think the federal practice in the budgets of the last several years has been reasonable. I could argue with the details of the mechanism of averaging private sector forecasts, but so what. It's been made obvious, it's not that problematic, and I'm not sure if anybody could be doing any better anyway.

The issue for me is the relationship, once you have established an economic forecast and what that means, between what that and other factors mean in terms of revenue, and what that and other factors mean in terms of expenditure. The real issue is understanding the dynamics of each individual revenue source. Having been in this position when I worked in departments of finance, there are experts on particular revenue sources who know everything about them. There's volatility that's unanticipated. For example, corporate tax in Ontario is particularly volatile because of the very legitimate capacity of corporations to time their tax payments. That's reasonable, but it means you can have big swings, depending upon factors that might not be self-evident.

There are similar problems in forecasting program costs, especially where you have open-ended programs like the guaranteed income supplement, tax expenditure programs, and so on. You have to know the depth and details of those programs, and that's really where the issue of forecasting arises—the challenges. So what it means is that a good fiscal forecasting team has to build up a detailed and specific knowledge of both the revenue and expenditure sources and what they mean. It's not so much an issue of economic forecasting.

The second point I want to make—it might be one that everyone has already agreed upon, but I think it bears making again—is that this is not an auditing function. It would be inappropriate to build this function into the role of the Auditor General, because audits are retrospective; they're based on evidence about what has been done. Forecasting is prospective. It's not meant to be precise, nor can it be precise. It's always an estimation within a range of probability, and it requires a completely different technique and approach from the Auditor General's. In fact, I think it would detract from the credibility and role of the Auditor General to assign this task to that office. It would be inappropriate. That doesn't mean that if there were a parliamentary budget office the two offices couldn't work together and cooperate in some ways. I'm sure they could and should, and maybe they could even save money by sharing administration, and so on.

The last point I want to make is seemingly a technical detail—that is, if you do decide to establish a parliamentary budget office, and I hope you do, one of the critical key components is where will they get their information and how will they acquire information?

They need detailed and timely information. Much of it that is available, the Department of Finance and the Canada Customs and Revenue Agency collects, but it has to be accessible in some fashion or other to a parliamentary budget office. If the parliamentary budget office cannot get detailed information from government and from government departments, it will not be able to function. So I think one of the challenges for parliamentarians in trying to design a functional office is how can you assure that the PBO will get the information that it needs when it needs it?

I believe it would have to have access, obviously, well beyond freedom of information. It might mean, in some ways, trying to find a way to deal with confidentiality guarantees for third parties and essentially give the PBO, the parliamentary budget office, the kind of access that a government function would have and build up the Chinese wall kind of approach where confidentiality had to be maintained.

I think that is one of the critical questions, and I'd urge you, if you are looking at the U.S., at the Congressional Budget Office, to look at the information sharing agreements they have there. I don't know anything about them personally, but there may be examples in other jurisdictions that would be useful.

Let me just conclude, then, with a few words about why I think it would be a good thing to establish a parliamentary budget office. I made the argument elsewhere in print that I believe it would contribute to the quality of public debate. The more knowledge and transparency there is, the better the quality of public debate, and regardless of whether you think large surpluses should go to transfer additional money to the provinces, to reduce federal taxes and have a tax transfer to spend in additional programming to address issues of poverty, regardless of what it is that you think ought to be done with that fiscal situation, you can't have a rational debate unless you have some clear consensus of what it is. I would urge, therefore, that the quality of public debate will be improved by having a second point of view.

I'd also add, I suppose more fundamentally, that the primary role of Parliament—and we read about it in history—has been to control the chequebook. I doubt whether anyone would disagree that the role of Parliament in terms of its authority vis-à-vis government taxes, expenditures, and so on has diminished over the last many decades. I think it would be an excellent idea if Parliament assumed some of the role of the check and balance on the executive authority with respect to the control over the exchequer, which is the traditional parliamentary reason for existing, the first one.

The final point I want to make is that I think a parliamentary budget office would be good for the government of the day as well. A little bit of competition will sharpen everyone's capacity. It will make them work better and more transparently. It will help governments keep governments out of problems that they can create for themselves, keep the golden apple out of sight, or something. I think it will also offer government the capacity to make a budget

with a great deal of credibility that it otherwise might not be able to attain.

In other words, if an existing authority says this is the best and most reasonable fiscal forecast we also could come up with, within a range of reasonable differences, and the government and the parliamentary budget office agree, even if it ends up being wrong afterwards, people like me are not going to complain. We're going to say, well, maybe we can think about different ways of doing that, but we won't see it as an attempt by government to bring forward mis-estimation.

Members, those are the few opening remarks I wanted to make. Thank you very much.

• (1545)

**The Chair:** Thank you, Mr. Mendelson.

Mr. Darby.

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

Very briefly, as you know, we have already embarked on an exercise involving at least three, and potentially four, different forecasting agencies, or personages with forecasting expertise, to project the federal fiscal position. We have the experience now of having gone through one round of that exercise, and I think from our perspective we feel fairly comfortable about our first attempt, but there are a few learnings.... And I would echo, to some extent, the remarks of Mr. Mendelson, if I could, Mr. Chair.

Definitely, as we go forward, we would feel more comfortable if we had a fairly detailed and comprehensive set of historical estimates on expenditures and revenues—more detailed than what was available to us in the current exercise. We talked at the previous committee hearing about cooperation between the Department of Finance and the various forecasting organizations or personages, which underscores the importance of this. I think this gets to Mr. Mendelson's remarks, in terms of how there is often a certain level of detail that you feel more comfortable in having when you prepare a budget forecast, particularly for the current fiscal year and as you go forward.

Second, there's also a theoretical element. I speak for myself here, and hesitate to speak for the other forecasting agencies hired to do this work, but our primary function in the past has always been to forecast overall economic conditions. We have done this without ignoring the fiscal situation at the federal and provincial levels. And I think that the Conference Board, frankly, has one of the more sophisticated fiscal blocks within its economic forecasting model. However, as I indicated, our primary focus in fact was not to come up with an estimate going forward of the federal surplus or deficit. We could certainly improve our forecasting estimates by digging down in further detail in the various revenue and expenditure items that depend upon economic conditions. We would love to have the opportunity to do that.

Finally, with respect to liaison between ourselves and the committee and among ourselves as forecasting enterprises or personages, I think there is a certain amount of labour, if you like, involved in that communication and liaison experience, particularly going forward. At some point, depending on the circumstances, I think the committee might want to consider if we need some further secretarial resources or a small secretariat—perhaps on a very part-time basis—to help in this endeavour. I'm just raising this as an issue. Again, building on Michael Mendelson's points, I think that as we go forward, depending on the level of credibility and accuracy and depth we want to pursue in this exercise, there may be benefits from doing it at a more detailed level than we are currently engaged.

To summarize, we need good historical information at a detailed level, so there are as few surprises as possible in the budgets as they come forward or in the spending estimates through time. We also need some resources, if you like, to help improve or deepen the theoretical content of the projection models; and finally, if it proves necessary, perhaps some small additional resources to help the clerk potentially with the secretarial duties required to continue smooth functioning.

Thank you very much, Mr. Chair.

• (1550)

**The Chair:** Thank you, Mr. Darby.

Mr. Anderson.

**Mr. John Anderson (Vice-President, Strategic Partnership and Alliances, Canadian Council on Social Development):** Thank you very much.

My background in this area is that in the past I taught political science and did research on the areas of business and government for many years. I've also worked recently in terms of both the alternative Ontario budget and now I'm on the steering committee for the alternative federal budget and have been for several years.

I want to thank you for giving me the opportunity to make this presentation. I want to say that I think it's to me very significant that this panel on forecasting is being held on International Women's Day, which is today, March 8, which is a day set aside around the world for us to recommit ourselves to equality for women. International Women's Day was established in 1910, initially to commemorate the struggles of American women workers in the garment industry to climb out of poverty by achieving equal pay and better working conditions.

And how, you might ask, is this related to budgetary fiscal forecasting? I would submit that the absence of a neutral effective budgetary forecasting process, tied to the commitment to spend any newly discovered surplus on debt reduction, has led to a situation where the government is unable to effectively deal with our social deficit and the crucial social issues out there, such as child poverty, aboriginal poverty, visible minority and women's poverty. Women's poverty now stands at a rate of almost 15%, about 2.3 million women, and there are 300,000 more women in poverty in Canada today than men. This is from Statistics Canada's "Income Trends in Canada".

The alternative federal budget has for the last ten years now been more accurate on the question of predicting the size of the surpluses than has the federal government. This huge underestimating of surpluses, which I think Jim Stanford in a presentation to this committee recently said was in the order of \$85 billion over ten years, is an important issue that must be addressed.

There are two problems, as I've said. One is the continuous underestimation of the surplus where the government is in a situation where it is not able fully to plan to deal with major social issues. The solution to this issue, I think, as Michael Mendelson said, is to develop a mechanism such as exists in other countries and other jurisdictions that is independent of political parties and that can lay out publicly not only the predictions as to the surplus, but all the assumptions and thinking behind the surplus so the public as well as government can fully understand the predictions that it makes. I think this question of transparency of assumptions is extremely important when we're looking at developing something like an independent budgetary office, because right now we don't have the full range of assumptions that are made by the finance department. And I agree with Michael that it's not the economic forecasting that is the problem, but rather the estimations of government spending and revenues.

The second problem in this process, and this is why it has become a problem, is that the unpredicted surplus right now is basically applied exclusively to lower the debt when Canada's debt-to-GDP ratio is going down and continuing to do so as a percentage of GDP even if no new money were to be put against the surplus, and when Canada has the lowest debt-to-GDP ratio of all the G-7 countries. It's really the combination of the lack of accurate forecasting and then the mechanism that kicks in where the surplus is applied against the debt without any real debate or choice on that issue, and in fact when there are huge social issues such as poverty—which I mentioned, child poverty particularly—that need to be addressed, and need to be addressed right now. When we don't have the surplus and we're not able to predict this surplus, then we miss many years of planning that could be used to tackle some of these pressing social issues.

•(1555)

The last federal budget estimated over the next five years the government would have a total, by my calculations, of \$28.5 billion in the contingency reserve and prudence funds, and the alternative federal budget estimated this amount would be even higher, and predicted—this was before the current budget—there would be about \$45 billion in surpluses over the next three years.

So there are really important decisions we have not been able to make, because these are not simply minor issues of being out by a small amount, and so what? We're talking about the future of our children; we're talking about the future of aboriginal peoples, or other pressing social issues—the future of child care, a fully funded child care program, for example.

So what kind of mechanism do we need to examine fiscal forecasting? I don't have detailed models; I'll just say some of the points I think are important. One is, of course, the neutrality of the mechanism. It must not be part of the government. The lead members of that mechanism must not be appointed simply by one political party.

Two, we need a more expansive mechanism than the welcome appointment of the four economists Paul has been talking about. They of course are doing a great job, but they are all employed elsewhere; I think we need people who are going to be dedicated on a full-time basis to this.

On the other hand, we need a cost-effective mechanism. We don't want to have an exercise at the high end, where there is some lavish spending on setting up some kind of Canadian CBO. We need one that has access to the necessary data in the fullest sense. Lastly, we need a mechanism very quickly. We cannot afford to spend three years studying what mechanism we should have, doing cross-country benchmarking, holding hearings across the country, and so on. This is something we should settle relatively quickly.

And lastly, we need to disentangle the issue of the surplus and the budgetary predictions—fiscal forecasting—from the automatic spending of the surplus on debt reduction. The amount of money is estimated, I think.... Jim Stanford said there was an average surplus of \$8.5 billion over the last ten years. Statistics Canada calculates the total amount of incomes by which poor people are under the poverty line. Of course, there are many different measures of poverty, but one calculation is something like \$16.7 billion every year. That is in pre-tax income. If we had that surplus and could use that surplus for something like reducing poverty, we could cut poverty in half in very short order, and be able to meet the UN millennium goal of reducing poverty in half world-wide—meet it in Canada—and this is something the Government of Canada has signed on to, these millenium goals.

I see this as a very important issue, one that can not only push forward our ability to make sounder economic forecasting and fiscal forecasting, but also give us the tools to deal with some of our pressing social needs.

Thank you.

•(1600)

**The Chair:** Thank you, Mr. Anderson.

Mr. Robson.

**Mr. William Robson:** Thank you.

I was told I would that I would have ten minutes, so I promise you I won't go over that.

I'm grateful to be here. This committee's deliberations are always useful, and I think the question you are addressing right now is a very important and timely one. As I understand the key focus, it is first of all whether an independent body might strengthen Parliament's ability to deal with budgetary matters, and if it would, to recommend who could give that advice and how.

My answer to the first question is yes, I think an independent body could strengthen Parliament's fiscal control. But I do say "could", because whether it actually will depends on how clear a view we have of the problems we want an independent body to fix. I don't have—as none of us does—complete answers, but let me try to move us ahead by sketching three problems that confront us right now on fiscal forecasting—one easy to fix, one of medium difficulty, and one much harder.

For an easy fix, let me start with something I don't think we need independent advice for at all, but I want to use some of my time on it because it affects our discussion of deeper issues. And Pete DeVries is behind me here; maybe I'll get hit in the back with a styrofoam cup.

Budgets present Parliament with the wrong numbers. Canada's public accounts are good by world standards. They always have been. They're not perfect, but they've been getting better over time. I just do not understand why Parliament lets the government present budgets on a basis that isn't consistent with the public accounts.

Some of you know already, but I will just underline it, that budget presentations and the Department of Finance's fiscal monitor net about \$13 billion worth of spending against revenue. So both sides of the budget are badly understated, and it creates a gratuitous obstacle to answering what really should be a simple question, which is whether the results turned out like the government said they would. That question is the next one I want to get to. Did the results turn out like the government said they would?

Let me just note unhappily that the budget papers respond to the Auditor General's criticisms of netting by talking about a working group. I don't think you need an independent advisory body, and I don't think you need a working group. I think that budgets and the fiscal monitor should show gross numbers, and I don't think Parliament should accept anything else.

My second point to do with things not working out is easy to state, but getting into it in depth can lead us into complicated territory. It's an obvious point—stuff happens. The world surprises us constantly.

I believe there are some charts in front of you, and I don't want to lean too heavily on them, but what I did in preparing for today was go back 25 years and look at what each year's budget predicted was going to happen—what change in revenue, what change in interest payments—and then, at the end of the year, what the public accounts said actually happened.

In the chart, there's a set of black bars across the bottom that show the difference.... They're not in there, actually. I'm showing changes. It would be better to show levels, to compare the levels, but I can't because the budgets present netted numbers. Right away, there you go—there's this problem in just making a comparison. So I show changes.

To be brief, what you see when you look at the revenue variances, what the budget predicted and what actually happened, the difference between them, is pretty much what you'd expect, at least for the first couple of decades. Economic surprises mean the government misses the mark, but it doesn't always miss the mark in the same direction. Over the course of the first 20 years in this chart, errors in revenue averaged pretty much close to zero, and the differences in what was predicted by way of interest costs and what actually happened also basically reflect cyclical surprises.

I think independent advice could help Parliament a lot in dealing with that type of thing, making budgets under economic uncertainty. That's my medium-difficulty fix. It's difficult to frame a budget when you're thinking about a world of uncertainty, where you have a pretty good sense of what your expectation is, but there are possibilities well to the side of that and you want to assign probabilities to them. I think an independent body could be very helpful in helping people think concretely about what the risks are. I think we can talk more about that during the discussion.

Let me close with my tougher problem. I think part of the inspiration for the question you're looking at does arise from concern about under-projections of revenue and spending in the last few years. There is a suspicious consistency in the revenue under-projections since the beginning of this decade. I don't think lack of independent advice is the only problem, though.

• (1605)

I don't like to skip the third chart in my handout, because that's the one that contrasts what the budget said happened to spending with what actually happened to spending. But in the interest of time, let me move on to the final comparison that I made, which compares surprises on the revenue side and surprises on the spending side.

When I started putting this together to come here today, I wasn't sure what I would find. Let me just take you through the thinking that led me to do this.

Suppose surprises thrown up by the economy were the only thing we had to deal with. As I was commenting earlier with regard to revenue and interest, what we probably would see over time is that the difference between the budget forecast and what actually happened would average out to zero. On average, you'd be right even though you'd be constantly a little offside because of surprises. There's something else we would see if that was the case, though. When the economy was weak, revenue would come in lower than we were expecting, and spending, mainly because of EI payments, would come in higher than we were expecting. When the economy was strong, the opposite would be true: the revenue would come in higher than expected and spending would be lower. The correlation between surprises on the revenue side and surprises on the spending side would be negative. When you overshoot on the one, you would tend to undershoot on the other, and vice versa.

Now suppose surprises in the economy aren't the only thing going on. Suppose the government has a target for the bottom line. When less money comes in than expected, it spends less, and when more money comes in than expected, it spends more. In that case, the correlation between surprises on the revenue side and surprises on the spending side would be positive. When you had an overshoot in revenue, meaning more money than you expected, you'd have more spending happening than you had expected, and when you had an undershoot and less revenue came in, you would see less spending than you had expected.

In my final chart, that was my thinking—and as I said, I was doing this in preparation for this, and I'm sure there are better ways to present it. What I did was say, well, let's do a comparison: let's add up surprises on the revenue side. By that I mean how much more or less money came in than what the budget forecast, and also how much you had to spend in interest payments. Did you have a positive surprise there? Did you have to pay less interest than you expected so that you had more money overall? So there was more revenue and lower interest costs on the one side. Then, what happened with spending? Did spending overshoot or undershoot what was predicted in the budget?

With the black bars at the bottom of the chart, I just looked at the correlation over five-year periods. Was the correlation negative or was the correlation positive? Sometimes surprises affecting fiscal room and over- or undershoots in spending did move in different directions, as I said they ought to do if you were just taken by surprise by the economy, with more revenue than you expected, less spending than you expected, or vice versa, meaning less revenue and more spending. In the early 1980s that was true, and in the early to mid-1990s that was true. Ups and downs in the economy were affecting the budget in the way you would expect.

However, it hasn't always been like that. Sometimes the correlation between surprises in terms of the amount of fiscal room the government had and over- or undershoots in spending was positive. It happened during the mid- and late 1980s, when the Conservative government was wrestling with the deficit; it's happening now, when revenue has been coming in stronger than the budget was forecasting and, contrary to the assertion by my colleague here, I'm afraid, a government that's embarrassed to show surpluses is spending it.

I supported the fight against big federal deficits. I think there are times when focusing on the bottom line makes sense; I think other witnesses before this group have said that. But if a bottom-line target means reacting to positive revenue surprises with late-in-the-year spending binges, then it's time for something different. I think an independent agency advising on fiscal forecasting would help us frame budgets that would be more robust when we're taken by surprise by what happens in the economy, but the fix for the situation we're in right now is not a new organization.

The striking thing for me in last month's budget was that it said the increase in spending in the current fiscal year, the one that's about to end at the end of this month, will not be the \$4.5 billion that Parliament was told it would be this time last year, but in fact will be \$17 billion. Even relative to the size of the budget, there is no overshoot comparable to that in the last 25 years. That is off the scale compared to anything we've seen in the last 25 years. I think I'm somewhat echoing what Michael Mendelson said when I say that if Parliament's ability to control public funds has deteriorated that badly, then no amount of independent fiscal advice is going to help.

Thank you.

• (1610)

**The Chair:** Thank you.

We'll go to members. Again, I don't know whether Mr. Penson will agree or not, but we'll allow some of the witnesses to interact. However, I'll monitor that.

Mr. Penson, the witnesses are yours.

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

**The Chair:** You have seven minutes.

Then I have Monsieur Loubier, Monsieur McKay, and Madam Wasylycia-Leis.

**Mr. Charlie Penson:** Thank you, Mr. Chair.

I'd like to welcome the panel here, although I can hardly see them at the other end of the room.

I was encouraged to hear pretty much unanimous support for the idea of an independent budget process of some type. I know that some people have said it may not want to look quite like the Congressional Budget Office, but we have to remember that they have been in business for some 30 years. I think the idea was to act as a check and balance against the executive branch. We're sort of in that situation again.

In that regard, I would ask Mr. Darby this, and then I'll throw it open. Obviously you're telling us that in order to make this work, we are going to need cooperation from the finance department. We were trying to explore this with a couple of other witnesses this morning. Are there are limitations in the finance department itself?

It would mean that they don't have the ability to give us timely updates and the numbers you would need to do the projections we're asking the fiscal forecasters or an independent budget office to do. To me, that is the most important part of all this. When you're forecasting a year ahead, surely you can be out, but if we have forecast corrections three or four times a year, that gives parliamentarians an opportunity to make changes in direction.

I would ask you this: Are there are any limitations? Is there a need for staff in the finance department to provide you with the kind of information that would be required if you were doing the independent budget forecasting we are asking for?

• (1615)

**Mr. Paul Darby:** It's an excellent question. I also think Mr. Mendelson might have some on-the-ground experience with this, and we have Pete DeVries in the back.

First of all, you're talking about making it work. I think we proved it could work, and fairly well, without the total cooperation of the Department of Finance. There are numbers that are published. We had the November statement. They weren't as up to date as perhaps we would hope, but nevertheless they are a good guide at least for spending our revenues halfway through the year. We have some information that's also published in *The Fiscal Monitor* or by Stats Canada, which is more timely and also aids us in the process.

I think we can do the job. I think the issue is to do the best job possible or to do a better job. Indeed, it would be useful to have access to the most recent estimates on revenue and expenditures available at the federal Department of Finance.

Now, in terms of what limitations there may be on that data, frankly, I may not be the best witness. I could only speculate. There are certainly issues potentially with respect to confidentiality. I'm speaking particularly of data relating to issues that are potentially before the courts. There may be issues with special requests that might require extra resources at the Department of Finance in order to generate the data. It's something that would have to be worked out over time.

Honestly, I may not be the best witness to respond. Perhaps others could.

**Mr. Charlie Penson:** Mr. Darby, we are going to have finance department officials here and we'll be asking those questions.

**Mr. Paul Darby:** Yes.

**Mr. Charlie Penson:** It would be helpful if Mr. Mendelson or others could identify whether they think there's a lack of resources that limits whether finance department officials could make a more constructive contribution to this process.

**Mr. Michael Mendelson:** I don't have a good answer to that. I don't know enough about the capacity the finance department has at present.

I think the more pressing problem right now for a parliamentary budget office would be to ensure that the office has access to the information the finance department has. It's not only a question of the government being reluctant to part with information; there are also issues around third-party confidentiality that will be important. There are some other meaningful issues of confidentiality the finance department will have that are not just barriers to put in the way. Those will have to be negotiated.

**Mr. Charlie Penson:** Hopefully we can get to Mr. Robson, but can I ask you this? In the United States, some 30 years ago when this issue broke, my understanding is that Congress was concerned that the information was not reaching them and it was resting with the executive branch. Do you see the same kinds of parallels today in this discussion?

**Mr. Michael Mendelson:** Of course it's the role of Congress and the role of the executive in the U.S. The role of Congress and the role of the executive in the U.S. are quite different.



My own answer is that I believe we could benefit in Canada from some rebalancing, and to that extent I would see a parliamentary budget office as certainly not correcting the issue of complete executive control over the fiscal. I agree with Bill in that. It's not going to correct the problem, but I think it can go some way in providing some more balance and in allowing parliamentarians to have more access.

I also want to say that I do believe that when I say "parliamentarians" I honestly believe that there's a role, aside from their party affiliations, for individual MPs who have a strong interest in public policy and who can play a role if given that opportunity and if given adequate information. So I think that a PBO could play some rebalancing role and I don't see anything wrong with that at all.

**The Chair:** Mr. Robson.

**Mr. William Robson:** I think that without making light of the information issues, one advantage of an independent body is that it would be able to use the existing information in ways that are difficult for the Department of Finance to do. I'll just offer two examples.

In real life you have to think in terms of probabilities of outcomes. We may have a sense that the surplus is likely to come in at \$5 billion, but somebody just looking at past fluctuations might say, well, there's obviously a 50% chance either way, and when you're thinking further out, maybe a 10% chance that we'd have \$8 billion, or a deficit. It's very difficult for the government to put out information like that. People want from the government a point estimate. They want from the Department of Finance a point estimate, which is why we have the budgets that we do now with a balanced budget and the prudence factors and so on that give you these definite numbers. I think an independent body is in a better position to talk frankly about risks around the forecasts, from which then parliamentarians can say "Okay, well, where am I comfortable?"

Another related issue would be around some of the contentious issues, like if you raise taxes or if you lower taxes, what's the revenue yield going to be? It's very difficult for the Department of Finance to do anything other than say, well, if we're charging at 21% and we knock off one percentage point, then revenue is going to go down proportionally. Well, the real world doesn't work that way. An independent body is a little more easily able to ask, what do academics say, what does past experience show, and get us away from the static forecasting.

• (1620)

**Mr. Charlie Penson:** Mr. Robson, would an example of that be if you cut the corporate tax rate you might get more revenue because the corporate sector would do more business and therefore more money would actually come into the treasury, even though the rate was cut?

**Mr. William Robson:** We've seen in the federal budget recently that some business tax cuts haven't had anything like the negative revenue impacts that a static analysis would have indicated.

**Mr. Charlie Penson:** That's what you're referring to—

**Mr. William Robson:** People will debate why that's the case, which is why it's contentious for the Department of Finance to come

right out and say it will do this. But an independent body has just a little more latitude to raise those possibilities.

In Ontario recently, where a business tax cut was rescinded, I have heard commentators say that they're somewhat depressed at how much extra revenue forgoing that tax increase has actually resulted in for the government. So some tax bases are very elastic, but it's difficult for the Department of Finance to take a strong position on those issues.

**The Chair:** Thank you.

Monsieur Loubier.

[*Translation*]

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

I greatly enjoyed this afternoon's presentations which, fortunately, contrasted with those we heard this morning. This afternoon, we heard intelligent, objective presentations that will assist us in our work.

One thing in particular became clear to me. Mr. Robson asked us how Parliament can accept such far-fetched numbers. It's not that we willingly went along with this, it's just that some situations are beyond our control. These comments brought to mind the fact that in 1997, at a time when we had started to break out of this vicious cycle of deficits, I had tabled a private member's bill calling for a balanced budget. The government would have been required to maintain a balanced budget and if, for example, it had started to slip back into a pattern of deficits, it would have been required to eliminate that deficit within four or five years.

The bill contained a number of other provisions, specifically one requiring the Minister of Finance to be accountable to Parliament. The Finance Minister would have been obligated to come before Parliament and justify his figures once or twice a year if there were any marked discrepancies between earlier forecasts and actual budget numbers. This provision would have applied to revenues, expenditures and surplus or deficit projections. At the time, people weren't so concerned about surpluses, because the government was still running a deficit.

Mr. Martin rejected this bill, but that isn't the issue. This issue is this: if we were to establish right now an independent office like the one in the United States, would we not also have to adopt concurrent legislation compelling the Minister of Finance to come before Parliament to justify any budgetary discrepancies between forecasts and actual figures and economic updates, whether it be with respect to revenues, expenditures or surpluses, released by this independent budget office? Wouldn't this be a desirable adjunct? As you yourself stated, Mr. Robson, if Parliament does not move to release credible budget projections, democracy will be ill served. I believe each one of you has touched on the issue of the democratic debate. If, on the one hand, an independent office makes its own projections, while on the other hand, the Finance Minister maintains that his office is correct and is not accountable to Parliament, then the problem won't be resolved.

Should we not give this added option some thought?

•(1625)

[English]

**Mr. William Robson:** I think it would inevitably be the case that a body of this kind that produced independent estimates would produce a new kind of interaction between MPs generally and the Minister of Finance. It would promote exactly the kind of discussion we should have. The problem we face right now is that we have not made a transition out of a mode of fiscal policy forecasting that I think was appropriate in the day when we were trying to get to a balanced budget from a situation where the public debt was mounting faster than we could afford to pay the interest.

Having emerged from that, we are trapped now in a situation where we forecast a balanced budget, we add prudence factors, economic uncertainty factors, and the contingency reserve on top of that, and whenever there's any uncertainty the tendency is to pick the more conservative estimate, because we know we don't want to end up with a deficit. Under those circumstances there is always going to be a large gap between the forecast that is made and the actual outcome, because everything is biased in one direction.

I won't comment on the statutory requirements you refer to. It may well be that Parliament would find that desirable. I think the fuel for the substance of that debate would be there if you had an independent body that was able to put forward a forecast that said "we think this is our most likely outcome"—whatever it is on, say, revenue. "We think there is a 30% chance that it will be this much above," say, or a 30% chance below. Then Parliament has some way of judging how likely this independent body thinks it is that what the Minister of Finance is claiming is actually likely to be the case.

[Translation]

**Mr. Yvan Loubier:** I believe Mr. Darby had something further to say, but I'll ask him to hold off for a moment. If the Finance Minister is not made accountable to Parliament, then he will continue giving the same answer that he has given for the past eight years. Each time I would rise in the House to ask a question, he would respond by saying that my numbers were far-fetched and then he would sit down again. Neither he nor the Finance Department were required under law to be accountable for these projections.

In January, we tried to extract some more precise figures from the Finance Department. However, there is no legislation in place requiring the department to supply us with these numbers. If the department had no hand in ensuring that the independent budget office ran smoothly and if the minister were required to justify any discrepancies between the figures released by the independent office and his own department's projections, then indirectly, the Department would be obligated to come up with more precise figures.

I don't know how you feel about this, but the situation does pose a conundrum of sorts.

[English]

**Mr. William Robson:** I agree, but this gets into somewhat delicate territory. We've just had a budget presented that showed, as I mentioned, that the actual amount of spending in the current fiscal year is wildly at variance with what Parliament was told a year ago.

If Parliament is prepared to accept that, then as I said, I think an independent body is not going to solve our problem. It really does

come down to a fundamental question as to whether Parliament can seriously be said to control public funds anymore.

**Mr. Yvan Loubier:** Monsieur Darby.

**Mr. Paul Darby:** I have a couple of remarks on this very important question that gets at the heart of the process.

As just a little history, in September—or I guess it was in August, leading up to the September health accord—we were asked by the federal Department of Finance to independently verify the amount of fiscal room available to the federal government. In effect and in essence, this represents a public recasting—at least, the information was distributed to the provinces—of the federal financial position at that time, leading into those negotiations. The idea was, to some extent, to take that off the table in those negotiations so that the federal and provincial governments, going in, could more or less agree on how much fiscal room was available at the federal level.

I think the federal government is sensitive to the fact that their fiscal situation changes throughout the fiscal year. What is not clear to me is the extent to which Parliament is involved. It's agreed that in Canada generally we often have majority governments and there are issues that arise from that situation, but certainly I think at least you would want to have potentially the opposition—and in a minority government situation, it's a little more delicate—with that information themselves as these important negotiations will be taking place between various levels of government about policy initiatives that are so important to Canada.

So potentially, in July it would have been possible, if we were doing this on a quarterly basis, for an independent body to report to Parliament that the federal surplus had gone from \$4 billion, in its estimate, to now—let's pick a number—\$14 billion, offering the federal government important fiscal room in negotiations with the provinces around health care.

•(1630)

[Translation]

**Mr. Yvan Loubier:** That's what we're trying to do. Because we have a minority government, we were able to invite you here this afternoon. That would not have been possible before. We're beginning a new process and ushering in a new era.

[English]

**The Chair:** Merci, Monsieur Loubier.

Mr. McKay.

**Hon. John McKay (Scarborough—Guildwood, Lib.):** I suppose that could go the other way as well.

**Mr. Paul Darby:** Yes, it could.

**Hon. John McKay:** It certainly could.

**Mr. Paul Darby:** That would also be important, though, for Parliament to know.

**Hon. John McKay:** Presumably by the department approaching you and saying "Let's all arrive at a consensus figure as to what money we actually have here", they took, as you say, that number off the table. Either way, they took it off the table. So that's already happening.

**Mr. Paul Darby:** And in a sense, one can only applaud a certain degree of transparency at that point. I think the issue is that this is something that—if we agree that it was a laudable exercise to undertake—should perhaps become part of a more formal and regular process going forward.

**Hon. John McKay:** Let me push you on that point a bit, Mr. Darby. You started off your remarks about you needing cooperation from the department.

The thesis of this committee has been that the department doesn't get it right, that they wildly overshoot, year after year. We've heard it all, all that sort of stuff, and that gets parroted month after month. Yet you want to go to the selfsame department and get that information.

The more you get, if you will, in bed with the department, the less reliable your information might well be, because you're somewhat compromised. If in fact you want to go that way, that's a choice, but in some respects you're already compromised.

On the other hand, how can you ever expect to work for the government again if you're going to, in effect, set up an alternate body that will do nothing other than criticize the government? So how does this work?

**Mr. Paul Darby:** I would say two things, if I could, in response.

First, when we talk about trying to get more accurate information, we're really only talking historical information. We want to start on the same page. Our sense is that getting historical information does not, in a sense, put us in bed with the government going forward into the forecast exercise.

There are issues here that frankly we struggle with as well. In our own work we have a tendency to underestimate the personal income tax collections. There's something about the models we use, the structure, the way incomes are evolving in Canada that seem to be generating more income than our equations would predict. This is something we'd like to explore. We can explore that independently, and we do, from the Department of Finance. This is a crucial question when you're thinking about forecasting. But we would like to think at least we all start with the same historical base. I think that's all we're talking about here, and I don't think that compromises the independence of our work with respect to the Department of Finance.

**Hon. John McKay:** Presumably reasonable people could agree at that point.

**Mr. Paul Darby:** Yes, on the history.

**Hon. John McKay:** Okay.

**Mr. Paul Darby:** I think if we have access to the resources the Department of Finance has built over the years to collect that history and make sure it's as accurate as possible, that would only improve our own estimates as well, without necessarily meaning we would have the same forecast as the Department of Finance. As you know, we came up with three quite different forecasts.

**Hon. John McKay:** You mean the three modelers who were in last week?

**Mr. Paul Darby:** Yes.

The other issue is about working for the federal Department of Finance. Again, it's an issue, for sure. I think we would be forgoing

that kind of revenue for those fiscal projections, but at the same time we feel we are being fairly compensated by the committee, and we thank you very much for that. As a result, we're quite prepared to go forward with this work, which also, frankly, at least for the moment, seems to be quite steady.

**Hon. John McKay:** I go from the standpoint that in law you can't work for the crown and the defence, right?

**Mr. Paul Darby:** That's right, yes.

**Hon. John McKay:** You could choose to work for one or the other, but you can't switch horses halfway. That seems to me to be the kind of dilemma the four economic modelers find themselves in: that presumably, if they work for this tentative forecasting office, then fine and dandy, but their services could not be used by the government.

• (1635)

**Mr. Paul Darby:** My understanding is that perhaps we could not undergo a similar economic forecasting exercise, but contracts in completely different domains would still be available to us. We might have to verify that.

**Hon. John McKay:** All right.

Let me move away from that issue and go on to the issue of economic forecasting.

Mr. Mendelson started off by saying that the problem is not economic forecasting. Is that the sense of the panel here, that the issue is not economic forecasting, that the issue is what you do with the money afterwards? Is that fair?

**Mr. Michael Mendelson:** It's not what you do with the money. It's the relationship between the economic forecast and the amount of revenue and expenditure it implies. It's not the economic forecast per se, but rather what it implies fiscally.

I don't know what others think, or whether they agree with that.

**Hon. Maria Minna (Beaches—East York, Lib.):** He says it's the economic forecast.

**Hon. John McKay:** The premise again of this committee is that the economic forecasts are wildly out of line.

**Ms. Judy Wasylycia-Leis (Winnipeg North, NDP):** It's fiscal forecasting, and that's his point.

**Hon. John McKay:** What I want to make clear is what the issue is here as far as you are concerned. Is it the way the government uses the money, or is it the way the government predicts revenue streams?

**Mr. Michael Mendelson:** Let me be absolutely clear. I'm not here talking about the way the government uses the money. If you asked the panel, we'd probably all disagree—that is, everybody sitting here. I know Bill and I would disagree, because we've disagreed on many other panels. This may be the first time we've ever been on a panel and have agreed.

We're not here talking about how you use the money. I'm here on the premise that if there's more information available to members of Parliament and the public, there will be a better public debate about what you do with the money, and the country will be able to better express its democratic views eventually. How you use the money is a second order of question.

I would really urge that if it's possible.... I don't see this as being something against the government, or against the Department of Finance. I don't see it as necessary to take a defensive stand on this issue. I think it can be very important for the government. There will be a downturn in the economy, unfortunately, coming in the next sometime—we don't know when. I could predict that with utter certainty: there will be a downturn in the economy coming.

One day the Department of Finance is going to have to appear somewhere and say, "You know, folks, that estimate we made is wrong; it's going to be way worse than we thought." That day is going to come. I don't know if it's going to come this year, next year, or the year after. When that day comes, it's going to be very important that they be able to be credible. It will be important not just to you and to them, but also to the country and to its ability to weather whatever recession comes.

I see having an alternative source of information that's non-partisan as very important, and important for the country in terms of its ability to deal with economic change and to make reasonable fiscal decisions. I know the first tendency of the bureaucracy is to try to ensure that it keeps control over everything, but I think there is a broader perspective. That is, this could be a very positive element that could add to the credibility, add to the accuracy, and add to the quality of the work the Department of Finance does.

Having said that, let me just clarify: no, I don't think the problem is one of economic forecasting. I think that is a red herring. The problem is one of fiscal forecasting, which is primarily the relationship between any given economic forecast and the level of expenditure and revenue, and that's a different order of question.

There are other issues and other roles, by the way. For example—

**The Chair:** Quickly.

**Mr. Michael Mendelson:** For example, in the current budget there's an estimate that in benefits Canada will save \$2 billion. Is that a credible estimate? It's kind of important to the budget. Is there an alternative source of estimation? Has anybody been able to give any accuracy or any kind of substance to that figure?

I would say another very important role for something like a parliamentary budget office is, on the direction of your committee or members of your committee, to be able to undertake an independent analysis and say whether that is a credible estimate or not. So I think the capacity to look at the individual items as well, on the direction of members of Parliament, is another critical aspect of a parliamentary budget office.

• (1640)

**The Chair:** Thank you, Mr. Mendelson.

I'd just like to remind Mr. McKay that I don't regard myself as a judge. I don't think this is a court of law. I regard myself as a babysitter.

Ms. Wasylycia-Leis is next, for seven minutes.

**Ms. Judy Wasylycia-Leis:** Thank you, Mr. Chair.

I'd like to thank all the presenters this afternoon. This has been an excellent discussion.

I think it was useful to have that last exchange, just to remind ourselves why we're here, which is to discuss the merits of some sort of independent capacity attached to Parliament to provide forecasts, vis-à-vis budgets, as a fundamental overriding concern.

The catalyst for it has been the inaccurate forecasting over the last ten years—no question. That doesn't provide the only focus for us, but the government's been out some \$90 billion since 1997, which gets at the question of what could that money have gone for if we hadn't had this system and put it all against the debt. That's why John's question is very important, especially on a day like today, International Women's Day. We're dealing with poverty, child care, and violence, and the government's saying we don't have the money. But we know that \$90 billion over the last ten years went against the debt to hardly change our debt-to-GDP ratio. It's not just a numbers issue here; it's a political issue, it's a policy issue, it's an issue that's important to Canadians. It's a democracy issue.

I think we're also here today because it's a minority government. This happened because a motion went through, an amendment to the Speech from the Throne, asking us as a committee to review this issue. So we take this quite seriously. I know that the government sometimes has a hard time with the notion. Certainly the Minister of Finance doesn't seem to yet appreciate what we're doing.

That really gets to my questions. I'll think I'll start with Michael, because as I said in the House, it was Michael's piece in the *Globe and Mail* that actually grabbed people's attention early on and got us thinking. Was it in September?

**Mr. Michael Mendelson:** Yes, I think so.

**Ms. Judy Wasylycia-Leis:** It got us thinking about the possibilities. Then the motion was made, with the help of the Conservatives and the Bloc, in terms of the Speech from the Throne. But when we subsequently raised the merits of an independent office in the House and used the example of the Congressional Budget Office, the response from the minister suggested to me he didn't quite understand it.

First he said we don't want to use the American example because they have an annual budget deficit that's very nearly the total. So he missed the point that this is an office to forecast surpluses and deficits and give us independent advice. He also went on to suggest that the idea of the CBO was not transferable to the Canadian system, for a variety of reasons.

So I'd like to start with Michael, in terms of how you deal with those arguments. Then I'd ask for a comment from each of the other three on whether the CBO is a model or not, and if not, how do we adapt it to...? Do you support the idea of an independent office attached to Parliament, and if so, how would you structure it?

**Mr. Michael Mendelson:** We do have something to learn from the U.S. example in this case. The Congressional Budget Office is an institution that's been around for many decades and is probably huge. I don't know what its budget is, but I suspect that it's probably bigger than that of our own Department of Finance. In Canada, an effective parliamentary budget office would be, I suppose, 12, 13, or 14 professional people. In other words, it doesn't have to be huge. It would cost money, there's no question about it, but it would be a small amount of money.

I would see it as very important to establish an institution of Parliament, if I can call it that, that would have a history and be able to build up knowledge and capacity over time—as has the Library of Parliament, for example—and ways of working and institutional culture. That would be a very important addition to the capacity of Parliament and the country.

It does not solve all the problems. Ultimately, it's up to voters. Do you care or not care? If voters don't care, then it isn't going to change, and we all know that. But it's also an important part of democracy to give voters the information as best as possible so they can make those decisions as well as they can.

We can't, holus-bolus, adopt the CBO model. I hope you'll take a close look at it. I haven't, other than to look at its written material. I hope you'll be able to take a close look at it and borrow those aspects that are relevant to a parliamentary situation and discard those that aren't.

• (1645)

**Mr. William Robson:** There's a lot to be said about that. One of the things that an independent body is able to do that the Congressional Budget Office does quite well is look at some of the longer-term questions. It's very important for us. We have the chief actuary, for example, on old age security and guaranteed income supplement trying to estimate what the outlook for those things is over the long run.

One of the things that very much does bother me about the situation we are in now, where we have these last-minute decisions on what to do with the money that was unexpectedly there.... I don't mind surpluses. On average, as I was saying earlier, you would expect to win some and lose some, and at the end of the year, if my income has been higher than my spending, well, I've saved. There is nothing wrong with a surplus.

But what happens is that we make some strange decisions. We have these end-of-year decisions to put money away in foundations and trusts. If you are intent on establishing a new shared-cost program for institutional child care, you can't do that on a one-off basis. It's clearly an ongoing commitment, well into the future. The budgeting process we have now does produce some peculiar fiscal decisions, and one of the things that it might be able to do, such as we're talking about, is give some credible advice about what the long-term commitment might be under a range of assumptions. I think that would be very helpful for Parliament.

**Mr. Paul Darby:** Again, I'm not an expert on the Congressional Budget Office in the States, but any effort to set up an independent body, I would imagine, would benefit from a study of the benefits and drawbacks of that organization.

I would like to emphasize Mr. Robson's comment that frankly, some of the best work we have done at the Conference Board has been looking 25 and 30 years out, and we always do that when we look at the fiscal-prospects work that we do for federal finance or the provinces. Frankly, that's something you don't have the luxury of doing in the budgetary documents. Some of the implications can be scary, and you need to know that earlier rather than later. I would certainly emphasize that point.

**The Chair:** Thank you, Mr. Darby.

I'm going to go to—

**Mr. John Anderson:** Could I make a couple of comments?

**The Chair:** Quickly.

**Mr. John Anderson:** I think the issue I mentioned about accountability and transparency is extremely important, and at the present time we just don't have that in terms of the Department of Finance. And that's normal under our kind of system, because it's a very politicized way of making budgets. I think if you take out some of that forecasting, you depoliticize that forecasting, and I think that allows you to get at some of the issues.

That's not to say that a mechanism such as a budgetary office, or whatever you would like to call it, would not make mistakes. I think it will make mistakes. The American one has made mistakes. I think we must remember it's not going to be a perfect mechanism, but it will allow us to have a debate around those mistakes and around those assumptions, and to get at the assumptions—what did they estimate wrong?—which will not be politicized, which will not be the budgetary office doing this because they wanted to do something else, etc. It will be a much clearer debate around why they overestimated this or underestimated that. I think that's really important.

I think the other point is that in terms of... I think also it has a wider role in the United States. And I'm not saying we should replicate the American model, but having independence makes them.... It becomes a tool of public education as well in terms of what the budgetary process is, which the Department of Finance really can't be. The fact alone that it produces documents that allow citizens to better understand the whole budgetary process I think is very important.

• (1650)

**The Chair:** Thank you, Mr. Anderson.

Members, just to remind you, we're voting at 5:30, but the bell's at 5:15, so we're going to try to adjourn by 5:15.

**Hon. Maria Minna:** We're to be there by 5:15.

**The Chair:** I have Mr. Penson, Monsieur Loubier, Ms. Minna, then Mr. Bell, and then we'll call it a meeting. You have five minutes each.

**Mr. Charlie Penson:** Thank you.

First, Mr. Chair, I'd just like to take issue with Mr. McKay's analogy that parliamentarians and finance officials are sort of like the crown and the defence. It seems to me we should not be looking at this as an adversarial system. Surely, the Department of Finance is there to serve the people of Canada through their representatives.

**Hon. John McKay:** Oh, really.

**Mr. Charlie Penson:** So I think reliable information should be available to parliamentarians, and this process really is designed to help that.

Mr. Anderson, you spoke about that, I think, in that we would all be working from the same base at least. That doesn't mean there can't be errors in projections, because that's an uncertain process, but at least we have the same data to work from.

We had Mr. Drummond before us this morning as one of the witnesses, and he seemed to indicate that the switch to accrual accounting was largely the problem with this whole process, and it was the reason we've been so far out on the surpluses the last year or so. Now that they've gone to accrual accounting, we could be out billions of dollars—\$4 billion to \$5 billion a year easily—just on that basis. So I'd like to put it to the panel: what's your assessment of what he was essentially saying?

**The Chair:** I like Mr. Darby's expression, so I think you should answer first.

**Mr. Paul Darby:** I'm slightly puzzled. We had a sense that the movement to accrual accounting in fact should make it more transparent in terms of the budgetary estimates coming forward from the Department of Finance. Also, we had done a lot of our work based on Statistics Canada information on a national income accounts basis. We've always had estimates of the surplus and debits on a national income account basis as well, and when we went to a public accounts basis, it was kind of tough sometimes to make that transition. We all applauded the movement to accrual accounting, because we felt that would get us closer to the national income accounts figures and make our relationships between national income account drivers like GDP or income and the outcomes on the fiscal side more transparent, and we felt that modelling relationship would be easier to handle.

Now, there may be some issues around the switch from one system of accounting to the other that could cause problems in the year that switch is made, but that presumably is only a one-time problem. So I'm not actually sure without getting more information from Mr. Drummond where he's going, but frankly we applauded generally the movement toward accrual accounting.

**Mr. Charlie Penson:** I wonder, just before you leave, if once you've had a chance to maybe look at what he said, you could help the committee with some analysis based on looking at what he said.

**Mr. Paul Darby:** I would be pleased to do that.

**Mr. William Robson:** I have just a quick comment on that. I think that moving to accrual accounting certainly does present additional areas where judgment is required, but most people would say that accrual accounting is good for that reason, because it gives you the tools to present a financial picture that's more in line with economic reality; and I'm in that camp. I think the move to accrual accounting did make sense.

I would infer from what you've said, not having heard Don directly, that he is talking about some of the new elements where judgment is involved. It goes with the territory. Cash accounting can be relatively straightforward, but there are situations where it can also be quite misleading, so I guess we're faced with a trade-off there, and given the choice, I'd support the accrual accounting.

**The Chair:** If I just may add, it wasn't a question of whether to be for or against accrual accounting. What happens is that with accrual accounting, especially when it comes to income tax revenue, they were getting the figures a couple of months after the year end. That's where the problem was. It was the first year the exercise was happening.

**Hon. John McKay:** It's all about timing.

**The Chair:** That's right.

**Mr. Charlie Penson:** Mr. Chair, I want to follow up with Mr. Darby.

You were here as part of our team on fiscal forecasting on February 22. The estimate you had for this year's surplus at that point was \$9.1 billion, I believe. I think all of the forecasters had thought the equalization, \$2.8 billion, was going to be included in that forecast, and it's not. But there has been some late-March spending announced equivalent to that amount. I see the budget that just came out says \$3 billion. Where would you come down, given the latest information?

• (1655)

**Mr. Paul Darby:** We haven't updated, as you know. We're in the process of doing that now, or we'll start that, I guess, in a couple of weeks.

I would hesitate to scoop myself, in a sense. We will have a new economic projection. We'll have the most recent expenditure and revenue estimates from the government in its most recent budget, and we will undertake a new analysis with more recent information. A more definitive answer will be forthcoming. I think that's part of the beauty of this process, that every quarter we'll be updating the fiscal estimates based on the most recent information.

But not to duck the question, based on the information that we would have had at the time, when we did the last exercise, which was before the budget, we would have had a surplus estimate of roughly \$12 billion on the day heading into the budget. In fact, if you look at the spending estimates published in the budget, they were roughly \$5 billion more than what we would have, at that time, forecast. This, I think, gets to the issue of having the most recent and most up-to-date information available to us.

There was spending on tsunami aid. There was other spending that took place through the year that we weren't necessarily aware of. There was some last-minute spending that also took place in the year, which we weren't necessarily aware of, nor was Parliament, for that matter. All of this suggests to us that if you factor in that data, which we did not have, my budget estimate of roughly \$12 billion.... I'd have to take \$5 billion off that, and I'd have an estimate of close to \$7 billion, if we were to do it again with the good information. That compares, I guess, to their estimate of approximately \$6 billion.

So in some sense, it's not that far off. But again, it's hindsight, looking back and being aware of the roughly \$5 billion in spending that we weren't even sure was there.

**The Chair:** Thank you.

Monsieur Loubier.

[*Translation*]

**Mr. Yvan Loubier:** Thank you, Mr. Chairman.

First of all, I'd like to apologize to our witnesses for the parliamentary secretary's earlier comments, which were more in the nature of thinly veiled threats.

[*English*]

**Hon. John McKay:** Oh, Loubier, give it a rest.

[*Translation*]

**Mr. Yvan Loubier:** I find it rather disgusting to see him disregard the meaning of government, as he proved to us earlier. I'm prepared to undertake to verify if the government's position is the same as that of the parliamentary secretary, who is uttering thinly veiled threats about contracts that the Finance Department could potentially award to firms like C.D. Howe.

**The Chair:** I don't think any threats were uttered, Mr. Loubier. Please state your question.

**Mr. Yvan Loubier:** You appear to be very interested in issues such as democratic dialogue, transparency and so forth. I find it interesting that economic forecasters are concerned about these aspects of public life and democracy.

Would you not agree that by continuing to take the same approach as was taken eight years when the first surpluses were being recorded, the government is in fact leaving it up to a handful of people, specifically a few senior Finance Department officials, to define the nature and intensity of the democratic debate in which Parliament should engage with a view to identifying the real resources available to address the priority of the nation's citizens? Is that your vision of the future?

Given the parliamentary secretary's vision of the future, I realize my comments are rather blunt. However, most of the people seated at this table do not share his view. Nevertheless, we'll verify that with the government.

[*English*]

**Mr. Paul Darby:** Well, certainly I think the panel has indicated already that is indeed an important part of the benefit of having an independent forecasting agency, the sense that Parliament and the public at large would have information available to them on a more regular basis and in a more transparent fashion with respect to the amount of funds available to make policy decisions. I sense that we feel that's a fundamental advantage from having an independent fiscal forecasting agency.

That is certainly not the only benefit. I think the panel has underscored a number of benefits, including a longer-term view; an ability to question some of the relationships that are presented in the budget and to perhaps do some theoretical analysis of those relationships—which the finance department is not necessarily publishing or making transparent, for a number of reasons; education

of the public in terms of the budget-making process and how it works; and a greater ability to deal with risk factors, so we are not so wedded to a point estimate around the forecast, because you don't necessarily have to look like you have all the answers or because you won't necessarily be required to give a point estimate only.

There may be others that I'm missing, but I think those are all important advantages from having an independent forecasting agency. But there's no doubt that the first one, the one you've emphasized, is crucial to the workings of a democracy.

On a personal note, I can't tell you the extent to which we are energized and excited at the Conference Board—and I'm sure our other forecasting partners are as well, including Jim Stanford, I imagine—about this opportunity. We really see it as something that could benefit all Canadians.

• (1700)

[*Translation*]

**Mr. Yvan Loubier:** Mr. Robson.

[*English*]

**Mr. William Robson:** I would cite the example of the role recently played by the projections of the chief actuary when it came to the futures of the Canada and Quebec pension plans. It was very important to have that information out there, because it was something Parliament or the Quebec National Assembly needed to deal with over a timescale beyond that of one government. I think we were very well served by that.

The other comment I would make is to reinforce the point that it is difficult for the Department of Finance to talk in terms of probabilities. From the Department of Finance we want point estimates; we want single numbers, as Paul Darby was saying. But as for the numbers in the budget, where you have a \$3 billion contingency reserve and then \$1 billion, \$2 billion, \$3 billion, \$3.5 billion, \$4 billion, we don't know whether those numbers are realistic reflections of the risks, and we don't know what kind of probability to assign to our going outside that range. There are technical approaches to that, which are very difficult for the Department of Finance to make. I think an independent body could serve us very well in saying, "Based on the past surprises the economy has thrown up, how far above zero do we need to aim in order to have a reasonably small chance"—10% say—"of not ending up below it?" And then instead of relying on a single number, parliamentarians would be able to judge how comfortable we are with that: "Do we want it higher or do we want it lower?"

[*Translation*]

**Mr. Yvan Loubier:** I would have liked to ask another question about debt management.

[*English*]

**The Chair:** Ms. Minna, and then Mr. Bell.

**Hon. Maria Minna:** Thank you. I just have a very quick question.

[*Technical difficulty—Editor*].... Mr. Manley spoke publicly about the frustration of missing forecasts. But I want to say that I understand from the different presentations that the primary issue is not the forecast, but the missing of the revenue and expenditure part when we get to that aspect of things.

I think, Mr. Robson, you had mentioned earlier in your document shows that the estimate was \$2.8 billion but that we will end up with \$7.2 billion, and that this type of error could cost us in the future. I guess my question to you is twofold. One, how would a public entity help us in that sense specifically? And two, what in your opinion has actually been causing that, apart from intentional...which I don't think is the case? But what do you think is actually causing that problem?

**Mr. William Robson:** I think that over the last few years, part of the answer is simply that the momentum of the fiscal turnaround has been so strong that we've surprised ourselves on the upside. As you overachieve your targets on the budget balance, one of the things that happens is the debt drops faster than you expected and interest payments drop faster than you expected. So there has been a certain element of happy overachievement, at least from my perspective, of the original objective of balancing the budget.

The economy has surprised us positively. I've been taken by surprise. A lot of people expected that in the early 2000s we would go through a recession, as the U.S. was weaker, so again we were lucky there. So there has been that aspect to it.

Now, what does concern me, however, is that, as I say, if the economy is just taking you by surprise, you ought to see some offsetting fluctuations, and more recently, I think the nature of the fiscal targets we set ourselves has become a problem. We are setting ourselves up for a fall, in my view, and I know the rest of the panel would take a different view on some of this, because the federal government has been increasing spending very late in the day on a variety of programs. We may prove to be a bit unfortunate on that in terms of overreaching, if what Michael Mendelson was describing comes to pass before long.

I do have concerns about the longer-term fiscal outlook, and I would prefer to see a new kind of budgetary process, where we are able to confront realistically the fact that we know there are uncertainties. We have a sense of where we want to be, on average, but if from time to time we're taken by surprise, we let it happen. We don't feel we have to spend the extra money that comes in, and conversely, if the day comes when we have less revenue than we are expecting, I don't want us to be in a position where we're suddenly late in the year trying to pull all kinds of spending out of the system that again wouldn't have been necessary if we had been able to take the longer view.

• (1705)

**Mr. Michael Mendelson:** I'm not sure if this is a "right on" to the question, but let me just premise my answer by saying I'd like to make it clear that I am strongly of the view that this is not adversarial, and I mean that sincerely. I think we are blessed by having a very strong and high-quality Department of Finance, and I know many of the people there are very outstanding public servants. Many of them would do much better in the private sector if they

wanted to, and there is a terrific, dedicated group of people who work very hard.

Having said that, I've been in the position of writing budgets, and I know that governments of all stripes are constantly tempted to fudge the estimation, which is always uncertain in any case, in ways that will be most politically beneficial for the government of the day. Traditionally in provinces, the first budget at the beginning of a mandate is always talking about how disastrous the fiscal situation is, and at the end of the mandate it's always how wonderful the situation has become, and it's not necessarily the case that that's always reflecting objective reality.

Those kinds of pressures are real and they exist, and this government's approach in the last several years has been to be very cautious about its estimates. I think that looking at a pattern over a long term, it's hard not to come to the conclusion that there hasn't been a systematic underestimation. It's from different sources. And if I were in the Department of Finance and under pressure to ensure that I would overachieve each year, I wouldn't necessarily structure my overachievement in the same way. I wouldn't necessarily every year underestimate revenue. I might do it in different ways and build in my fudge factor, if I can call it that. I'd build it in in different ways. It's not like everybody would be sitting there saying "Let's lie. Here are the real numbers." It's just a matter of where you put your estimation. Is it at the low level of the probability or is it at the high level? It's those kinds of issues and those kinds of pressures.

So I think there is a role for an objective check and balance.

**The Chair:** Thank you, Mr. Mendelson.

I just want to give Mr. Anderson about 30 seconds.

**Mr. John Anderson:** I think that having another body allows for a better debate on those issues. I don't think it's necessarily going to solve the problem, and perhaps on some occasions that independent body may come up with exactly the same forecasts as the Department of Finance. That's fine too.

I would echo what Mr. Mendelson says. I don't think it's a confrontational process. But having an independent body is having a body that is going to think differently about the issues and doesn't have the same interests—which are very different for a government, which has particular interests. I think that allows us to get at some of the issues, as I said before, in a much less politicized fashion, and I think that's all to the good.

**Mr. Paul Darby:** Just to echo that quickly, if I could, Mr. Chair, in a situation, for example—speaking very practically and tactically—where we feel we're underestimating personal income tax collections on a systematic basis, it would be much easier for an independent body to address that in a theoretical fashion than perhaps the Minister of Finance, and it would be a healthy debate. That's an example of how that would improve the situation.



Secondly, let's be very careful. Yes, over the past, one could argue, it hasn't been so much the economic forecast as it has been the relationship between economic variables and the revenue and expenditure items. But there's nothing like wandering into a forecast that was made say six months ago, where you said it was going to be 3% growth and now you think it's going to be negative 2% because you're going into a recession, for that to entirely change. You want to get to know about that as quickly as possible, and you want to have all of those risks on the table very early. There's nothing like a 1981 into 1982 recession to kick the entire fiscal structure out from under you.

• (1710)

**The Chair:** Thank you, Mr. Darby.

Mr. Bell.

**Mr. Don Bell (North Vancouver, Lib.):** Thank you.

My question was going to be for Mr. Robson, but I'll also address it to Mr. Mendelson because of your comments.

Mr. Mendelson, did I hear you say there hasn't been systematic underestimation?

**Mr. Michael Mendelson:** I said that there has been systematic underestimation. The evidence has been there time and again in the last several budgets.

**Mr. Don Bell:** I just wanted to make sure of that.

Mr. Robson, in your statement on page 2, in the third paragraph, you said, "The pattern of variances between budget promises and the results as reported in each year's public accounts are not random". Earlier this morning we heard from one of the presenters that there has been no one consistent source of error; the problem has been with updating fiscal forecasts. Then I heard the comment here today from Mr. Mendelson that economic forecasting is not the problem but fiscal forecasting is the problem. I'd like to hear from you on those contradictory comments.

**Mr. William Robson:** I think there have been times when the economy has taken us by surprise, and mainly the variances you see between what the budget said was going to happen and what actually turned out are simply a function of the fact that the cycle surprised us on the upside or the downside. That certainly has been the case in the past.

I am concerned that the tendency, as has recently been the case, for spending to grow but otherwise adapt to however much money is available is a problem. That indicates that you're not really setting clear-headed priorities ahead of time and then rolling with the punches as you seek to achieve them; instead, late in the year you're typically, in recent years, adding to spending in a way that clearly is going to allocate resources differently from what you would have done if at the beginning of the year you'd been sitting down, say, in a group like this and deciding what you wanted to do. So I think there are real consequences of the approach to fiscal forecasting we have now.

I don't want to overstate the ability of an independent body to fix this problem for us. But it seems to me that having gotten the public debt problem we had under control, we're now in a position to say we should now be more flexible about the bottom line and have a

sense of where we want to be on average. An independent body like this can help us think about the risks on either side of it in a way that the Department of Finance simply can't do because they, by their nature, have to commit to a single-point estimate. I think an independent body that can talk realistically about the risks on either side would put Parliament in a better situation to decide how big a surplus we should aim for, if indeed we should aim for a surplus at all, and what exactly is the level of risk we're comfortable with.

**Mr. Don Bell:** This is my final question. If you have a body like that, how do you minimize the potential for philosophical bias? Whether you draw those people from the C.D. Howe Institute or the Centre for Policy Alternatives, you're going to get philosophical differences as to how that information is interpreted, whereas the Department of Finance follows the philosophy of the government in power.

**Mr. William Robson:** I have a partial answer to your question. In many of the instances we're talking about, you can look at the past. How big have the ups and downs in the economy been? How much have interest rates tended to move year to year? That gives you a sense of what your range of error is. There are other sources of bias in forecasts, but I think that alone can help us go a long way to where we want to be simply by giving us some kind of empirical base for deciding what the risks are.

**Mr. Michael Mendelson:** I'd like to add my two cents to that. I believe it is possible to build an institutional culture that will be non-partisan and will attempt to build its views as constructively and empirically as possible. But it will take some time. It will be up to Parliament in establishing the parliamentary budget office to set the stage for that kind of institutional culture to be built. My evidence that it can be is the CBO, which I think has managed to maintain a non-partisan perspective even though it has had partisan leadership from time to time over many years, and it is a respected institution.

• (1715)

**Mr. John Anderson:** Haven't we done that in Canada with the Auditor General's office in a different area to build that kind of independent culture?

**Mr. Don Bell:** Thank you.

**The Chair:** Just on that note, when we're working on the fiscal forecasting, should economic prudence or a contingency reserve be included in those numbers? Who should decide what that amount should be?

Thirty seconds each.

Mr. Robson.

**Mr. William Robson:** I don't like the way we're doing it now. I think it was good while we were digging ourselves out of a hole, but at this point I would like to see a specific target for a budget surplus justified with regard to the risks on either side.

For example, to put a number on it, say we wanted to have only a 10% chance of running a deficit. Work through the numbers. What does that mean we should aim for in a surplus? That would justify it differently and create a very different dynamic from what we face now.

**The Chair:** Mr. Mendelson.

**Mr. Michael Mendelson:** I think that's a choice for the government of the day to make, but I would urge that they do it in a transparent way so the real number is the real prudential factor. If it's \$8 billion, let it show in the budget as \$8 billion. If it's actually \$4 billion, let it show as \$4 billion.

**The Chair:** Thank you.

Mr. Anderson.

**Mr. John Anderson:** We don't have all the information on the table to make those judgments right now. I would also repeat that right now that contingency reserve is connected to debt reduction, and I'd like to decouple that.

**The Chair:** Thank you.

Mr. Darby, I think I can answer your question. We had not included it in the....

**Mr. Paul Darby:** We had not included it.

**The Chair:** That's right. Thank you.

Thanks again for your time. It was interesting.

The meeting is adjourned.

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