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Chair

Mr. Massimo Pacetti

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•(1110)

[Translation]

The Chair (Mr. Massimo Pacetti (Saint-Léonard—Saint-Michel, Lib.)): Good morning, everyone. We are going to get started now because it appears that Mr. Lapointe's presentation is quite long.

We are here pursuant to Standing Order 108(2) to study federal fiscal forecasting. We have with us Mr. Lapointe, Mr. DeVries and Mr. Rochon, all three of whom are from the Department of Finance. Welcome.

You have 30 minutes, but it would be appreciated if you could go faster, if possible.

Mr. Paul-Henri Lapointe (Assistant Deputy Minister, Economic and Fiscal Policy Branch, Department of Finance): I will go as fast as possible, Mr. Chairman.

First, I would like to thank you for inviting us to appear before the Standing Committee on Finance.

I am going to briefly introduce the colleagues who are with me here today. Peter DeVries is the General Director in the Deputy Minister's Office, and Paul Rochon is the Director of the Fiscal policy Branch.

[English]

What I would like to do is go over three things. First of all, very quickly, I'll give you an overview of the forecasting process we follow. Then I want to turn to the risk we are facing when we update our fiscal projections, with a discussion of the recent forecasts by the four private sector economists who appeared in front of this committee a couple of weeks ago. I will end with a few comments on the CBO.

[Translation]

First, I am going to say a few words about the forecasting process. When we update our fiscal projections, we first undertake a survey of private sector economists. We do that survey on a quarterly basis. We get their forecasts of economic growth, GDP growth, as well as inflation, interest rates and other significant economic variables. The average of those forecasts then serves as the basis for our own fiscal projections.

Then—and this is something we do every fall—we meet an advisory group made up of the chief economists from the banks as well as the heads of four Canadian modelling firms. We discuss with them the findings of the survey of private sector economists and the economic risks they foresee. When fiscal data from the previous year

are available, we discuss our interpretation of the results, as well as the latest fiscal developments in the current year.

We then have to make an allocation. For example, we get data from the private sector on nominal GDP growth. That then has to be allocated into its various components: corporate profits, wages, etc. This part of the process is quite important. We then use that data to run models that generate our fiscal projections on a national accounts basis, and then we convert those fiscal projections into public accounts projections.

In the fall, we use the four private sector models to translate economic assumptions into fiscal projections, and we take an average of those projections. We then convert those figures to a public accounts basis, and then we report that in the fall update.

For the budget, we translate the economic assumptions into fiscal projections ourselves.

[English]

Once the budget is tabled, we regularly follow the economic developments during the course of the year. The main economic event, if you want, is the release of the first quarter national accounts at the end of May. Why it is important is because Statistics Canada also makes a revision to the estimate of economic growth for the previous year. That helps us and, in fact, particular economists as well to understand the current economic development, but more importantly, the outlook ahead.

We also of course review the national accounts that come out during the remaining part of the year. The second quarter national accounts, released at the end of August, will serve as the basis for the fall update, and the third quarter national accounts will serve as the basis for the budget.

•(1115)

We also monitor monthly economic indicators such as employment, unemployment, and retail sales, for instance, and international trade numbers.

On the fiscal side, the key development is of course the final fiscal results for the year that ended at the end of March. If we do better, we have to assess how much of that is due to one-time factors and how much of that is due to other factors that suggest this will continue this year and into future years. That helps us interpret the fiscal results of the current year as well.

We also look at the monthly fiscal results that are reported in *The Fiscal Monitor*. The fiscal results are important not only because of what they might suggest for the outcome for the year, but they are also an indication sometimes of the revisions Statistics Canada is going to make to the economic release they have done. It's because Statistics Canada will often look at the fiscal numbers as an indication of the strength of personal income, for instance, of wages and salaries.

When we do the fiscal update in the fall, we normally have the results up to September—for the first six months of the year, therefore—while for the budget, depending on the time of the budget, we have the results up to November or December.

As part of our ongoing monitoring, we meet regularly with the CRA to discuss revenue developments. We maintain regular contact with the Office of the Comptroller General in Treasury Board as well as the Office of the Auditor General in terms of assessing the provisions for liabilities. We monitor departmental spending against the parliamentary authorities, and finally we maintain contacts with crown corporations because their books are consolidated with the government financial statements, so it is important that we know how they are doing and how that is going to influence our fiscal results.

Just to show the importance of the monthly monitoring and the caution we have to exercise when we look at the monthly results, I'll illustrate this with the corporate income tax revenues. Corporations are required to remit monthly payments based on last year's tax liability or an assessment of the current year liability. For corporations that have their financial year ending in October, mainly the banks, if their profits have exceeded the estimate they use as a base to give their monthly payments, they have to make an adjustment. They have to give us what we call a settlement payment that comes in December. Non-financial corporations, mainly, that have their financial year ending in December will remit the settlement payment in February or March.

As a result of this, a lot of the corporate income tax revenues will come in the last three or four months of the year. If you look at the last four months, for instance, you will see that the corporate income tax receipts in the last four months can represent almost 60% of the receipts for the total year. In some years it could be as low as a little bit above 35% of the total year corporate tax receipts. We have to be careful how we interpret the monthly numbers because of these settlement payments in those months.

One point I should make here is that these payments are made within the fiscal year. They are not made in the coming year, as Jim Stanford suggested in his presentation to this committee recently.

Let me now turn to risk management and the risk we are facing when we develop the fiscal projections. First of all, I'll just give you a reminder that the budget balance is the difference between two large numbers. When we do fiscal projections, we rely on fiscal forecasting. We know economists can sometimes be wrong about the economic outlook; we have to translate these economic forecasts into fiscal projections, and there are a number of steps we have to take here. That could also bring some variance between fiscal projections and economic performance. Then we have the accrual accounting adjustment we have to make as a result of this.

• (1120)

As you know, based on the results of last year, we had total revenues we reported of \$186 billion and spending of \$177 billion. But in fact the revenue base we have to forecast is higher than this because the federal government collects taxes, PIT, on behalf of nine of the 10 provinces, for instance, CIT for six of the 10 provinces, and so on. We also collect the CPP premiums as well, so the base on which an error can be made is larger than what is often believed.

On the spending side as well, the spending in the budget is reported on a net basis, but for forecasting purposes we have to look at the gross spending. The total base of revenues and spending we have to forecast would amount to a little over \$150 billion, as you can see on this chart. A 1% error on the wrong side would mean a swing in the budget balance of \$4.6 billion, more than the total of the contingency reserve and the economic prudence.

One other point I want to make is that some people have argued that for the revenue-to-GDP ratio, a reasonable working assumption for forecasting purposes is to assume it is stable for the time. But with an economy of \$1.3 trillion, a one-tenth of 1% error in that ratio would translate into a revenue change of \$1.3 billion, so a small error in projecting the revenue-to-GDP ratio would mean a substantial error in the budget balance. As the next chart shows, the revenue-to-GDP ratio is not stable. It has fallen substantially since 1999-2000 as a result of the tax reductions, and it declined slightly in the following years as a result of further tax reduction, partly offset by the strength of the economy.

Let me now turn to the economic forecast uncertainty associated with the economic forecast.

• (1125)

[*Translation*]

As I said, we use the average of private sector forecasters. Economists have a great deal of difficulty in predicting turning points within an economic cycle, as well as spurts in economic growth. In times of rapid expansion, economists tend to underestimate economic growth.

As I was saying earlier, the economic data that economists use for their projections are subject to fairly significant historical revision. It is hard to predict what is going to happen today if you do not have an accurate reading of current or recent economic developments.

The composition of income also has to be taken into account. As I said before, the private sector economists give us a figure for economic growth. However, for the purposes of fiscal forecasting, you need to have an idea of the distribution of, among other things, corporate profits and wages as well as consumer and investment spending. These factors influence tax revenues.

To illustrate these changes, I would point out that between 1997 and 2004, corporate profits as a percentage of nominal GDP have grown by 4.7 per cent. This figure may seem quite small, but in the current economic context, that represents a difference of about \$60 billion more. Furthermore, the share of wages and investment income has gone down. Because the average tax rate on corporate profits is far higher than the average personal income tax rate, a change like that is definitely going to contribute to faster growth in our revenues.

This slide shows the projections of private sector economists and the published figures. For example, in the 1994 budget, the economists predicted economic growth of 4.4 per cent for that year. In fact, the nominal income growth was 6 per cent, a difference of 1.6 per cent. If you take the average of all 10 years, you can see that growth has been underestimated by around 1 per cent per year. The same phenomenon applies to interest rates, but there is less of a difference in this case, except for certain years, like 2001.

As I said earlier, translating our economic forecasts into fiscal forecasts is another source of uncertainty. The first thing I should point out in this connection is that the private sector economic projections are based on the national accounts. However, it so happens that in the national accounts, given the goals of that accounting, neither pension income nor capital gains are included. Both of these, as you know, are extremely volatile. So if you go only by income growth on a national accounts basis, in periods of significant capital gains, growth in the tax base will be underestimated. The opposite occurs when there are capital losses.

[English]

Then there is the issue of translating the national accounts projections into public accounts.

Here, just quickly, is the distinction between the two accounting systems: the public accounts are designed to show a comprehensive statement of the financial position of the government's financial activities, while the national accounts are the measure of the current production and income generated by different sectors in the economy, personal and government, throughout the year of business.

I will highlight some of the main differences between the two accounting systems. One is the universe of the national accounts. The national accounts would exclude some crown corporations that are included in the public accounts because they depend to a significant degree on funding from government.

• (1130)

There are substantial differences in the treatment of capital assets. The national accounts would not include provisions for legal liabilities. For instance, aboriginal liabilities would not be included in the national accounts.

The national accounts would deal with foundations and trusts. They would report the transaction when the trust or the foundation remitted a payment to the ultimate recipient. In the public accounts we account for the transaction when the government makes out a cheque to the foundation or to the trust.

In the public accounts we also take into account employee benefit liabilities such as the cost of health care and veteran benefits. We have to account for the full cost of these benefits, not on a pay-as-you-go basis.

Then there are revisions to the national accounts we have to take into account when we translate one into the other. A good example of this was the last fall update, when we had to make adjustments to the national accounts. We have to continuously look at the two concepts and make a reconciliation between the two estimates.

Then we have to take into account the reaction to tax changes such as the provisions in the current tax system that allow individuals or corporations to delay tax payments. A main distinction between our approach and that of the CBO is that when we do introduce a tax reduction, for instance, we will account for the cost but we will not take into account the possible response of individuals to the tax reductions, because there is no economic model that will tell you the magnitude of the response and the timing of the response. I think the Americans have learned from past experience that this can lead to very bad results. Look at the experience under Reagan, when they were expecting substantial additional revenues from the tax reductions, revenues that never materialized.

We also have to take into account how much individual Canadians are going to contribute to their RRSPs, because that will affect the tax at the end of the year.

Finally, on the corporations, there is a provision in the Income Tax Act that allows losses to be carried forward for 10 years and carried back for three years. What this does is really weaken the linkage between profits and the tax payable during the year.

There is a large stock of unused losses, which we now estimate at \$120 billion. The difficulty in linking the accumulated losses to profits is that the corporations that report profits in one year may not be the ones that had accumulated substantial losses in the past. It's hard to make a connection between the losses carried forward and the profits during the year.

Just to illustrate the absence of a close correlation between the economic base and the tax receipts, we can look at the GST. As you can see from the last column on this chart, the "Tax Base", the growth is relatively stable but there is large volatility in the GST received during the year. That results from the fact that there is not a one-for-one matching between the gross receipts and the refunds we have to make on the basis of the input credit that companies will claim. There is a wide variation in GST revenues as a result of this.

●(1135)

The final category of risk I want to flag comes from accrual accounting and the fact that we have to recognize revenues when they are earned, not when the cash is received. In the case of personal income tax, we get a lot of cash in the period of April and May, and that money would typically belong to the previous year, so we have to make those adjustments during the course of the summer.

Just to give you an illustration of this over the last few years, this chart shows the year-end accrual adjustments we have to make to personal income tax. As you can see, it ranged from a negative of \$5 billion in 2001-02 to a positive of \$3 billion for last year. That certainly introduces a significant element of uncertainty when we look at the monthly numbers and we want to project what the final outcome is going to be for the year.

The other revenues are primarily reported on a cash basis, but again, we have to make adjustments up to the end of May to make sure the cash belongs to the right fiscal year as well.

Then we have to recognize liabilities, as I said earlier, that are not recognized in the national accounts. That covers environment, aboriginal liabilities, and legal cases. We have to make provisions for loans and loan guarantees, and we have to make adjustments every year for the liabilities associated with employee benefits in the federal public sector.

Here are some very quick comments on the results from last year. When you look at the difference between the outcome and the forecast in the budget, you see the bulk of it came from the higher-than-expected revenues. PIT came in at \$1.4 billion higher, corporate income tax at \$1.5 billion, and other revenues at \$1.3 billion. Spending was \$2 billion lower, primarily for direct program spending resulting to a large extent from departmental lapses.

If you look at the numbers we had when we did the budget forecast in March 2004, you see we were assuming we were projecting growth for the year as a whole of 2%. It came out at 4.7%. When you look at the details, you see on the personal income tax we had growth to the period up to January of 1.6%. We were expecting we would do somewhat better in the remaining months of the year, but we did even better than this, and I mentioned earlier the accrual adjustment we had to make, which amounts to \$3 billion for last year.

Corporate income tax revenues were up 24.8%, largely because of large settlements we got from the bank sector in December; we were not sure exactly what the source of those large settlement payments was.

We were looking at profit growth of about 10% in 2003. We projected growth of 16.7% on the basis of this, but the outcome was better than this; corporate income tax revenues were \$1.5 billion higher than expected.

The GST was coming in much lower than it had the previous year, again because refunds were growing faster than gross receipts. We were expecting some reversal of this. In fact, there was a reversal and it was more significant than was expected at that time.

●(1140)

“Other revenues” as well, largely from crown corporations, were running slightly above what was experienced the year before, and we were expecting this would unwind in the remaining months of the year. The opposite happened. We had further growth in the other revenues, largely from the lower provision against loans for crown corporations.

Let me jump to the recent forecasts presented to this committee as compared to the budget forecast. You can see that the Conference Board and François Vaillancourt are both expecting a much larger surplus in 2004-05, 2005-06, and 2006-07. The CCPA expects a much larger surplus, 7.2% and 7.4% higher.

Their forecasts all take into account the January fiscal results. The January fiscal results would show growth in revenues of 7.1% compared to the 5.2% we have in the budget.

Personal income tax has been running higher than expected, at 7.3%, but it is because of the one extra remittance period in January, and we expect it will unwind in the coming months. We think 5.5% growth in PIT is still quite a reasonable estimate for the year.

The corporate income tax is very much in line with what we expect in the budget.

The goods and services tax is coming in higher, again because refunds are growing at a much slower pace than gross receipts, as we point out in the budget. We expect it will be reversed in the coming months, but if it isn't, we are going to do better this year but worse next year because the refunds will come in at some point, and it will be either this year or next.

“Other revenues” are growing at 10.2%, reflecting to a large extent the sale of Petro-Canada, which was a one-time event.

With the appreciation of the Canadian dollar, which will depress the gains on foreign exchange, we expect growth of 8.6% for the year.

If you look at the spending side, you see the elderly benefits are very much in line with what we expected. Employment insurance benefits are very slightly weaker than what we expected. The big difference is in the transfers to provinces and direct program expenses. The thing to note here is that the results up to January do not reflect the health care and equalization payments as a result of last September's and October's agreements, nor do direct program expenses reflect the other measures that were announced in the budget, which will be reflected when the legislation is passed.

I'll turn to each individual forecast, starting with the Conference Board's. What is noticeable here is that we have somewhat higher PIT revenue this year, but very much the same in 2005-06 and weaker in 2006-07. They have stronger corporate income tax revenues, reflecting their estimate that corporate profits will be stronger than what was expected at the time of the budget.

They also have "Other revenues" somewhat higher, despite the fact that they have an appreciation of the Canadian dollar in their forecast. I think they have assumed that other revenues, when excluding the sale of Petro-Can, will grow in line with the nominal GDP, but we believe that will of course be weaker as a result of the smaller gains on foreign exchange.

• (1145)

One thing to notice—and this is noticeable with other forecasts as well—is that they have EI premiums lower but EI benefits even lower than what we have in the budget. Given the budget announcement and the assumptions of the approach we have been taking that revenues would match benefits, there is some inconsistency here. If they expect benefits to be that much lower, their EI premiums should also be lower to reflect the fact that—

The Chair: Monsieur Lapointe, on the next three or four, maybe we could just go quickly through them, because we're going to run out of time.

Mr. Paul-Henri Lapointe: Perhaps I should move to the next one.

They're showing a much higher surplus in 2005-06 and 2006-07. You will see that it is essentially due to the higher corporate income tax revenues they have estimated. Just like us, they are expecting weaker growth in corporate profits, but they are assuming fewer accumulated losses will be applied to corporate profits in the next two years. The assumption is that at this stage of the cycle the accumulated losses have been used up. As we have seen earlier, this is not the case, so I think their forecast is clearly at risk here, keeping in mind the validity of the corporate income tax revenues as well.

[*Translation*]

I am now going to say a few words about François Vaillancourt, who made projections for four components of income and used the budget projections for all other components, including expenditures. What is remarkable here is the growth in personal income tax. These projections show a \$5 billion increase in revenues in 2004-05, and \$4.7 billion in 2005-06.

The next slide shows that his projections far exceed those of the other forecasters. That is explained by the fact that in converting his national accounts projections into public accounts projections, he used an adjustment factor of \$3.4 or \$3.5 billion. That adjustment, which we applied in the update, is no longer appropriate today.

• (1150)

[*English*]

Mr. Charlie Penson (Peace River, CPC): Mr. Chairman, I have a point of order. I know this is good testimony we're getting and a good presentation from the finance department officials, but I'm concerned we're running out of time here for questions, which is the main purpose, I think, of having officials here today. My understanding is that you asked for a half-hour presentation, and

we are running long here. I'd like to move to the questions by the members, Mr. Chairman.

The Chair: Well, we started 15 minutes late because the members came in late. We haven't had a presentation like this, and because of the complexity of the material, I think it's worth our while. If we have to, we'll have them come back to answer our questions, but I think it's worth listening to the presentation, because they've put an effort into it—

Hon. Maria Minna (Beaches—East York, Lib.): I would like to hear it, certainly.

The Chair: —and it's going well.

Monsieur Lapointe.

[*Translation*]

Mr. Paul-Henri Lapointe: I will take five minutes at the most.

I would like to make another point about Mr. Vaillancourt. The next slide shows quite a marked difference in EI premiums. Mr. Vaillancourt attributes this drop to measures in the last budget. However, to my knowledge, there were no such measures that would justify a reduction in EI premiums for 2004-2005. As you can see, his estimates regarding EI premiums for next year and for 2006-2007 are far lower than the average of the others.

[*English*]

I'll finish up by very briefly talking about the CBO, because I know there is a lot of interest here in the CBO. As to what the CBO does, as you know, it's an independent office that provides advice to Congress. They also produce biannual updates of the ten-year economic and fiscal projections. They do analysis of the present budget, they cost all the spending for the legislation and measures that have been passed by Congress, and they provide analysis of the monthly fiscal results.

But when you look at their forecasts compared to those of the OMB, which is the administration's forecaster, there is not that much difference. Some years they do better; other years they do worse. If you compare the two bars on the graph here, on average they have not done better than the OMB. During the period up to 1999-2000 they both understated the surplus; the following three years they both understated the deficit, and last year they overstated the deficit.

Finally, I'll just give you a sense of what is coming in terms of updating and finalizing the numbers. We are going to look at the March results; they will be available in early May. We will be looking at the cash balance for the whole year. In April and May we are getting the tax-on-filing payments and making refunds, all of which we are going to assess during the course of the summer. In late summer we are going to do the accrual adjustments, and once the numbers have been finalized, they will be reviewed by the Auditor General. They will be reported in the annual financial report in mid-September to early October, and the final results are typically presented in the *Public Accounts of Canada* later in the fall.

I want to thank you for your attention.

• (1155)

The Chair: Merci, Monsieur Lapointe.

Mr. Penson.

Mr. Charlie Penson: Thank you, Mr. Chairman, and I'd like to thank the finance department officials for being here with us today. I know you've had long and distinguished careers in finance, and that's an important part of public service.

I hope, Mr. Chair, the officials here will recognize the process we're going through to try to be better informed as parliamentarians, so that we have numbers we can work with in terms of making public decisions that are important to Canadians. The Parliament numbers, as I like to call them, will be important to us.

I also want to acknowledge the officials' help on quarter four results. I think that's important and I hope we can continue to have that cooperation as we move forward with this process.

Mr. Chairman, my time is short, so I would like to move quickly. I have basically three questions for Mr. Lapointe.

First of all, I'd like to know what you think will be the timing of the final data for the fiscal year just ended.

Maybe I'll give you all of these questions and you can work through them. To establish a historical database going back, we would ask you to revise the fiscal reference tables for 2004, basically going to a gross accounting basis so it shows the breakdown. We'd like you to go even further back if possible, but 2003-04 would be important to us for greater transparency on expenditure and revenue breakdown.

I'll stop there and see if I can get you to answer those two questions.

Mr. Paul-Henri Lapointe: The final data would typically be available toward the end of August or in September, because as I said earlier, we have to work throughout the summer, looking at the accrual adjustments we have to make on the tax side—tax revenues and liabilities, for instance—and the numbers have to be reviewed by the Auditor General. In some years we have experienced some delays, especially since we moved to accrual accounting, because it has involved a degree of complexity we were not used to. I would say it will be the end of August or early September for the final data.

In terms of the details you described, they will be provided in the *Public Accounts*, and they would typically be available in late October.

Mr. Peter DeVries (General Director, Deputy Minister's Office, Department of Finance): Actually, Mr. Chair, there's a 10-year summary in the *Public Accounts* with the numbers on a gross basis.

There was a comment made by the Auditor General that she felt the presentation of both gross and net numbers was confusing in the *Public Accounts*, so we decided last year that the *Public Accounts* would only include gross numbers. If you go to volume I, section 1, of the *Public Accounts*, you'll see a 10-year summary that has the numbers on a gross basis for all components of revenues and all components of expenditures.

Mr. Charlie Penson: Thank you.

Mr. Lapointe, you were talking about the final numbers having to take into account the accrual adjustments. How big a factor is that in terms of those adjustments? Are we talking 10%? What are we talking about in terms of percentages? What's the give and take here?

Mr. Paul-Henri Lapointe: You saw last year that the adjustment we made on the personal income tax side was a plus of \$3 billion. We have to make other adjustments post-March 31 to other components of revenues such as GST and corporate income tax. On the spending side, we have to assess what commitments departments have made before the end of March and how much of the budget authorities they had last year they are not going to use, and that is also done during the course of the summer. Last year's lapse was about \$3.5 billion, so it gives you a range of the kind of adjustment we are talking about.

Then we have the provisions we have to make for liabilities, such as environment, aboriginal court cases, and provisions for serving loans. Some years they will be positive. If, for instance, we had expected a liability on an issue that has been resolved at a lower cost, then of course some of the provisions we had booked before will be unwanted. It's hard to give you a figure because it varies from year to year.

• (1200)

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

The other matter is—I'm just getting back to what you told us about the *Public Accounts* being available—what we're looking for is the adjustment to the fiscal reference tables. That's what we're requesting.

Mr. Paul-Henri Lapointe: Oh, it will be done typically with the annual financial report.

Mr. Peter DeVries: The key element, Mr. Chairman, is that it does take us a fair amount of time in order to prepare and finalize the results. As Mr. Lapointe said, they have to be audited by the Auditor General of Canada, and normally her opinion on those numbers is not available until early September.

The reason for the delay largely relates to the accrual of the tax numbers. The Canada Revenue Agency begins to process the personal income tax data based on their May 31 assessment, so they have to wait until after May 31 before they have access to the files, which they normally would not get until late June or early July. Then it takes them at least four or five weeks to process that data to come up with an accrual number and then have their office, as well as the Office of the Comptroller General and the Office of the Auditor General, audit those results. That's why there is some time lag between, say, March 31 and when we're actually in a position to publish the numbers sometime in September.

Mr. Charlie Penson: That's helpful. Thank you very much.

The other question I have is, what problems might you see as we move forward as a committee if we try to establish an independent forecasting office here? We know of a couple of other jurisdictions that have that. Do you see any pitfalls? Do you see any problems we might encounter along the way, Mr. Lapointe?

Mr. Paul-Henri Lapointe: I will say in all modesty that whoever does the forecasts—I went through the risks we are facing here, and we saw the experience with the CPO—there will always be differences between the forecast and the outcome, so one should not have too high expectations that—

Mr. Charlie Penson: I agree with that, Mr. Lapointe, but we know from talking with the people from the CBO that they would be out high as much as they would be out low. It's not always one way. So yes, forecasting bodies can be out just by their very nature, I understand that, but it's not always one way.

Can you see any problems? In the United States, what they do is they have an act that directs their administration to provide raw data to the CBO. Is that something we would require here?

Mr. Paul-Henri Lapointe: We are more than willing to work with whoever does the forecasts and talk to them in terms of how we interpret the results, just like they would do in the U.S.

At budget time it was difficult, if not impossible, for us because of the workload we were facing.

We'll see what Tim O'Neill recommends. Part of his mandate is to look into ways to improve the forecasting process and the forecast.

Mr. Charlie Penson: When do you expect the report?

Mr. Paul-Henri Lapointe: We expect the report sometime next month.

The Chair: Thank you, Mr. Penson.

Monsieur Paquette, and then I have Ms. Minna.

[*Translation*]

Mr. Pierre Paquette (Joliette, BQ): Thank you, Mr. Chairman.

Thank you for your presentations. It is always very educational to have your point of view.

Before coming back to the main topic of debate, I would like to ask two technical questions.

I have noticed that in fiscal forecasting, growth is calculated based on the GDP price index. In the last few years, that has always been lower than the consumer price index. We know that wages are

negotiated based on the consumer price index, which has increased by about 2 per cent. That leads to an underestimation of nominal growth. I observed this when Mr. Manley did his update in Halifax. At the time, there were problems with SARS and fires in British Columbia, and Mr. Manley decided to reduce real growth without touching the inflation rate. That is why we ended up with a much bigger surplus than forecasted.

I understand that in order to calculate nominal growth macroeconomically, you have to use the consumer price index. However, it seems to me that this creates a bias when it comes to calculating the tax base. For example, because the Canadian dollar is strong, the exchange rate currently favours a decrease in inflation rates and in the GDP price index.

I would like to know how you handle that situation. I have noticed that in the case of at least two budgets, this has given rise to a major underestimation of income growth.

• (1205)

Mr. Paul-Henri Lapointe: In determining the tax base, it is important to use the most global price index possible. That is why the GDP deflator index is the appropriate one. Clearly, some years, it grows less quickly. For example, if the prices of raw materials drop, it is highly likely that the growth of the GDP deflator will be smaller. This method give a much better reflection of the growth in the tax base than if we were to use the consumer price index. The CPI is but one component.

Mr. Pierre Paquette: I agree with you. However, perhaps a price index should be developed specifically for budget purposes rather than using the GPD price index. You mentioned that raw materials did not necessarily have any effect on the growth or lack of growth of the tax base. I would suggest that you look into that. I can tell you that in Mr. Manley's case, I would have been able to forecast the surplus exactly because I used the consumer price index instead of the other index that year. The phenomenon was confirmed the following year as well.

On page 6, you refer to the budgetary balance and the difference between two large numbers. I guess you raised that point to show that in terms of both revenues and expenses, it is not always easy to predict everything. In terms of revenues, we can see that there was a significant underestimation. As for expenses, are those the gross expenses following the decisions made in subsequent budgets?

For example, Mr. Chrétien announced at the first ministers' meeting in January 2003 that if there were a surplus, \$2 billion more would be spent on health. Was that amount attributed to the budget to which it should have been attributed?

Mr. Paul-Henri Lapointe: It was fiscal year 2003-2004.

Mr. Pierre Paquette: When that is inflated, it distorts the comparison somewhat. When the government knows at year end, in March, that there will be additional surpluses, the time has clearly come to solve certain problems. We have seen that with Mr. Martin.

Knowing that there will be additional surpluses has the effect of inflating gross expenditures after the fact. By the same token, that reduces unforeseen surpluses. Taking the analysis further, I would like to eliminate the effects of political decisions made after the fact. The same thing happened this year in Mr. Goodale's budget.

The following question is more fundamental. The International Monetary Fund published its report last March. That report stated that among the countries of reference, Canada had the highest average error in its budget forecasting and that it was the only country that systematically significantly underestimated its budget balances. How did you react in the department to this statement by the International Monetary Fund? It is a recent report: it came out in March 2005.

Mr. Paul-Henri Lapointe: First of all, I have to say that I thought the International Monetary Fund did an excellent analysis of forecasting processes and comparison of the performance of various countries. I think that will be very helpful to Mr. O'Neill when he prepares his report.

It is important to note that the International Monetary Fund made a number of comments, the first being that in the past seven years, Canada's economic growth has regularly surpassed the forecasts of both public and private sector economists. It also noted that the Canadian economy, more than those of the other countries considered, is exposed to significant volatility, due in part to its greater dependence on raw materials.

In comparing these countries to one another, it also noted that those that are subject to greater volatility tend to be more cautious in their economic and fiscal forecasting. There is some logic to that. Canada's performance proved better than everyone's prediction for this period. As I said in my presentation, growth was underestimated, but the fact that the situation is more volatile here than in many other countries that do economic and fiscal forecasting should give cause for caution.

• (1210)

Mr. Pierre Paquette: The budget already takes that into account. We have a contingency reserve, and even added an economic prudence fund. That should normally mean that prudence is factored into the evaluation of those reserves. They grow, in my view somewhat artificially, year after year, hiding the size of the surpluses. However, your answer suggests that ultimately, misfortune has struck the department. In recent years, the forecasts of the Bloc Québécois and even of the Canadian Centre for Policy Alternatives have always been more accurate than those of the department when it comes to the surpluses. By that, I do not mean that this has always been so. You have been more unlucky than we have.

Mr. Paul-Henri Lapointe: Clearly, some have had better results than we have. That is precisely why we review our forecasting methods: to see whether we can improve our economic projections.

That said, I come back to what I was saying earlier. We have been through quite a unique period: there has been very strong growth coupled with increasing corporate profits. As I mentioned, the tax

rate is higher than in other sectors of economic activity. Who could have predicted that corporate profits would reach a higher level today than in the past 30 years? In short, a series of factors have had a beneficial effect on the budget situation.

The Chair: We are already at nine minutes.

Ms. Minna.

[*English*]

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

Thank you for coming. I learned quite a few things today, especially if you compare that with what the forecasters we've been meeting have said.

I wanted to take you back a little bit to the forecast from the Canadian Centre for Policy Alternatives. They seem to me to be the most positive or higher in terms of having larger surpluses, more than the other forecasters, and over the last 10 years they seem to have been fairly consistent and fairly accurate, at least as far as their forecasts of our surpluses are concerned. I wanted to ask you a couple of questions with respect to their projections specifically.

Another was, if you could, clarify a bit further your comment with respect to corporate income. What we heard Stanford say was that the corporate payments and taxes continue for a few years after the actual corporate income or the corporation's economy starts to go down a bit. If you could, explain that a little as to how that happens—and in fact is that the case? Do you expect that to happen in the way they've made that assumption or not, or are they overestimating that? It's hard to tell who's....

Mr. Paul-Henri Lapointe: There are two things he says I would take issue with. I talked in my presentation about the settlement payments the corporations make if they have underpaid during the course of the year. His assumption is that the settlements will take place the year after, and that is not the case. They take place during the current fiscal year. You cannot count on corporate income tax revenues coming in stronger because you think profits are coming in stronger and therefore corporations will have to make large settlement payments. They occur in the current fiscal year.

Second, he makes the argument that, given the state of the business cycle we are in where we have had several years of fairly strong corporate profits, corporations have used up their accumulated losses for tax purposes. Therefore, even though corporate profit growth may slow down in the coming year, they are going to pay more taxes for profits they report through the year.

You saw the numbers on the accumulated losses. They are still huge, so I don't think we can count on the assumption the average tax rate on corporate profits will go up in the coming years as a result of the fact that corporations have exhausted their accumulated losses. It is not the case.

• (1215)

Hon. Maria Minna: I go back to this particular organization because it's the one I have followed a little bit more in the last number of years. My question to you is, what would you base their accuracy on? What would you say has caused them to be so accurate, apart from the corporate taxes? Is that the only difference?

Their last presentation to us and the ones before have consistently said the main reason we underestimate our surpluses as a government is that we are not accurately estimating the income and expenses. It's not the GDP or other core data; it's the income and expenses we are not estimating accurately.

Those are the points they've made, and as I said, in the past they've been consistently more accurate in the surplus crystal-balling, if you like, or at least in the analysis than—

Mr. Paul-Henri Lapointe: I acknowledge the fact that on average he has done slightly better, but I would like to note that he has clearly overstated how much better he has done. When you look at his forecast, typically around the budget, what he does is compare his own forecast on a status quo basis before the budget measures to our budget forecast after the budget measures. So we are comparing apples and oranges.

If you remove from the budget projections the initiatives that are contained in the budget, the difference between the two forecasts is not as large as he claims; it is much lower than what he claims. But I acknowledge the fact that on average he has done better.

I think his assumption has turned out better, that the revenue-to-GDP ratio would not fall despite the tax reductions we've had. In the end, he was closer to the truth because of what I would call the good fortune of a strong economy and, as was mentioned earlier, the change in the composition of income toward components on which we apply greater tax rate than others. So I think this is a good part of the explanation.

I don't know if Peter or Paul would want to add anything to this.

Mr. Peter DeVries: Yes, Mr. Chairman, I want to add one thing to it.

As Mr. Lapointe indicated, beforehand they would present their numbers, but at a highly aggregate basis. Normally we would get three lines—total revenues, total program expenses, and public debt charges—and you could never see underlying those numbers what was causing the numbers to do what they were doing.

I think one of the benefits of the exercise this committee has undertaken is that now we see the details of his forecast, and in looking at the details of his forecast, it's much easier now to analyze why he's assuming what he is assuming. I think, as Mr. Lapointe pointed out, in the current round he is assuming some very extraordinarily strong growth in corporate income taxes based on what we believe are two faulty assumptions.

Now, at the end of the day, it may still turn out that corporate income tax revenues are going to come in a lot stronger than what we're forecasting. But if it's based on what he said to this committee last April, then I would be suspicious. If it's based on the assumption that corporations are going to have huge settlement payments next year or in this current fiscal year because they under-reported last year, that's not the case, because as Mr. Lapointe said, those settlement payments are made within the fiscal year, not between fiscal years, and the same thing with regard to the loss carry-forward provision.

I think one of the big benefits has been able to look into his forecast to see what assumptions he is using and then being able to question those assumptions.

• (1220)

Hon. Maria Minna: I have one last question, and it's really more of a comment.

Given the fact that, as you said earlier, if we are 1% off, you can be \$4 billion off, or what have you, and that's a big difference. So maybe the issue is not so much the accuracy of pinpointing the actual forecast right on the dot, but what we do with the surplus once it happens.

We now have a system where we say the surplus automatically goes to debt reduction. Canadians are saying, look, we have a lot of other issues we'd like to apply it to, and the Auditor General at one point said it didn't necessarily have to go to debt reduction. Maybe it's how we treat that surplus and the legislative mechanisms that are needed to deal with it as opposed to worrying so much about pinpointing the accuracy, but deciding how we deal with the surplus. That may be more of a policy issue, but maybe there's a question there.

Thank you.

The Chair: Thank you, Ms. Minna.

Mr. Pallister.

Mr. Brian Pallister (Portage—Lisgar, CPC): Thank you, Mr. Chairman.

Thank you, gentlemen, for being here. Your presentations were most worthwhile.

I think this whole exercise has been most worthwhile. It has provoked a discussion that we haven't had in the past and that we need to have in the future. Having Parliament's numbers to generate a response from you, and so you can tell us why they're wrong or right, or why you disagree with them or agree with them, is worthwhile because Canadians have been deprived of a chance to have the debate about what to do with this under-reported surplus for a long time.

So I have a remark to make and then I'll go to a question. My remark would be this. If you were wrong one year—and you spent quite a bit of time helping educate us on why it's difficult to project numbers—I could understand that. I understand that better now than I did before the presentation, frankly, and if you're wrong two or three times I might even be able to understand that, but when you're so consistent—as the IMF has reported, we're the most consistent at this—at under-reporting surplus, when you're so consistent it just doesn't.... You haven't explained to us why that is. That reflects a bias.

I don't know if you golf, but if you've ever been involved in a Texas scramble—it's a best ball thing—you might have four people on your team, and if you're putting and the first guy hits a putt and it goes hard left and the second guy hits it the same way, you'd question his accuracy, but if the third guy did the same thing, you'd question his intelligence, and then the fourth guy, you'd say he was just trying to miss on purpose. I think really that's where we're at here. It's an issue that you're trying to miss on purpose.

So I want to ask you, when did this become policy? When did we decide as a country we were going to deliberately be on the conservative side in our projections?

Mr. Paul-Henri Lapointe: I should note that the fiscal objective of the government is not to balance the budget on average over ten years; the target is to balance the budget every year. So this is why we build prudence into the contingency reserve, and when we look at individual components, we try to make a best assessment of what can be reasonably assumed.

Just to refer to the year-end adjustment on personal income tax, we have three years' worth of observation since we moved to accrual accounting. So we don't have a long track record on which to base our assessment. So we have to come up with a best assessment.

• (1225)

Mr. Brian Pallister: Prudence in what contingency? Prudence in contingency is kind of like an insurance policy to make sure we don't go into deficit, and the price for this is that by under-projecting surplus we lose the ability as a country to debate what we could have done with that money. Is that a fair analogy?

Mr. Paul-Henri Lapointe: I would not go into this. What I'm trying to describe is how we do our fiscal projections, and as I said, we have a contingency reserve in prudence to deal with economic events, to deal with unexpected changes in how we translate economic into fiscal projections.

When we look at the details, we have to make assumptions. To give you an example, in the last budget, coming back to the corporate profits that are running at a 30-year high, you can make the assumption that it will continue to grow or it will stay there. On the best assessment we could make, we had assumed that it would slightly come down in the coming years. We may be wrong, but this is the situation we are facing. There is a lot of uncertainty. We are making the best judgment we can make about where things are going to turn out, and we may be wrong or we may be right.

Mr. Brian Pallister: To carry the analogy further, a very high percentage of the putts that don't get to the hole don't go in. I've heard it's as high as 90%.

So the fact of the matter is that your contingency projections and so on, your conservative policy, is depriving Canadians of... For example, the agricultural lobby may say it wants more help for BSE, and the government will plead poverty on the basis of numbers that are radically lower, projected numbers, than would actually have been the case. That would be accurate to the last eight or nine years.

My concern is how we get more accurate numbers more quickly, so let me ask you that. That's where I want to go with this. You referred to lags in economic data and so on, and we're looking for updated numbers as soon as we can get them so we can have a fulsome discussion on where we're going, and you mentioned lags of two months, or three months, or so. What kinds of resources do you need to give us more accurate data sooner—for example, within a period of a month? What kinds of resources would that require? I'm curious.

Mr. Paul-Henri Lapointe: We depend on Revenue Canada, on Statistics Canada, to base our economic and fiscal projections. There are constraints as to the speed and quality of information you can get, and certainly in the world there are things that can be improved,

there's no question about this, but there is a limit. We are always going to be faced with imperfect data, available with some lags. There are little things we can do about this. In some cases, perhaps, we can get access faster to some data, but it is of poor quality as well.

So I'm not saying everything is perfect, that nothing needs to be changed, because we do make changes. Last year, for instance, we decided in the last year to follow the crown corporations more closely, because they were a source of surprises in the last couple of years. So we hope we are going to get more timely information as to what their financial situations are and how—

Mr. Brian Pallister: We'd like to be able to get some information on some of the crown corporations too.

Thank you.

The Chair: Thank you.

Mr. Bell, and then I have Mr. Côté, and then Mr. Penson.

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

If you go back to slide 21, the conceptual differences, you talked about the universe of public accounts. Could you take me through that again, just the beginning of that part there, the treatment of capital assets?

Mr. Peter DeVries: With regard to the universe, the government of course for its financial statements includes all those entities over which it has control, and so in that context all the enterprise crown corporations such as EDC, such as CMHC, are included as part of the government's overall financial statements, as well as all of the crown corporations that are appropriated crown corporations to whom we give money in order for them to carry out their mandate, CBC, VIA Rail, AECL, etc.

With regard to the national accounts, they only include those in the government sector to which the government provides at least 50% or more of their funding. So in the case of, say, VIA Rail, it is not in the national accounts universe as part of the federal government sector. Instead, it's part of the business sector. It's the same thing with CMHC, the same thing with EDC, the same thing with AECL. So that's one of the issues where we have to bring these in. When we do our projections on a national accounts basis, then we have to bring in these entities that they do not bring in.

With regard to the accrual of tax expenditures, the national accounts base their accrual adjustments on market value. The government bases them on historical value. So we have to do the conversion in that case.

With regard to the liabilities, the national accounts do not include any provisions for liabilities. So the government is on full accrual. It has recognized to date all of its estimated liabilities with respect to the environment, with respect to aboriginal claims, with respect to any legal case that is currently before the government. In the national account system, those are not recorded until there's actually a final settlement.

With regard to trusts and foundations, we book the liability in the year in which we make the commitment to those foundations to which we're going to give money, or trust. In the national account system when we transfer money, say to the provinces through a trust arrangement, they will record it only when the province receives it, which could be a year hence, or which could be three or four years hence.

With regard to foundations, as Mr. Lapointe said, national accounts only records it when the ultimate recipient receives the money, so in the case of a foundation, say the Canadian Foundation for Innovation, we book a liability to them in the year in which we establish that liability. Statistics Canada will record the economic event resulting from that when, say, the University of Toronto actually builds the new lab. So that could be quite some time into the future.

• (1230)

Mr. Don Bell: I suppose that's the area to question. So then it's really hard to follow the flow of that money then, because it doesn't get recorded until it's actually expended. Is that right?

Mr. Peter DeVries: That's right. On a national accounts bases, that's what happens.

Mr. Don Bell: So it isn't related then. Because of the time lag, there isn't an annual accounting, I would guess.

Mr. Peter DeVries: There is annual accounting in the sense that the information is available from the Canadian Foundation for Innovation when they actually transfer the moneys to the ultimate recipient. And this goes back to what the purpose of the national accounts is. The purpose of the national accounts is to record the impact on economic activity. The purpose of the public accounts is to provide a set of financial statements to Parliament based on the appropriations and the legal authorities for that which the government had received in the course of the year.

Mr. Don Bell: That answers my question, thank you.

The Chair: Thank you.

Monsieur Côté.

[Translation]

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

Thank you very much. I am going to read all of this documentation very carefully; it was a bit late in getting to us.

Like Mr. Pallister, we are astonished to see that year after year, there are differences among forecasts, whereas those of the Bloc Québécois and other economic organizations have been much more accurate.

You mentioned earlier that the government was not in the business of planning 10-year budgets, but that it did so one year at a time. With all due respect, I would point out that in the last budget, the projections cover five years. The government's projections are not just for the current year, they also attempt to establish a budget framework for the next five years.

Naturally, it is rather disappointing to be singled out by the International Monetary Fund as the worst country in terms of

forecasting among the countries of reference. The errors are such that last year, for example, we went from 1.9 to \$9.1 billion. In addition, this phenomenon occurs systematically. Some witnesses, including the independent forecasters who work for the Standing Committee on Finance, have clearly shown us that in terms of spending, the department's projections were quite accurate, in fact. Things are going quite well there.

However, given that we are talking about economic variations here, I would like to know how it is that only revenues are systematically underestimated. It is not just that the bottom line showing the budget surplus is not right. The amount of spending is almost always accurate, but revenues are always understated. How do you explain that?

• (1235)

Mr. Paul-Henri Lapointe: I would like it if you were right in saying that we make mistakes only with respect to revenues; however, I must confess that we also make some with respect to expenditures.

To come back to revenues, as Mr. Peter DeVries was saying earlier in reply to another question, in the past it was difficult to compare ourselves with private sector forecasters because, very often, we did not have enough details. At the moment, the exercise we are carrying out in cooperation with private sector economists has the advantage of giving us more details about their financial projections.

When I look at the presentations made by these individuals two weeks ago, I do see, of course, that their surplus projections are higher than those in the budget. The first thing that strikes me is the fact that there are considerable discrepancies between the projections, however, what strikes me even more are the details. One of the forecasters projected revenues from corporate income tax that were much higher than those forecast in the budget. They were about 20 or 25 per cent higher. Similarly, the projections made by another forecaster were lower than those in the budget. If we look at each revenue component, we cannot say there is a consensus. I think this is a very clear illustration of the difficulties faced by forecasters when they make financial projections of this type.

There is no unanimity.

The Chair: Mr. Penson, followed by Mr. Loubier.

[English]

Mr. Charlie Penson: That's very helpful, and I think what you're saying is very important. Yes, each of these forecasters has a different forecast, but wouldn't you agree, Mr. Lapointe, that having timely information or timely updates is important to all of us, including you?

Mr. Paul-Henri Lapointe: There's no question about that.

Mr. Peter DeVries: One of the reasons we publish *The Fiscal Monitor* on a monthly basis is to at least provide some information out there on an ongoing basis as to what is happening.

Mr. Charlie Penson: Yes, and that's helpful, Mr. DeVries, but I would suggest that the presentation of our finances as a country isn't quite as clear as it might be. You've mentioned *The Fiscal Monitor*; we have a whole number of things Canadians look at, and it is a bit confusing: the budget, *The Fiscal Monitor*, the *Public Accounts*, the fiscal reference tables, and the annual financial report. If we could get a better standard, it would let us understand that better.

Here's an example of the transparency we're looking for. In the budget document itself that was just presented, I would ask, why doesn't your department show personal income tax on a gross basis, and why is the child tax benefit not shown as an expenditure?

Mr. Paul-Henri Lapointe: Well, we do provide a breakdown between gross and net in the annual financial report, and we show the numbers on a net basis in the budget.

But this is something we are looking at to see whether we should show the revenue and the spending numbers more on a gross basis in the future. This is something we are very much looking at right now, to have a consistent presentation from one document to another, even though right now the annual financial report provides reconciliation between the budget and the public accounts.

• (1240)

Mr. Charlie Penson: Mr. Lapointe, I agree with that, but the problem is that it's quite a bit later. Isn't it a year later? So that's not so helpful.

I think you're probably going to deal with the other side of that question, the child tax benefit, as well.

Mr. Peter DeVries: I'll maybe just add one thing to that. You will recall that in the fall update we did provide a full reconciliation between the national accounts numbers and the public accounts numbers. In that reconciliation we did list the Canada child tax benefit as one of the reconciling items, so we did provide an update there.

The reason we present the numbers in the budget on a net basis as we do is that it's the way Parliament has authorized the government to spend its money. The child tax benefit is actually part of the income tax system. Now, is that a good reason? But that's how it is. It becomes part of a tax expenditure, not part of direct program spending.

It's the same thing with the goods and services tax credit. It's netted off the GST. The reason it's netted off the GST is that it's a rebate, just like any of the other rebates that are part of the GST system.

Even, say, the appropriations Parliament gives to the government are on a net basis, so cost recovery revenues received by departments are netted off their total appropriations. That's how Parliament approves the appropriations to departments, and that's what we're reporting in the budget.

Mr. Charlie Penson: I'm sure that's entirely accurate, but it does make it confusing. A lot of people would ask why the child tax benefit is not regarded as an expenditure. Well, that explains it.

I think this is a very useful process we're going through, and I'm happy that you folks from Finance see this as beneficial as well.

In other jurisdictions where they have a sort of checks and balances system, it doesn't mean that either one of those budget offices—for example, the Congressional Budget Office or the administration's office in the United States—has it exactly right, but at least they have a chance to see what the other one is doing. The administration provides the data that is required for the Congressional Budget Office in order for them to have pure numbers to work with, and I think that would be beneficial.

Mr. Chairman, those are all the comments I have.

The Chair: Thank you.

Monsieur Loubier.

[*Translation*]

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

Good afternoon, Mr. Lapointe, Mr. Rochon and Mr. DeVries.

You are well aware of my great respect for you, Mr. Lapointe. You know that I very much admire your work, your experience and your contribution. As I was listening to you earlier, it occurred to me that there was something wrong somewhere in what was said. You say it is a good thing that economists have been hired, because, by making comparisons, we can see that there are significant discrepancies. However, the discrepancies are not all that large. *Global Insight* was completely off compared to the others. However, if we look at the average of the others, we do come up with something quite solid.

You say that you too find this interesting and enlightening. Why did you not do this before? You choose five forecasters, you remove the most optimistic and the least optimistic forecast, you keep the other three and you take an average. You could have done the same thing at the Department of Finance. When, after two or three years, you saw that things were not working and that you were not able to make accurate forecasts, you could have done exactly what we did: call on some forecasters, eliminate the figures that were too high or too low and keep the average.

Second, you say that the major economists are consulted quarterly on macroeconomic parameters such as interest rates and GDP growth. I believe you, but the use you made of this information seems to have caused major problems since 1997-1998, in particular, when the first surpluses were recorded. I do not remember exactly which year it was, but I remember that one year, when the budget was tabled—these were quarterly projections—over three years, there were three zeros entered for the federal government's surpluses. That made no sense.

I sometimes wonder whether you have not been swallowed up by the political machine. The Minister of Finance did not want any debate about the surpluses and the real leeway he had, and he dragged public servants into this political manoeuvre. What happened is technically impossible. Between 1997-1998 and 2003-2004 alone, a surplus was recorded at the end of each fiscal year. The cumulative total of this surplus is around \$70 billion.

In addition, if we look at the new initiatives, year after year—and one year earlier we had been told that there was no surplus—we see that the new initiatives such as reduced income taxes and investments of all types by the federal government amounted to \$140 billion. One hundred and forty billion dollars plus \$70 billion makes a total of \$210 billion for the period from 1997-1998 to 2003-2004. I think that is a major error. You are very cautious with respect to each revenue item. However, I think there is something wrong somewhere in the arguments you are putting forward. I would prefer that you tell me that there was some political control somewhere, because that I would believe a little more readily. This in no way diminishes my respect for you and for your competency, but I find this illogical.

• (1245)

Mr. Paul-Henri Lapointe: I will not discuss your arithmetic, but we could talk about that at length.

Mr. Yvan Loubier: I am quite prepared to talk about that.

Mr. Paul-Henri Lapointe: I can only repeat what I said earlier: Canada's economic performance has surprised many people for the last several years.

I recall, for example, that when we prepared the budget in 2001, just after the events of September 11, all economists were very pessimistic about economic growth in 2002. There had already been a dip in the economy worldwide, and people expected that the events of September 11 would have a significant impact on economic growth.

And we did see quite poor economic growth in the next quarter. However, after that, an absolutely phenomenal recovery surprised everyone. Economic growth was 2 per cent higher than we had predicted in 2002. We had a number of surprises of that type.

I was also talking about the growth in corporate profits, earlier. We were all somewhat surprised by that. We are talking about this at the moment with other economists in order to better understand the phenomenon. The fact is that the income tax on corporate profits are higher, and this contributes to our revenue growth during this period of economic growth.

You may tell me that this could be luck, but there was a series of factors that resulted in a number of pleasant economic surprises.

I was saying earlier as well that our objective was to balance the budget each year. In order to maintain this objective, we include the contingency reserve and economic prudence. When we look at each of the expenditure or revenue items, we have to decide which hypotheses are the most reasonable.

Yes, we do make some mistakes in some cases. However, a number of factors resulted in some positive surprises in recent years.

Mr. Yvan Loubier: You had some surprises in the seven years I mentioned. We even had the surprise one year—and I forget exactly which year that was, time goes by so quickly—there were problems with SARS—

• (1250)

Mr. Paul-Henri Lapointe: That was in 2003.

Mr. Yvan Loubier: ... and Asian Flu. There was everything. In 2003, that's right.

Despite all of that, surpluses abounded and turned your 1.9 into 9.1. So there were signs that the situation was not all that bad. As a matter of fact, every time the Minister of Finance does his economic update, there are always two or three economists the next day who say that it's exaggerated, that the surpluses are going to be far greater. Some throw out figures, and some figures are closer to the truth.

I asked you a question earlier: how is it that for one budget—I think it was 2002—there was a forecast for the next three years where three zeros were marked down for the surpluses. That looks like a bit of political illusion.

If you tell me that the minister didn't step in and ask you to tone down your projections and present the most pessimistic scenario, I'm going to have a hard time believing you.

Obviously, you're not going to tell me everything today. However, I know that the then Minister of Finance as well as the ministers who followed him, Mr. Manley and Mr. Goodale, are not people who really enjoy discussing options, the leeway the government has, because they would raise a lot of expectations.

If you give me an explanation like that, I will accept it, and in terms of follow-up, we will be more rigorous. Otherwise, it's incredible and surreal.

The Chair: Quickly, please

Mr. Paul-Henri Lapointe: The three zeros you referred to are due in part to measures included in the budget. As I was saying earlier, there is the contingency reserve and economic prudence of one billion dollars for the first year, which increases to three billion dollars in the third year. So it is not three zeros.

You seem to be suggesting...

Mr. Yvan Loubier: [*Inaudible*]

[*English*]

The Chair: Mr. Penson, just quickly.

Mr. Charlie Penson: Mr. Chair, I know I said I was finished, but I can't help but jump in here on this.

Mr. Lapointe, the reason we're all here today is that there's a serious credibility problem over the surplus issue, and it's growing. Mr. Loubier talks about your projections of zero for the planning surplus for the next five years. Given the history of the last seven years, this is the type of thing that hurts your credibility. But it's not just yours; everybody involved is tainted in the process...the private sector average consensus, all of that.

My point is that at a time when we've had corporate malfeasance run the gamut in this country, it's important for government officials to be as credible as possible. Therefore, we simply have to get a better handle on this. That's one reason we're asking for a budget forecasting model we can use ourselves. Surely the department has to recognize there's a credibility problem here.

Mr. Paul-Henri Lapointe: I simply mention again the review that is under way, and we are certainly looking forward to seeing the recommendations of Mr. O'Neill. Yes, the forecasting methodologies can be improved; the question is to determine how they can be improved, and we're hoping that as a result of Mr. O'Neill's report we can find ways to do our job better.

The Chair: Thank you, Mr. Lapointe.

I think the government has made it very clear that they're expecting a positive balance sheet or a positive turn in the government's numbers. Is that not part of your answer? I think the government has made it very clear in the last few years that we don't want to go into a deficit position, that we want to be in a positive position. Has that not been clear?

Mr. Paul-Henri Lapointe: I think the target is a balanced budget or better, and this is backed up by the contingency reserve and prudence. The government is not targeting a surplus. The fiscal anchor is to maintain—not to go back into a deficit.

The Chair: My question is, how do we turn this exercise into a positive one? I'm still a little confused as to whether we have the Finance officials work with this independent body. Do we set up a budgetary office? What would your recommendations be?

I know that last year with the economic update you did hire four independent consultants, but it seems that was under a temporary contract and it wasn't done for this year.

Mr. Paul-Henri Lapointe: This process goes back to 1999. What we did last year was provide in the fiscal update more details as to how we translate the fiscal projections that were given to us by the four modelling firms for the public accounts and as to what we report in the fall update.

[*Translation*]

The Chair: That's done once a year?

[*English*]

Mr. Paul-Henri Lapointe: Yes, it's in the fall.

[*Translation*]

The Chair: It wasn't done for the 2005 budget.

Mr. Paul-Henri Lapointe: No. We do that exercise with the forecasters from the four firms for the November update.

The Chair: How can the exercise be accurate if they are hired once a year for two or three weeks and given whatever numbers we want, or you want? How can the result be accurate?

• (1255)

Mr. Paul-Henri Lapointe: Here's what we do for the update: we give them the findings of the survey of forecasters, of the economic projections; we also give them details about the composition of growth between corporate profits and wages; and they then generate fiscal projections based on their models. That's for the update. All right?

Between the update and the budget, in December, we conduct another survey of private sector economists in order to get an update of their economic projections. We then translate those into fiscal projections.

Finally, in the budget, we generally provide an update, and in this budget we reconciled the budget projections with the projections in the fall update, which were based on private sector forecasts.

The Chair: Don't you think it would be helpful to use independent forecasters more often, perhaps quarterly?

Mr. Paul-Henri Lapointe: It's certainly something that could be contemplated. Once again, we are awaiting the report of Dr. O'Neill. He is examining all of those aspects: transparency, methodologies and access to the numbers.

The Chair: But the preference...

Mr. Paul-Henri Lapointe: Then we will see what the...

The Chair: Okay. What would the department's preference be?

Mr. Paul-Henri Lapointe: I don't want to take any position on the recommendations that Dr. O'Neill is going to make.

The Chair: Doesn't Mr. Lapointe have an opinion?

Mr. Paul-Henri Lapointe: I prefer to await the results of the report.

The Chair: Thank you.

[*English*]

Thank you.

On that note, this meeting is adjourned.

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