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Chair

Mr. James Rajotte

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● (1530)

[*English*]

The Chair (Mr. James Rajotte (Edmonton—Leduc, CPC)): I call this meeting to order. This is meeting 30 of the Standing Committee on Finance.

I want to welcome all of our colleagues back. I want to welcome our two very special guests to the first hour and a half of the session today.

Our orders of the day pursuant to Standing Order 108(2) are a study on the report of the Bank of Canada on monetary policy.

We're very pleased to have with us here this afternoon from the Bank of Canada, the governor, Mr. Stephen Poloz. Welcome back to the committee, Governor. We have the senior deputy governor, Mr. Tiff Macklem. Mr. Macklem, welcome back to the committee as well.

I understand, Governor, you have an opening statement. Then we'll hear questions from all members of the committee. Please begin at any time.

Mr. Stephen S. Poloz (Governor, Bank of Canada): Thank you very much, Chair. It's a pleasure to be here. I appreciate the opportunity for Tiff and me to be here to share with you some of the highlights from our recent economic outlook.

The bank, of course, aims to communicate openly and effectively so that Canadians know how we are achieving our mandate to promote the economic and financial welfare of the country. One of the best ways that we do this is by appearing before this committee and answering your questions.

I'll briefly discuss the bank's outlook for inflation, and then move on to our outlook for global and Canadian economic growth. I'll touch on some recent bank research and finish with trends that we are observing.

Inflation in Canada remains low. We expect core inflation to stay well below our 2% target this year, returning to target over the next two years. Total CPI inflation, however, will move closer to the target in the next few quarters due to temporary factors. Let me take a moment to explain.

We expect economic slack and heightened retail competition to keep core inflation below target until early 2016. At the same time, higher consumer energy prices and a lower Canadian dollar will contribute to total CPI inflation moving up.

Total CPI inflation will remain fairly close to target throughout our projection period. This is even as upward pressure from energy prices dissipates, because the impact of retail competition will gradually fade and excess capacity will be absorbed. When this happens, core inflation will gradually make its way up to 2% and catch up with total CPI inflation from below.

[*Translation*]

Let’s now move to our economic outlook.

Global growth should gather steam in the coming three years as the headwinds that have dampened growth dissipate.

Overall, we see global economic growth picking up to 3.3% in 2014, moving to 3.7% in 2015 and 2016. In Canada, real GDP growth is expected to average about 2.5% in 2014 and 2015 before easing to around 2%.

These numbers are essentially in line with the Bank of Canada’s January outlook, but they don't reflect the actual quality of the outlook, which has changed in meaningful ways, especially for emerging-market economies and Europe.

Growth in Europe is modest, but inflation remains too low, and hopeful signs of recovery might be stalled by the Russia-Ukraine situation.

China and other emerging economies are showing solid growth, although there are some growing concerns about financial vulnerabilities—specifically, increased market volatility in response to political uncertainty.

The economic recovery in the United States, however, is proceeding as expected, despite recent softer results largely due to unusual weather. In fact, private demand could turn out to be stronger than we had thought.

● (1535)

[*English*]

The issues Canada's economy faces are not unfamiliar to you. Competitiveness challenges continue to weigh down our export sector's ability to benefit from stronger growth abroad.

Given the importance of the export sector to an open economy such as ours and given the growing wedge between Canada's exports and foreign demand, the bank has deepened its analysis of the export sector, specifically non-energy exports.

By breaking down non-energy exports into a large number of subsectors, interesting facts and new trends emerge. To start, we're discovering that there are some subsectors, such as machinery and equipment, building materials, commercial services, and aircraft and parts, that are in line with their fundamentals, or in some cases doing even better than their respective U.S. benchmarks. This suggests that as the U.S. recovery gathers momentum and becomes more broadly based, many of our exports will benefit. The lower Canadian dollar will also contribute to the recovery of these subsectors.

Other subsectors, including auto and truck makers, food and beverage suppliers, and chemicals, will also be helped by a lower Canadian dollar, but this will be to a lesser extent since they are experiencing greater competitiveness challenges. Their recovery will be slower.

The big picture tells us to expect a gradual convergence between the growth rate of Canada's exports and that of the U.S. economy. This more granular research indicates that the wedge between exports and foreign demand will endure, and make no mistake: this wedge is real and it is large.

The good news is that we now know more precisely just where it is, with about half of our non-energy exports. The bad news is that these subsectors are doing worse individually than we thought before. This deeper understanding of our export sector is valuable, but it does not make us any less concerned about the challenges ahead.

Looking forward, we continue to believe that rising global demand for Canadian goods and services, along with the assumed high level of oil prices, will stimulate business investment in Canada and help shift the economy to a more sustainable growth track.

[*Translation*]

We continue to expect a soft landing for the housing market and Canada's household debt-to-income ratio to stabilize. Nevertheless, the imbalances in the housing sector remain elevated and would pose a significant risk should economic conditions deteriorate.

We are observing, anecdotally at least, an increased awareness of this risk. Consumers are showing responsibility; for example, homebuyers who opt to buy less house than they qualify for so they don't find themselves overextended if interest rates rise.

Banks, as well, are underwriting loans more carefully, ensuring that people can service their debts if rates go up. So, while the risk could be significant, we are comfortable that it is not outsized.

[*English*]

To sum up, the bank continues to see a gradual strengthening in the fundamental drivers of growth and inflation in Canada, but this view depends largely on the projected upturn in exports and investment. There is a growing consensus that when we do get home, interest rates will still be lower than we were accustomed to in the past. This is because of our shifting demographics and further, after such a long period at such unusually low levels, interest rates won't need to move as much to have the same impact on the economy.

With underlying inflation expected to remain below target for some time, the downside risks to inflation are important, as are the risks associated with household imbalances. The bank judges that the balance of these risks remains within the zone for which the current stance of monetary policy is appropriate, and as you know, we decided on April 16 to maintain the target for the overnight rate at 1.0%. The timing and direction of the next change to policy rates will depend on how new information influences this balance of risks.

Just before Tiff and I respond to your questions, I would like to take one more moment to say a few words about the man sitting next to me.

Tiff's contributions at the bank started long ago as a new recruit with a fresh master's degree in hand. I hired him then. His contributions throughout his career have been significant. At the bank, we'll miss him for his intellect and management skills, but we'll also miss a great friend to many, myself included. We can rest assured that Tiff's contributions to the financial welfare of Canada will continue as the dean of the Rotman School of Management, where he will be busy ensuring that the next generation of economists and business leaders are prepared to take Canada into a prosperous future.

Tiff did such a great job as senior deputy governor that to find his replacement we've had to split his position and look for two people to fill his shoes. I'm pleased to report that we will be in safe hands.

● (1540)

I look forward to introducing you to Carolyn Wilkins, our incoming senior deputy governor. Carolyn will oversee the bank's strategic planning and operations and she will share responsibility for the conduct of monetary policy.

I also look forward to working with our new chief operating officer, Filipe Dinis, who will be responsible for managing all of the bank's administrative functions.

With that, Tiff and I are happy to take your questions.

The Chair: Thank you very much, Governor, for your opening statement and your opening remarks. We appreciate that.

Also, on behalf of all the committee members, I want to thank Mr. Macklem for his outstanding public service to this country. We wish him very well. We've always appreciated him very much in committees. We do wish you all the best in your next endeavour, Tiff, and thank you.

Mr. Tiff Macklem (Senior Deputy Governor, Bank of Canada): Thank you.

The Chair: Members, we'll begin questions with Mr. Cullen, please.

Mr. Nathan Cullen (Skeena—Bulkley Valley, NDP): Welcome to both. Tiff, I'm new to this committee, but if I had known of this auspicious occasion, a watch from the committee would have been in order, but I see the chairman is far too frugal for such things, so words will suffice for today. Congratulations on your appointment to Rotman.

Mr. Tiff Macklem: Thank you.

Mr. Nathan Cullen: Thank you, Governor, for your introduction.

I have some initial questions and my colleagues will follow up on them.

I want to pull apart the difficulties you're mentioning in some of our export sectors. You made some distinction in the subsectors, ones that seemed to be responding and certainly connected to any improvement in the U.S., in particular, and others that are not so responsive.

Can you find a pattern in which to guide us in understanding this? Some of those subsectors, intuitively, I would have said benefited both, yet you pulled out auto, food and beverage, and some others that are not. You talked about competitiveness. I wonder if you could be a bit more explicit for us and, as best you can, describe what the risk entails, particularly about those subsectors which you believe will not be benefiting from any recovery south of the border.

Mr. Stephen S. Poloz: Yes, of course. I would call the member's attention to a background paper which we published on our website last week. It's a four- or five-page piece which summarizes this, so I'll attempt to bring out the highlights for you now.

The methodology is not very complex. It's that in our macro models we use to model the entire economy, exports are modelled as a single category or in resources and non-resources. There are still quite a lot of things that are inside the non-resource bucket.

What we've observed over the last 18 months to two years is a growing wedge between the fundamental drivers of our non-resource exports and how many exports were actually selling. Right now, we're at about $35 billion to $40 billion fewer exports than our models would have predicted at this time.

Looking beneath this into the 31 subsectors, we're able to find a number of sectors, approximately half, which in fact have tracked their drivers quite well. That means the error term that we're concerned about is more restrictive to a smaller group, although it is still about half of our exports.

One of the ones you've mentioned is the passenger cars and light trucks. It has in fact matched reasonably well with growth and demand in the United States, not too surprisingly given the integration of the North American auto market. However, it has not historically been sensitive to exchange rate movements and as well, what we know is that the new investments that have gone into that sector in the last two or three years have primarily been outside of Canada. We reach from that the conclusion that although that sector is doing all right at this stage, we are not expecting it to contribute to a major closure of this gap that we've seen emerging.

The sectors that we believe are going to lead the way are mostly tied to U.S. investment activity, which has been relatively quiet given the stage we're at in the cycle. The U.S. recovery has been primarily driven by consumer demand and a rebound in the housing sector. Companies have not really started in full bore to invest in behind that.

We believe, in fact we stated this belief about six months ago, that as the U.S. recovery broadened into the rest of its sectors including investment and government spending—not surprisingly, state and local governments have been very tight budget-wise for some time—those constraints are easing up and so you're getting almost all cylinders beginning to fire. As that happens, we will see a stronger export recovery in Canada for many of the sectors that have lagged.

● (1545)

Mr. Nathan Cullen: Again, I'm trying to understand. Forgive me, I'm new to this file. A $35 billion to $40 billion gap seems significant in terms of the estimations considering how important those estimations are in determining where your forecast grows.

I'm still struggling to understand why you suspect that these different sectors will make up that shortfall or that gap, the trend line will improve given the two conditions are more of a consumer led rally and some U.S. government easing on austerity.

Am I hearing you correctly?

Mr. Stephen S. Poloz: In fact, we don't expect that shortfall to be made up in the near term. Our forecast is based on us having gone down into this deeper level. That wedge will persist, but through time, the growth rate of our exports will converge on the growth rate of the U.S. economy. That will leave this wedge we've discussed in level terms that will persist until such time as the competitiveness challenges in those sectors are gradually overcome or they broaden into other markets. Or, I think the most important part will be that as new companies are created, they are almost certainly going to be exporters, and they will be brand new business for Canada.

Mr. Nathan Cullen: The bank continues its position on the, to quote your reports, "significant risk" in regard to household debt. I want to move topics for a moment. You say it's "significant risk should economic conditions deteriorate" at all. What specific economic conditions do you find you're most concerned about when considering household debt, which is at a historically high level in Canada?

Mr. Stephen S. Poloz: Yes, household debt is at a historically very high level, so we believe that under current conditions and under our forecast it is sustainable and that it will in fact gradually unwind to more sustainable levels as employment growth spreads and the rest of the economy gets firing.

Mr. Nathan Cullen: I'm sorry, but what is sustainable to household debt rates that we're carrying right now that will gradually ease?

Mr. Stephen S. Poloz: The household debt ratio is about 165%. Debt service, of course, is extraordinarily low because interest rates are very low at this point. Our belief is that as the economy continues to close the gap and recover, those ratios will gradually improve because exports will take the lead in economic growth.

However, when we say the risk is that if there's a deterioration in the economic outlook that would be a more fragile situation, what we're referring to is if there were another shock. Let's say the U.S. economy were to falter and slip into recession, or something happened in Europe to cause another global downturn. That would cause unemployment to rise in Canada, and that's when debt service becomes more difficult.

The Chair: Thank you, Mr. Cullen.

We'll go to Mr. Saxton, please.

Mr. Andrew Saxton (North Vancouver, CPC): Thanks to the governor and the senior deputy governor for being here today.

We also would like to thank the senior deputy governor for nearly 30 years of service to Canada and wish him well in his new responsibilities going forward.

Governor, you recently remarked on the bank's monetary policy report, wherein you noted that the performance of Canada's export sector is critical to economic growth, yet competitiveness challenges still exist for Canadian exporters' ability to grow abroad. Can you please expand on what those competitiveness challenges are?

Mr. Stephen S. Poloz: Yes. The competitiveness equation is something from a company perspective that includes a large number of things, but the economists usually narrow it down to the relative costs of production, and what goes into that mix is any movement in the exchange rate. That would determine the price that you're able to sell, let's say, to an American buyer.

The bigger picture of this story, as we discussed in a speech last week, is that the rise in Canada's terms of trade that has happened in the last five to six years has in fact been an important gift to Canada. It's primarily resource prices that are high, oil in particular. When foreigners are spending more money on the things we're exporting, that's just more money that gets spent in Canada.

One of the consequences of this is that it tends to carry with it a higher currency. I liken that to walking your dog on one of those stretchy leashes. The terms of trade are the owner, and the dog is the exchange rate, and it zigzags around it, but they eventually leave the park together. The footprints look like an economist's chart, which means.... So you get the idea. They tend to be related over the long term.

The fact that our terms of trade today are about 25% higher than they were on average in the 1990s is a very significant development. It means approximately 7% more income in aggregate for Canada as a whole. This is pretty significant. One of the consequences of that, and one of the ways that gets spread around, is that the Canadian dollar goes up with it.

If you're a manufacturer in that mix, you have two things happening. The U.S. had this massive downturn, so you lost perhaps 40% or 50% of your export orders, on top of which the Canadian dollar drifted up over the course of that recession, because the price of oil was still rising. Those two things made it very challenging for that sector. As the U.S. cycle comes back, that's half the problem. The other half remains for our companies that over a long term have not been able to overcome those conditions with stronger productivity growth or other cost-saving measures.

That's why we say that about half of our export sector is labouring under that deterioration in competitiveness, and it for sure will take longer for them to gradually rebuild that, possibly through finding new customers in other growing markets, in Asia and so on.

● (1550)

Mr. Andrew Saxton: Would you also say that a lower tax burden on Canadian businesses, in particular Canadian exporters, also helps to make Canadian exporters more competitive internationally?

Mr. Stephen S. Poloz: Yes. As I said in my introduction, the competitiveness equation includes a lot of elements. Anything that costs a company money, whether it's a form of taxation or red tape or logistical connections, all of those things, if they're made better, then of course contribute to the overall competitiveness of the sector. But no single thing could be pointed to as the most important, except perhaps the relative productivity growth rates between ourselves and our competitors, and Canada has historically been lagging in that respect.

Mr. Andrew Saxton: Okay, thank you.

The G-20 recently met in Sydney and they pledged to raise the global GDP rate to 2% through their removal of impediments to growth. These measures include the removal of trade barriers and the expansion of free trade agreements such as our government's recent agreement with the European Union and also with South Korea, as well as the potential with the Trans-Pacific Partnership. In fact, it's also important to note that since coming to government in 2006, we've signed free trade agreements involving over 40 countries.

To what extent will expanding Canada's international trade have on contributing to economic growth and job creation here in Canada?

Mr. Stephen S. Poloz: Well, I believe that's a very fundamental contributor to that set of opportunities for companies. The Sydney declaration is intended to be aspirational. The fact is that in most countries, fiscal policy has done what it can, monetary policy has done what it can, and growth across the world remains, to some degree, disappointing relative to where we think it could be. So, as a group, the G-20 declared that they would bring other measures which are, if you like, removing impediments to growth, such as adding a free trade agreement removes tariffs, removes impediments to growth, to raise the potential for the world by about 2% in level terms over this five-year period, so, say, roughly, .04% per year.

I think that's a reasonable aspiration. It's been demonstrated through simulations with very complex models at both the IMF and the OECD, and Canada certainly has an opportunity to participate in that.

● (1555)

The Chair: You have one minute.

Mr. Andrew Saxton: Thank you, Chair.

In a recent speech, you noted that Canadian households across all age groups were getting wealthier despite the financial crisis and the great recession. Could you please expand on these findings for the committee?

Mr. Stephen S. Poloz: Yes, in fact Canadians have managed to continue to build their balance sheets through this. We know, just as a casual observer, that Canada managed the crisis better than most countries, although, of course, we had a down cycle, but it was not as big as other countries'.

As well, as many households own a home, we know the average price of homes has gone up and so there's been a wealth effect from this. Stock markets are strong. All those things go together to build up the wealth balance sheet for Canada's consumers.

I mentioned before about the terms of trade and it's a 7% increase every year in income for the country, which is very significant, and of course, it hinges on the maintenance of those high energy prices.

The Chair: Okay, thank you.

Thank you, Mr. Saxton.

Mr. Brison, please.

Hon. Scott Brison (Kings—Hants, Lib.): Welcome, Governor, and Deputy Governor.

I have a question on the potential of a housing bubble in Canada because the perspective outside our borders, from groups like the Economist Intelligence Unit or Paul Krugman or the OECD, is very different from that which I receive from Canadian banks. The OECD believes that we're vulnerable to a price correction, yet the banks are quite sanguine about the whole thing.

How would you explain the delta between the perception of housing valuations outside of Canada among these experts and the perception of the Canadian banks, and where do you fall in that, or who's right?

Mr. Stephen S. Poloz: I would say that in a sense there's a degree of truth in all of that analysis, as usual. It's important that we start there.

Hon. Scott Brison: What did you expect?

Mr. Stephen S. Poloz: Many of the metrics that one uses to decide whether or not a market is overvalued may be quite relevant for what we would say are normal times. Then immediately one realizes that we are not in normal times. In fact, our response to the crisis has been one in which interest rates went to extraordinarily low levels, and part of that policy prescription is that people will buy more houses, or buy them sooner in their life cycle. That has, to a degree, bid up prices across existing homes.

That situation, as we discussed a moment ago, we believe is a sustainable one and is in prospect of a soft landing, provided the rest of our forecast comes true. Nevertheless, as we say in our report, this is a vulnerable situation. So, yes, if there were a downturn in the economy, a rise in unemployment, that sort of thing, we would be vulnerable to some sort of price correction in the housing market. The banks, I'm sure, when they say they are sanguine, it's because they know that the quality of their underwriting has been very strong, that in Canada people don't normally simply walk away from their home because the price may have gone down. Prices have gone down from time to time in the past. It would not be the desirable outcome, but it would be one in which the economy could be resilient.

Hon. Scott Brison: Last week you told a Saskatoon audience that there's a growing consensus that interest rates will still be lower than we were accustomed to in the past. The Canadian Press ran a story, and the headline was "Canadians can bank on low interest rate environment for years to come". Given that your predecessor seemed to be trying to pull the punch bowl back a little bit in terms of warnings on this, is there a risk that you may be pouring some vodka into it, and may be creating an environment that creates a bit of a hangover for Canadian families, if in fact there is the correction you describe?

Mr. Stephen S. Poloz: Yes, there is a risk, and we're well acquainted with the risks, if I can classify them as low for long. So the possibility that there will be financial bubbles or unsustainable moves in housing, or increased debt levels, which are not sustainable long term, all those things come as a bundle, and we call them low for long risks. Those risks are growing the longer we stay like this.

We have to ask ourselves, why are we prepared to accept those risks? The answer is that we are not yet out of the downturn from the crisis. In fact, if we had not lowered interest rates and invited some of those risks, we would have had a much more severe recession. People's pension plans might have been hit pretty hard. It's all those kinds of things that would have been very negative for our economy. It is a risk, but it's one you deem acceptable, as opposed to some other risk which you would have instead if you didn't do it, if you tried to move interest rates back to a high level.

I think we have to keep in mind this full picture, and we are, in effect, balancing things as best we can.

● (1600)

Hon. Scott Brison: There's been a call for more high-quality housing data, including from CIBC economist Benny Tal. Would you agree with Benny Tal that it would be helpful to have publicly available more high-quality housing data to help Canadians make informed decisions on the housing market?

Mr. Stephen S. Poloz: I've been an economist for over 30 years, and I just love data, so if someone were to give me even more data on housing, I would eat them up and analyze them. We do have excellent data as it is. We believe we understand it, but there's no economic situation that couldn't be made better by having more data.

Hon. Scott Brison: Could we make more of that data public? Would that be helpful? For instance, do we track foreign buyers and sellers in the Canadian housing market? How important is that to measure?

Mr. Stephen S. Poloz: Well, I don't know if anybody really tracks that in the way we describe. It's something that could be investigated. If it were possible to bring those data sets to the table, we would be happy to analyze them.

Mr. Tiff Macklem: There is some anecdotal evidence on that, but we don't have systematic data on who owns properties. We haven't found it. We speak to builders. We get a sense from builders what's going on in the market, but we don't have systematic data.

Mr. Stephen S. Poloz: That's right.

Hon. Scott Brison: Maybe check on Kijiji or something like that; it's just a suggestion.

With the issue of aging demographics, and you've spoken to this in the past, how concerned should we be about the impact of aging demographics on our economy? Could we expect the same kind of dampened productivity growth in Canada with an aging demographic that we saw in Japan in the 1990s and Germany more recently?

The Chair: You have 20 seconds to answer that.

Mr. Stephen S. Poloz: Well, I would recommend the speech I gave in Halifax, where we did talk about that in detail. Very quickly, the short answer is yes. Those drivers come from population growth and workforce growth, and that is easing back as we age.

Productivity is a much more complex thing that comes from the mix of what we do and how much we invest in it, so we do have the opportunity to have an offset.

The Chair: Thank you, Mr. Brison.

We'll go to Mr. Allen, please.

Mr. Mike Allen (Tobique—Mactaquac, CPC): Thank you, Governor and Senior Deputy Governor, for being here today. We appreciate that.

I want to pick up on one of the things on the demographic side. In the monetary policy report on page 19, it talks about the GDP growth of around 2%. It also talks about "the growth rate of trend labour productivity being offset by a further decline in the growth of trend labour input, associated with demographic forces" which you referenced in your October 2013 report.

As you talk about this growth starting to pick up in the U.S. and other countries, with us maybe caught in the tailwind of that, do you see any impact on Canadian businesses in being able to actually hire these new workers?

Mr. Stephen S. Poloz: Yes, as we get farther out there, we can say with some certainty.... The thing about demographics is we know with certainty that next year we will be one year older. It sounds trite, but putting those implications through an economic model is quite telling. It means the workforce out there actually begins to shrink in a way that means our trend line and growth are gradually slowing down to about that 2% level.

As I was saying just a moment ago, we do have the opportunity to grow our business in such a way that productivity adds to it, so that we end up with a stronger growth out-turn. But right now we already have a pretty strong uptick in productivity in our forecast, precisely because of where we are in the cycle and the investment uptick we're expecting to happen as the export recovery proceeds.

That along with the introduction of new companies, which is a process we think is just getting back under way and where the big productivity hits come from, should be enough to get us up to that 2%. We're hopeful that you could get 2.2%, or those kinds of things, with some luck. That's basically what you're looking for out there.

Bear in mind that the big numbers that we got used to happened because we had 50 years' worth of baby boomers expanding that workforce at the same time. We're just coming off that hill now.

● (1605)

Mr. Tiff Macklem: I'll add one thing. Right now we think there is some unused capacity, some slack, in the labour market. There are certainly opportunities for further employment to take up that slack, and for the unemployment rate to come down. Then, in our own report, we expect it's going to take about two years for that slack to be taken up in the economy.

Once you get back to what we think is around the economy's potential, then the growth rate of employment will be roughly in line with the growth rate of the labour force. That's when, if you want to get employment growth up, you have to get new segments of the labour force participating more fully—older workers, aboriginal workers, and younger workers. You're going to have to draw them more into the labour force.

Right now there is certainly some scope. Our own projection is that in about two years that slack will be taken up.

Mr. Mike Allen: Okay.

I was talking with the forestry sector today, and they've experienced somewhere around 2.5% in the compound annual growth rate of labour productivity from 2000 to 2012. Yet they're also looking at having 60,000 people by 2020 in their strategic plan. We look at the dollar going down, obviously making equipment more expensive in the U.S.

Do you see any of these challenges? Some of their major gains have been made by modernized equipment and improved process. Do you see the Canadian dollar settling out where it is being a challenge?

Mr. Stephen S. Poloz: I really don't.... Well, on the margin, the answer to your question is yes. A 10% decline in the dollar makes certain bits of machinery that people import more expensive. But the dollar remains, in the historical sense, quite high relative to where we've been. Relative to, let's say, five to ten years ago, that equipment is quite a bargain compared with what it was when the Canadian dollar was much lower. I don't really think that's going to take too much of a shine off the investment story that we've laid out there.

However, the question about the shortage of workers is more meaningful to be thinking about. Any economy has the possibility of adjusting immigration levels and that sort of thing. Companies also react in different ways by spreading their production across different economies, capital-intensive production here in Canada, where labour is relatively scarce or more expensive, and some of it in other kinds of economies where the reverse is true.

They have an actual global model of production, such as in the garment business, for instance. That is what has emerged there. Even though employment in the garment business in Canada is much smaller than it was in the past, it's still one of the biggest in the world, and it's based in Canada. All the design and all that is still happening here.

These stories are complicated and they're individualized, so it's important not to make just a general comment like that.

I would say that the forestry sector has had a good record in terms of that productivity run. It's one of the ones where we would expect to see the demand side being influenced by that exchange rate. So, good news comes in.

Mr. Mike Allen: Governor, in your comments you talked about private demand and the potential for it to be better than what you actually think it might be at this point in time.

Have you done any sensitivity work in terms of what it could mean, and the draft it could create for Canada, if that private demand were up a little or down a bit?

● (1610)

Mr. Stephen S. Poloz: That reference to private demand is an economist's euphemism. It was first called animal spirits by our old economist Keynes.

What we know is that there's always this unexplained layer of macro decision-making in an economy. It's a bit like a herd effect: everybody is optimistic, so everybody gets optimistic. You tend to get this extra kick to the economy. It's exactly when that happens that the economists all underpredict what's going to happen next. Of course, the reverse has been true for the last three or four years, because animal spirits, such as they exist, have been absolutely crushed by this experience that we've been through.

Our belief is that while many of our models are overpredicting what has been actually happening, at some point those animal spirits will come alive and we'll get that unified upturn. U.S. investment is the place where you might expect to see that first, because they've been hit so hard and they've been waiting this long, and all the ingredients are lined up. It's why that risk is highlighted in our monetary policy report. That's the one area where historically we've underpredicted at this point in the business cycle.

The Chair: Thank you very much, Mr. Allen.

[*Translation*]

Mr. Caron, you have the floor.

Mr. Guy Caron (Rimouski-Neigette—Témiscouata—Les Basques, NDP): Thank you, Mr. Chair.

Welcome, Governor and Senior Deputy Governor. Mr. Macklem, let me first congratulate you on your appointment. This probably means that we will have an opportunity to see you again in committee from time to time.

My questions will first deal with the issuing of government bonds with a 50-year term. The government was quick to act. In the morning, we heard that the government was considering issuing those bonds and, by late afternoon, we learned that an amount of $1.5 billion had been issued and sold on markets.

We heard the version of the Minister of Finance, but could you tell me what the position of the Bank of Canada is in relation to the issuing of such long-term bonds? We are actually talking about 50 years.

Mr. Stephen S. Poloz: In this matter, the Bank of Canada acts as an adviser to the government. We manage the government's debt stock. In this situation, investors clearly want to have access to longer terms on the market. At the same time, that can allow the government to minimize the cost of its debt over a long period. In light of these considerations combined, it was suggested to move forward with the issue, which turned out to be very successful yesterday.

Mr. Guy Caron: I would like to know what that means.

In the spring of 2012, the Auditor General did a study on interest-bearing debt. He looked at the models used by debt managers. Here is what he had to say:

> The model's recent results show the advantage of issuing more short- and medium-term bonds rather than issuing long-term bonds. The model shows that such strategies, while improving the debt structure in the long run, would also reduce risks of increased interest charges.

The Auditor General's recommendation also took into account the rollover risk.

I understand that the government wants to provide longer-term funding with relatively lower interest rates. In this instance, should the government aim for a different composition of interest-bearing debt, heading toward long-term debt instead, or should it still be cautious and diversify the debt, as it has done so far?

Mr. Stephen S. Poloz: That is a very difficult question. The debt stock is high. The government must issue bonds in such a way as to meet demand and maintain cash flow in all areas of the interest rate curve.

Many factors come into play in this recommendation. It is very complex. It is important to consider market conditions and the needs of the government, while bearing in mind the bigger picture of debt stock.

● (1615)

Mr. Tiff Macklem: I would like to add something to that.

The debt strategy is established by the Department of Finance. As the governor mentioned, we are advisers.

The other factor is that the situation changes. During the crisis, the government launched a big budget stimulus plan, which made the debt go up. Today, the situation is reversed, to the point that we have to examine and adjust the strategy according to the needs.

Mr. Guy Caron: Does that explain the government's latest decision? According to the Auditor General's report, market participants want the government to increase the number of 30-year bonds, but debt managers have chosen not to go in that direction. In the case of long-term bonds of 30 or 50 years, it is often a question of retirement funds and pension plans.

[*English*]

Is that why debt managers this time actually agreed to it?

[*Translation*]

Mr. Tiff Macklem: There needs to be a balance. Pension fund managers or large insurance companies are very fond of long-term bonds because their liabilities are long-term. However, they represent only a segment of the market.

For the government, the curve goes up on average. It costs the government more for long-term loans than for short-term loans. There is indeed a demand for long-term bonds, but the government does not want to issue all its bonds in the long term, because that would cost more. It is a question of balance. It is good for the government that there is a strong demand for bonds, but our advice was to find a balance. So there are a number of objectives.

[*English*]

Mr. Guy Caron: So all in all, right now would your recommendation regarding the composition of the debt itself be as between short, medium, and long term, that it should not be changing?

Mr. Tiff Macklem: What I would say now is, as I mentioned, that the government's requirements are changing, and in combination with new standards for banks, that is affecting the liquidity of global markets to some degree. It's going to be important in the debt strategy to make sure there is enough issuance of the key benchmarks that we can maintain well-functioning liquid markets in Canada and that we have a very well-defined Government of Canada curve, because that is the benchmark on which corporate bond issues are pricing.

That is a new fact. As issuance comes down, it is a new factor that is coming into play and will need to be factored into the debt strategy.

The Chair: Do you have another question, Mr. Caron?

Mr. Guy Caron: I can try quickly. My question is for Mr. Macklem.

Last time you were at this committee, you stated that the lack of competitiveness for our exports and our production, all in all, that two-thirds of it was due to the Canadian dollar and one-third the lack of productivity growth.

Do you stand by these numbers at this point?

Mr. Tiff Macklem: Well, the numbers of course always change. Right now since the last appearance, the Canadian dollar has weakened somewhat, so the contribution of the Canadian dollar part would be a little lower than it was last time. But it hasn't changed that much so it wouldn't be that far off.

The Chair: Thank you. *Merci.*

Mr. Tiff Macklem: Mr. Chair, there's a graph in the monetary policy report that shows that exact calculation and you can see it coming down a bit.

The Chair: Thank you.

We'll go to Mr. Adler, please.

Mr. Mark Adler (York Centre, CPC): Thank you, Governor, and Senior Deputy Governor.

I want to talk a bit about the international scene. Certainly, the events in Ukraine have upset some economic projects. In terms of the European scene, our recovery is very fragile. The Europeans have been coming out of the depths of their recession. How much of a hindrance is the Ukrainian economic crisis on the European economy? How will that affect our recovery here in North America?

● (1620)

Mr. Stephen S. Poloz: Well, it's early days for this question. Right now, we treat it as a downside risk, and it enters in the way you described it, which is that the European recovery, such as it is, the output in the European economy is still substantially below where it was before the crisis. Their recovery is very young and fragile.

As we know from our own experience and in the U.S. experience, business uncertainty is one of the variables that has really held things back. It's that lack of confidence that slows things down. Business uncertainty cannot be improved by the situation we're seeing there, so we take it in that way as something we can't really measure yet. Direct linkages are actually fairly small. You could predict linkages through a European banking system perhaps, the sanctions and so on. You may predict implications for certain commodity markets, but it's the indirect effects which are more concerning, I would say. That confidence can get dented at such an early stage in the European recovery, and the European economy is a similar size to the United States, close to 30%, let's say, of the world. That would be the sort of downside risk that we would treat very seriously.

Mr. Mark Adler: I will shift around the globe a bit.

New Zealand has raised interest rates, the first economy to do so in a couple of years.

We've seen the U.S. rates being zero. First the FOMC, Federal Open Market Committee, was saying that they're not going to be increasing rates until inflation goes above 2.5% or unemployment goes below 6.5%. We have now seen inflation around that figure. We've seen unemployment at 6.7% in the United States, and now they're looking at other economic indicators in whether they are going to be increasing interest rates.

There has been talk now of these series of dots that appear on a chart; you've read all about that. How much of a problem is that for these projections, with the Fed going to be shortly stopping buying bonds, and how much of an effect is that going to have on our situation here in Canada? How much pressure is that going to put on you to increase rates here in Canada, if at all?

Mr. Stephen S. Poloz: Well, we begin the analysis with, we believe that the U.S. economy is gathering momentum and so it's entirely appropriate that there'll be, in prospect, some adjustment to monetary policy. The tapering, which last year caused what they called a tapering tantrum in financial markets, is now much better understood. I think markets are clearly distinguishing between gradually reducing the rate of purchases of debt by the Fed, and eventually a change to monetary conditions, and not necessarily hinging it on a particular variable, such as an unemployment rate or anything like that. It will be about general economic conditions and their inflation objective.

In our case, our monetary policy will be developed in a completely independent manner from that, based on where our economy is relative to its potential and, therefore, the implications for our inflation target.

Just as you can see New Zealand raising interest rates quite independently, you could see the Bank of Canada either adjusting interest rates or not adjusting interest rates, regardless of what the Fed may be doing. That of course may have some implications for our bond markets and so on, but it's the sort of thing that, if carefully explained, markets will understand. I think our interest rates aren't the same as U.S. interest rates now. Ours are 1%, not zero.

Mr. Mark Adler: Given that it is 1%, you said earlier that fiscal and monetary policy have done everything they can possibly do up to this point. You said a few weeks ago, on April 16, at a press conference, that you wouldn't rule out an interest rate cut to stimulate the economy. What would precipitate you to do that?

● (1625)

Mr. Stephen S. Poloz: Yes, I did say that, and the question remains relevant. What we have done is, in the zone of uncertainty that we've sketched out, we've tried to balance the risks that inflation may prove to be too low, against the risk that in acting to reduce that risk, we would worsen household imbalances, which are elevated and at a state where we don't wish to worsen them. We decided that we're about right in balancing those risks.

What would change that would be, for example, if the export recovery that we talked about earlier did not turn out as we expected. Say, the U.S. economy doesn't quite get up as much speed as we think and our exports don't pick up, then we'd be looking at a longer period during which the economy would be below potential, and at a much higher probability that inflation would fall significantly below target for a long time.

Then we would need to re-evaluate that balance of risks with that new information. That's why I said at the time that if something like that transpired, then I can't be taking rate cuts off the table because I can't forecast everything.

If the reverse were true, then the reverse would be the reverse. You would have a different story altogether.

That balance of risk is not some knifepoint or razor's edge, but rather a zone in which we try to manage the risk that we're facing, including forecast risks.

The Chair: Thank you very much, Mr. Adler.

We'll go to Mr. Rankin, please.

Mr. Murray Rankin (Victoria, NDP): I want to welcome both the governor and the senior deputy governor to the committee. I want to say in particular, as a proud University of Toronto alumnus, Rotman School is really glad to have you, sir. Thanks a lot.

I'm advised that the bank regularly has been overestimating export and investment performance in the past. If that's so, why has that been, and why was export performance finally downgraded?

Mr. Stephen S. Poloz: It's not just the bank that has been mis-forecasting these things. The economy has underperformed in these two respects in every economic model that I know of. When we ask ourselves why that is happening, it is of course our biggest research question. We look into things such as we discussed before, the animal spirits phenomenon, which is how much uncertainty needs to go away before a company will make its investment.

Given what we've been through over these past five years.... Many companies have disappeared; some 9,000 manufacturing firms have disappeared. The ones that survived may have downsized through the course of that period. We're asking when a company like that will be ready to re-expand to meet the new demands coming, let's say, from the United States or some foreign market.

The answer is they need to be more sure today, having been through all of that, than they needed to be five or ten years ago in a similar situation. This is that confidence thing, which is very hard to put your finger on, yet you know intuitively that it's true. You can talk to real people, and they'll tell you that it's true.

Our models don't capture things like that; it's as simple as that. On the export side, there are things now that, as I said, we are able to look at more deeply. We understand which sectors—we understand that they've had long-term problems maintaining their competitiveness—have lost market share in the U.S.

We can point to those and say that now we understand where it is, do we really understand what it is that is going to turn it around? That is what our model suggests will happen, but in the real world, it's real people making real decisions, so historical behaviour has not been a great guide to what we're seeing. And that is an excuse for how models work.

Mr. Murray Rankin: That's fair enough. Thank you.

I want to know whether you would agree in general terms with the Parliamentary Budget Officer's assessment that as a consequence of the last three Conservative government budgets, 46,000 fewer jobs were created and the GDP has been half a per cent lower than it would have otherwise been as a consequence of those austerity budgets.

Would you agree with that assessment of the PBO?

Mr. Stephen S. Poloz: I have not looked closely at that analysis, and that is really, I guess, a question for somebody else.

Mr. Murray Rankin: Why do you believe that employment growth was so sluggish in the latter half of 2013?

Mr. Stephen S. Poloz: I think it ties back to what we were saying earlier. Canada's main driver has always been that the natural growth in Canada has come from external demand, driving through exports and giving us more sales and therefore more investment and employment growth as we expand to meet that demand. This linkage has simply not yet taken hold in the Canadian economy, and so we have gone through a period when, although we thought it was about to happen, it simply didn't, and those expectations were dashed. I think employment plans were put on hold until it becomes more real.

Mr. Murray Rankin: I want to ask you again. Do you agree with the Parliamentary Budget Officer that spending restraint is “acting as a drag on economic activity and job creation”?

● (1630)

Mr. Stephen S. Poloz: Well, if you're asking me the basic question whether fiscal restraint reduces demand in the economy, then yes, it does; however, I don't have any sense of whether the numbers you have put on the table are fair numbers or good numbers. We have not done a similar analysis. The general proposition is true.

Mr. Tiff Macklem: The only thing I would add is that when we set monetary policy, we take into account all the things that are affecting the Canadian economy. Obviously, fiscal policy is one of those things. We take the government's plans as given, as they are published in their budgets. That is factored in and is taken into account when we take our decision. Given the combination of weak export performance and everything else going on in the economy, we have kept interest rates very low, and that is providing a lot of stimulus to the Canadian economy.

Mr. Murray Rankin: I'm wondering in a similar vein whether you agree with the C.D. Howe Institute and Statistics Canada that the temporary foreign worker program has increased joblessness. Is that something you have looked at?

Mr. Stephen S. Poloz: It is not something we look at, no. It's quite far removed from the mandate of monetary policy.

Mr. Murray Rankin: This is a question for clarification. In your opening statement today you talked about economic slack and heightened retail competition keeping core inflation below the target rate until early 2016. It's the expression “economic slack” that I don't quite understand. Is it the same as the material excess capacity, chart 12 on page 14? Is that what you're referring to?

Mr. Stephen S. Poloz: Yes, it is. That's one measure of it, and the unemployment rate would be another measure, or the capacity that is in the employment space. There are multiple measures, but that's what we mean.

Mr. Murray Rankin: It's a sort of shorthand for material excess —

Mr. Stephen S. Poloz: That's correct.

Mr. Murray Rankin: Okay.

If the downside risks that you've identified in the monetary policy report were to come to pass, and this is a general question, what would the bank's response be, and what would you recommend that the federal government do as a consequence of those risks?

Mr. Stephen S. Poloz: If a significant downside risk were to emerge and it changed the balance of risk that we talked about before.... Our balance of risk right now is that we think interest rates at 1% are in about the right place, taking into account the fact that imbalances in households are high and fragile, at the same time that inflation is below target and could fall further below target if there were downside risk.

If there were a significant downside risk that altered this picture, then you would have to talk about the possibility of having a lower interest rate in that situation, but you would then have a whole new set of risks to try to balance in deciding what the appropriate risk minimization strategy is for the central bank.

The Chair: Thank you very much, Mr. Rankin.

We'll go to Mr. Van Kesteren, please.

Mr. Dave Van Kesteren (Chatham-Kent—Essex, CPC): Thank you both for being here.

Tiff, we'll miss you. It's been a number of years that we've seen you here sitting beside the governor. You've always had a great input to the cause. We thank you for your service. We're going to miss you.

Mr. Tiff Macklem: Thank you.

Mr. Dave Van Kesteren: I want to ask a question. I've always been a great champion of our banking system. I really believe that the last great recession which, as you've said, Governor, we are trying still to climb out of completely has been a result of reckless behaviour on the part of banks. I read a report this morning from the Deutsche Bank. They had exposure, it says, to $75 trillion in derivatives. We know that the last great recession was largely a result of toxic mortgage derivatives in the States.

I'm curious, first of all, whether you monitor our banks, and second, as to whether you can give us a report on how our banks are faring in those areas that caused us those problems five years ago.

● (1635)

Mr. Stephen S. Poloz: It is actually our role to understand those things; however, it's OSFI's role to regulate our banks to ensure that they're meeting their requirements. The big picture, I think, of what went wrong in the lead-up to the financial crisis shows that it was leverage. There was a great deal of leverage out there that puffed up financial markets and led to a domino effect as things started to unwind.

Leverage doesn't disappear just because the crisis is over. When we go back to last spring, when the first mention of tapering happened and financial markets had a lot of volatility, that was again because there is leverage in certain areas of the market in which it looks easy, if the risk is low and you can stack up your position by leveraging it, to earn returns of multiple times in that situation.

Leverage is a fact of life in the financial markets. Part of the new Basel package, if you like, that the FSB, Financial Stability Board, is working through, is to ensure that there are limits on the leverage that banks can undertake. Those limits will actually be limiting, compared with what we saw in the run-up to the crisis.

We are in the process of developing an entirely new international financial architecture that already feels much safer than what we were living with before. It is not yet done. As a lead-up to the summit in Australia later this year, I would say that we're looking at probably 80% of the job being done, and that's a pretty significant step forward. There still will be new developments on the regulatory front.

Tiff, would you like to add something?

Mr. Tiff Macklem: I would add that from a Canadian perspective we have long had a leverage limit, a 20:1 asset-to-capital ratio. That is an important reason, among several others, that Canadian banks did better through the crisis. Because of this leverage cap, buying securitized subprime mortgages and making money on doing so by levering up was effectively not a good business model for them, because they couldn't lever up over their cap. As a result of that, along with good risk management, Canadian banks did not load up on those, and so when those products collapsed, they didn't create a big hole in our system. That thinking has been imported into the global rules.

Mr. Dave Van Kesteren: What I really wanted to hear, and I think I'm hearing, is that we still have those good Scottish institutes keeping our Canadian institutions strong and that we're not making those risky ventures that caused all this mayhem in the past.

Is that a good assumption to make? I think Canadians want to hear that, and I certainly want that to be the case.

Mr. Tiff Macklem: There is a very generous and long phase-in period to bring in the new higher Basel capital standards out to 2019. OSFI decided, quite intelligently, to make Canadian banks meet those now, and all major Canadian banks do meet those higher standards today.

Mr. Dave Van Kesteren: Good, thank you.

In the past, we had a lower dollar. Our illustrious chair and I were privileged to sit on the industry committee. We discovered that one of the problems that we experienced in the past is we didn't take advantage of that low dollar. You've talked quite a bit about the need for our productivity to improve. Are we seeing those same trends? There was an awful lot of clamour in the past—I'm talking in the past few years—that we needed to drive our dollar down. I don't know how we're supposed to do that. I always interpreted it as a sign of weakness in our economy. However, we have seen the dollar drop 10¢. Are we making the right choices now? I don't know if the Bank of Canada monitors those things, but are we not going to make that same mistake we made the last time and take that advantage? I know that the equipment costs a little bit more, but because we should see an influx of orders, are we taking advantage of that?

● (1640)

The Chair: Just a brief response, please.

Mr. Stephen S. Poloz: A brief response would be yes and no, because for every company we can find that has not, we can find another company that has. In the aggregate, we have lost competitiveness overall, and it's in that half of the export sector I talked about earlier where it's most severe. But the other half has done an extraordinarily good job. Taking advantage of a strong dollar to buy equipment is usually the way it works because the strong dollar makes it cheaper to buy that stuff. However, if you're in the middle of a recession, if your companies are getting hit very hard by that, it's very hard to come up with the kind of financing that it takes to do that at that time. It's easy to explain but not easy to forecast.

The Chair: Thank you, Mr. Van Kesteren.

I'm going to take the next round, as the chair.

I wanted to start with the issue of commodity prices, specifically the price of oil. On page 6, you talk about the Brent price, the WTI price, the Western Canadian price, in terms of its coming together. Your predecessor spoke quite often about constraints, especially to pipeline access. Because of the price changes, are you less concerned about constraints in getting these commodities to market?

Mr. Stephen S. Poloz: It's true that the current picture looks less concerning than it has at certain times in the past. At the same time, there isn't a very clear pattern in the periods of angst, as opposed to periods where it seems fine. I'm not confident that we can explain all that, but we do think that logistical connections are the key thing, the bottlenecks that have given rise to this situation in the past. Over time, that seems to be easing on trend line because of increased use of rail to make delivery, and certain pipelines have been expanded or fixed up, etc. The capacity constraints seem to be easing through time, and therefore, they get a gradual convergence in those prices, not total, but gradual.

The Chair: Okay.

The second big topic I want to raise, following up on some of Mr. Van Kesteren's and others' questions, is competitiveness and productivity, and especially on Canadian companies being able to maximize the situation of a higher dollar versus a lower dollar. You just answered very well in terms of the challenges of a higher dollar, that's a good time to be maximizing that because of the lower input cost. But as you mentioned, if you're facing financing challenges, then it's a very hard time for a company to do that.

I would like you to comment, and your predecessor also commented, on the fact that Canadian companies in the last number of months, perhaps years, have been sitting, to use a pejorative term, on a fair amount of cash and not actually using it.

Do you want to comment on that? Do you still see that as a problem for the Canadian economy, that companies are still being perhaps too prudent and not investing enough in their own enterprises and in the economy as a whole?

Mr. Stephen S. Poloz: I do spend a lot of time talking to the actual companies as opposed to relying on our models to explain this, and I find it to be very helpful to do that. What I pick up, as I was relating earlier, is the sense that companies and their boards have been through a lot in this period and so the bar for making a decision is higher than it has been in the past in terms of confidence in the outlook.

When you're looking out there and you see the U.S. economy going through a pretty good summer and then a bad winter, is that just because of weather or is it coming back? Those bits of uncertainty really cause companies to hold back, and it's totally understandable. It's true that balance sheets are healthy. We think that's excellent because it's one of the important ingredients to the upturn that we're describing.

What we think is that all the pieces are coming together with a stronger U.S. economy, more export growth, and the strong balance sheets, and of course inexpensive financing if that's the route you need to go.

All of those ingredients are ready. All we need is the extra degree of confidence that it's a sustainable growth upturn as opposed to another temporary one. I'm confident that's what we're seeing and so over the next year or two, we will see a big difference in that. But that's a forecast, it's not in the numbers yet.

● (1645)

The Chair: Just to be clear then, their actions in terms of maintaining healthy balance sheets over the last number of months, perhaps the last number of years, has actually been prudent on their part in the sense that they've looked at a lot of short-term actions and their response then has been reasonable to that rather than....

Mr. Stephen S. Poloz: My sense is that they're ready and they are not yet quite constrained in terms of their capacity. They can make the deliveries they're being asked to deliver with what they have and the time to invest is the next stage, and we'll see a significant increase in investment and the productivity numbers will show this, as well.

The Chair: My third and final point will be, if we were here in 1994 and we made a list of things that the government should do, from a fiscal and monetary point of view with respect to productivity and competitiveness, I suspect the list would have been completed by now.

That's in the sense of I think the government, from a fiscal and monetary policy point of view, has actually put in place a lot of measures in the last 20 years to address productivity and competitiveness and yet it's still a nagging challenge and one that seems to not go away, and frankly, the measures we've put in place seem to have not had as much of an impact as they should.

I have about a minute and a half if both of you want to address that.

Tiff, that may be your big job going forward, to figure out exactly why those measures haven't had more of an impact than we thought they'd have.

Mr. Stephen S. Poloz: I do not have a satisfactory explanation for that history over the last 20 years. It's very hard to explain how the economy has behaved in this respect. The thing is, when you talk to companies, they have great productivity stories to tell and yet it's not in the statistics.

What I believe is that through the aggregation process we get a picture that is different for Canada from what the underlying truth often is. For example, we have a big increase in the resource sector because of the rise in terms of trade, primarily the oil sector. In level terms, that's a low productivity sector. You have to drill a lot of holes and then some of them work and others don't work, and so on. It's not like a fine-tuned factory where you can boost productivity with a new machine.

That shift in the weight of the economy changes the overall productivity picture in a way that may be hard to explain, yet if you look down at the firm level, all is well.

I'm not trying to confuse the picture. I'm just saying it's not actually that easy for us to explain even ex post.

The Chair: Do you have a brief comment?

Mr. Tiff Macklem: As the governor says, this has been an ongoing puzzle. I would agree that successive governments have done many of the right things. I think one thing to keep in mind is that while productivity growth has disappointed, it was growing at least 1% over the last 20 years and of course just to get that 1% you have to do the right things.

If you go back in history when it was growing faster, you know that didn't come for free either. Just because we didn't see a big increase in productivity growth doesn't mean the policies had no effect. We were still getting one per cent.

Having said that, it is a long-standing puzzle and maybe I can get some of the brainiac professors at the Rotman School to put their minds to it.

The Chair: Thank you. I appreciate that.

We're going now to Monsieur Caron.

[*Translation*]

You have five minutes.

Mr. Guy Caron: Thank you very much, Mr. Chair.

I would like to talk about the models used by the Bank of Canada. There have been many references to animal spirits in difficult and uncertain times.

[*English*]

Back in Montreal I think you actually referred to these animal spirits in that sense, when you talked about.... I will find it eventually, but you referred to the difficulty and the models the bank is using are basically raising more questions than answers, because those times are difficult to predict and forecast. This is basically the same analogy.

You also mentioned, as a metaphor, that the dog is sometimes going in many directions while you're trying to lead it. On the other hand, after a while, you know your dog and you start to see a pattern and you can actually see in which direction it goes.

In terms of modelling, after what we've seen in the last three, four, five years, and the experience we had in previous recessions or previous chaotic times, isn't it possible eventually to adapt our models to that reality, to those animal spirits eventually? I do not say perfectly, because there is still a large part that is unknown, but eventually we'll need to include them to have a better idea of what to expect during such difficult times.

● (1650)

Mr. Stephen S. Poloz: The answer is yes. Economics will always be based on models, because we can't obviously do everything. so we try to abstract or summarize or simplify.

The problem we have is that we aren't actually through this one episode yet. The simple story I like to tell is about how we had a bubble. We're all familiar with it. We had the crash of the bubble. Bubbles leave behind craters, and the bubble was seven years in the making. It looks like it really is going to take up to seven years to repair all the damage that happened during that time, so we have another couple of years to go before we can say we're through this. We will have learned a lot about underlying behaviour during this episode, which will cause us to think about our models in different ways and indeed perhaps to redefine what it is central banks do in these times. We have changed quite a bit what central banks do through this, necessity being the mother of invention.

All that is to say that yes, there will be a new generation of models as we come out of it, but in the backbone of the models we have now, there's still what I think are basic truths that we will return to. They're so fundamental that we believe they will still be there. It's simply that we have to get through this thing and to come back together until we get to normal. While we've talked about how that normal may be drifting or evolving, it still has a lot of properties that we're used to and have applied over the past 30 years.

Mr. Guy Caron: I understand what you're saying, and that this is the reality. I agree with you that we still have something to learn from the current situation we're in.

On the other side, we've seen animal spirits, say, during the tech bubble, for example. Would you say that the models used by the bank and by the private sector as well have been modified, changed and adapted to that reality over that time, and does that lead us to be hopeful with this situation?

Mr. Stephen S. Poloz: That's an interesting parallel, because we had a tech bubble which we're all familiar with, especially here in Canada, and it collapsed, and very little happened. Very little happened in a macro-economic sense, but it was a much more narrowly focused bubble.

The one we're talking about in this decade was more one where leverage went everywhere. It was in the financial system, not simply in a particular sector of the stock market. Anywhere you could make a bet, you could get leverage and put it on that bet—commodity markets, housing markets, intermediaries in housing markets in the U.S. It went truly global that bubble, so the repair job is much broader and involves much more and, as you know, is requiring a whole new architecture for the financial system.

This is a substantially bigger thing than the tech bubble. Fundamentally, though, how it impacted ordinary people is not that different. The stocks went down. It had a wealth effect. It caused a little ripple in the economy. This one was really so much bigger, and it was synchronized.

The Chair: Thank you.

I'm going to Mr. Keddy, please, for a short round.

Mr. Gerald Keddy (South Shore—St. Margaret's, CPC): Welcome, Governor, and Deputy.

A fair amount of discussion here is on a couple of things that keep coming back full circle. One issue being discussed, and I'm not 100% clear on the answer, is the relationship, as the chairman mentioned, between competitiveness and productivity and the growth challenges. You mentioned in one of your statements on how the value of the dollar is hooked into competitiveness and productivity.

The part of that statement I don't think we've looked deeply enough at is the connection between...you know, when the dollar was trading at 36¢ to 38¢ lower than the American dollar. Too many small businesses thought that it was profit, it was exchange, and that's something totally different. I think part of it was simply an educational process, maybe an opportunity that was missed. The other thing that happened with the lower dollar is that the excess profit wasn't invested in machinery. A lot of it was invested in the people and wages, and wages went up exponentially and productivity, quite frankly, went down.

Do you want to explain that connection? I think it is a very difficult connection and one that is very difficult to control.

● (1655)

Mr. Stephen S. Poloz: Perhaps the simplest way to think of it is, think how an individual company would think of it. Is that company competitive and is it able to make a sale against someone else that does almost or exactly the same thing? If the company is, let's say, down the street, the exchange rate does not come into the picture at all. If you have a better, higher level of productivity in your operation than the person down the street has, you can offer the same thing for a lower price to the customer.

What if the person down the street has lower productivity than you have but has a better delivery system so they get it there two days earlier than you do? That is another element to the competitiveness equation, and the exchange rate still hasn't come in.

Now, we take those two companies and they're competing with somebody in the United States that does the same thing, and their costs, for a foreign buyer, are now impacted by movements in the exchange rate on top of all those other things. That's why this is in layers. If you look at the chart in the monetary policy report that Tiff referred to, it takes the relative costs between Canada and the United States and asks how were those relative costs translated into a single currency, taking account of the exchange rate effects.

The rise in the currency over the past 10 years has made a significant difference in that chart. Overcoming that rise in the currency would mean really increasing your productivity in your operation, or doing something completely differently to overcome that cost disadvantage; hence, the headwinds we described. I said that rise in the currency was associated with the terms of trade rise and therefore there's nothing we can do about it. It's a part of the macro picture.

The Chair: You can ask a brief question.

Mr. Gerald Keddy: The other connector in there…we know that household debt is somewhere, and you mentioned at 165%. At the same time, the net worth of the same household has actually risen over time. Again, that is still all hooked back to the value of the dollar, whether you're in the export business or you're selling to your neighbour down the street, and global demand of commodities, and we're a commodity-driven economy. You know, you have this inner lacing of all these issues and at the same time, the one place where we thought we were falling apart was in that net worth and the indebtedness of Canadian families—

The Chair: Okay.

Mr. Gerald Keddy: —and it really isn't falling apart there. It seems to be fairly strong.

The Chair: You may make a brief comment, please.

Mr. Stephen S. Poloz: Well, the answer is yes. That's correct.

The Chair: Okay. Thank you.

Mr. Stephen S. Poloz: You've summed it up well.

The Chair: Thank you, Mr. Keddy.

We'll go to Mr. Brison, briefly please.

Mr. Tiff Macklem: I do feel the responsibility to add that what you saw in the United States is net worth changed quickly. The value of their houses fell, the stock market fell, all of a sudden their network fell, but their debt didn't go away and that created a problem.

You're right, but it doesn't mean there isn't a vulnerability, so that's why the vulnerability is there.

The Chair: Thank you.

Mr. Brison, please.

Hon. Scott Brison: Speaking of net worth and capital, if we look at Thomas Piketty's *Capital in the Twenty-First Century*, and the risk when the rate of growth of income on capital outpaces that of earned income, would you agree with Mr. Piketty that there is a risk of deepening inequality if in fact we have sustained low growth, and at the same time high returns on capital?

Mr. Stephen S. Poloz: I've downloaded the book to my iPad, but I've not read it yet. It's a very interesting historical hypothesis. From what I know of it, those fundamentals are the question. If the return on capital is historically persistently above the rate of growth of earnings, then you have what we would call a long-term wedge between those things, or disequilibrium, and it would mean this persistence, or perhaps even growth, in inequality. That's the conclusion he draws.

Our own belief, in the models we use, has a convergence of those things. That's why we talk about how the real long-term interest rate will be lower as those demographics come down. It's a hypothesis I need to understand better. It certainly would have very little to do with monetary policy. In monetary policy we believe we make a contribution here by keeping inflation low and stable, and that's the one thing we can do to allow people to make the right decisions.

● (1700)

Hon. Scott Brison: As an economist, is there an economic risk, for instance, if Canadians aren't saving enough for retirement? Only 38% of Canadians participate in programs, for instance RRSPs. It's typically the same people who participate in TFSAs or PRPPs. It's roughly the same group of people. But for the majority of Canadians who can't afford to contribute, is there a risk that left to their own devices, Canadians aren't saving enough for retirement? If the thesis is that periods of higher growth in capital earnings versus economic growth would deepen inequality, is that not a risk to the economy?

Mr. Stephen S. Poloz: As you outline it, it would of course appear as a risk in these next few years as more and more people retire if they're not able to sustain their standard of living. In the big picture, it would suggest that investing whatever savings you do have in the capital markets will allow those savings to latch onto that return on capital, as opposed to the earnings strain. That's why the convergence is usually presumed in our long-term model.

Hon. Scott Brison: A lot of Canadian families don't have any excess income to invest.

Mr. Stephen S. Poloz: My understanding is exactly that, that savings are not as high as we would like to see them in that basic context, yes.

Hon. Scott Brison: I have a question on energy prices. Has the bank examined what the impact would be on the Canadian economy if we could get the world price for our oil, as an example?

Mr. Stephen S. Poloz: For our oil?

Hon. Scott Brison: Oil, yes.

Mr. Stephen S. Poloz: It would mean a few dollars more per barrel. I haven't done the math on that, but it would be significant money.

Mr. Tiff Macklem: We have done calculations from time to time. If you say the spread of WCS to WTI is $40, which would be a pretty big spread—it's a lot smaller than that now—you multiply that by the exports of oil, you can get a pretty big number, well into the billions. If the spread is narrower, the number is a lot smaller. The key point is it's been very volatile.

The Chair: Why don't we ask them to send in some follow-up information?

Mr. Saxton has a couple of minutes, and then we want to move to the Parliamentary Budget Officer.

Thanks very much, Mr. Brison.

Hon. Scott Brison: Thank you.

The Chair: Mr. Saxton, a brief round, please.

Mr. Andrew Saxton: Thank you, Chair.

I just have one last question that I'd like to ask the governor and the senior deputy governor.

In your statements today, you mentioned that Canada weathered the economic storm fairly well during the recession, as well as coming out of the recession. Relatively speaking, in fact, we did extremely well, but we're not immune to outside forces that could still weaken our economy. I'm interested to know what outside forces you think may make us vulnerable. Specifically, how will the tapering of quantitative easing in the United States impact our markets and our economy?

Mr. Stephen S. Poloz: Our vulnerabilities remain to the external environment, that's for certain. Our biggest one is that our export outlook is crucial to our getting inflation back to target, and that relies on the U.S. recovery being on all cylinders. If that were to falter so would the rest of our outlook.

We're also concerned about developments in China, where growth is clearly decelerating. We still think it would be around 7%, but it has financial vulnerabilities that make us concerned. As we talked before about Europe, especially it's a fragile recovery and it may interact with the Russian-Ukraine situation. Those are external things which we always must be mindful of.

In terms of the tapering, I don't see that as a major issue for us. The U.S. Federal Reserve is in the process of readjusting to a normalizing economy, and to the extent that they adjust to that, the normalizing economy will be beneficial for Canada. Yes, at some point, no doubt interest rates in the U.S. will begin to rise to become more normal. That will be coming in the context of rising U.S. growth and, we presume, exports from Canada into that higher growth, and therefore a stronger economy here. So when that comes at you, then it's not some external force, it's being all part of the same picture.

● (1705)

Mr. Andrew Saxton: Finally, there was an economist in the United States today who predicted that the tapering of quantitative easing will have a significant impact on asset values in the United States. Do you share that opinion as well?

Mr. Stephen S. Poloz: I think tapering itself is fully priced into markets as we see them today. I don't think the rest of the tapering program will have any further impact on asset prices. The curve has it already priced out.

Mr. Andrew Saxton: Thank you very much.

Thank you, Chair.

The Chair: I want to thank the governor, Mr. Poloz, very much for being with us.

Mr. Macklem, again, thank you very much in your last appearance before this committee. We hope to see you again before this committee in another capacity. Thank you so much for being with us and responding to our questions. If there's anything further, please do submit it to the committee. We'll ensure all members get it.

Mr. Stephen S. Poloz: No problem. It's our pleasure. Thank you, Chair.

Mr. Tiff Macklem: Thank you.

The Chair: Colleagues, we'll suspend for a few minutes and bring the Parliamentary Budget Officer forward.

Thank you.

● (1705)

(Pause)

● (1710)

The Chair: I call this meeting back to order. Colleagues, I would ask you to find your seats, please.

Before we go to the Parliamentary Budget Officer, we will be dealing with the first report from the finance subcommittee, and you should all have a copy of the report in front of you. It deals with how the committee is going to proceed with Bill C-31, and also with our youth employment study dates, main estimates, and pre-budget consultations. You should also have a calendar in front of you. I am very hopeful that we can deal with this expeditiously.

Mr. Cullen will be first to speak to this.

Mr. Nathan Cullen: Thank you very much, Mr. Chair.

I apologize to our guests. We're trying to cram in a little committee business before we get to you. I will speak as briefly as I can.

We've looked at this report in terms of the approach we are taking to the study of the recent Conservative omnibus bill. It will come as no surprise to my Conservative colleagues that, under this Conservative motion, the challenge the committee has is to divide the bill, in name only, so that committees around Parliament will then do a nominal study of various aspects, because the bill is so complex. However, none of those committees will be allowed to make amendments to the bill based on the witness testimony they hear. As you know, Mr. Chair, doing that is the job of parliamentarians, and we don't have the power to allow other committees to do that.

Under this process, they will then kick it back to this committee and, if history is any teacher, the committee will then take a rapid-fire approach to voting on amendments to a complicated bill when almost none of the voting committee members around this table will have seen the witnesses and heard the testimony. This is a bad way to do policy. This is a bad way for the government to conduct itself, and this has led to problems in the past. One would think that the best teacher is experience. The government has been through this before with these monstrous bills, and has taken this approach as a half measure due to the complexity and the massive non-financial elements of this particular piece of legislation.

Conservatives, I remember fondly, used to rail against this technique when in opposition and have since put the technique on steroids and made it common practice. It shouldn't be. It is an uncommon thing to act this way.

We have a massive tax treaty buried within this bill, the so-called FATCA, which may expose as many as one million Canadians. There are measures on temporary foreign workers. There are measures on reducing hospital fees.

There are measures within this legislation that deserve the respect we as parliamentarians can give them by doing our job. That's why people elect us and send us here.

With that, Mr. Chair, we argue that if a compromise can't be found on the way this legislation has been drawn up, the link between the work of committees and MPs will be broken. Committees were created in the first place to study legislation, hear witnesses, and affect legislation through amendments that we think are viable. The past has also taught us that on these omnibus bills—and I can't recall a single amendment from the opposition having been adopted by the government through hundreds and hundreds of pages of omnibus legislation—the government has refused virtually every single amendment based on expert witnesses. There is all of that as well as the experience that the government, in this omnibus bill, has had to fix measures from the last omnibus bill, which had in it measures to fix mistakes from the previous omnibus bill, so obviously the model has its shortcomings.

I'd implore the government to reconsider this approach. It doesn't work for them, and it doesn't work for the opposition, and it certainly doesn't work for the Canadian public we are meant to serve.

With that, in recognition of our guests being here, Mr. Chair, I, for my part at least, don't want to prolong this conversation. I don't know if other colleagues will have things to say, but this motion, as presented by my Conservative colleagues, does much of nothing other than provide confusion in a parliamentary process that's vital over a piece of legislation that is some 300 pages in length and that affects many aspects of Canadian law.

I suspect the next omnibus bill will have to fix mistakes that are in this one. What a way to run a country. It's no good, and I wish the Conservatives would hearken back to the position they held when they were in opposition and they had so much distaste for this type of technique.

I'll leave it at that, Mr. Chair.

● (1715)

The Chair: Thank you, Mr. Cullen.

I'll go to Mr. Brison next.

Hon. Scott Brison: I share some of the concerns described by Mr. Cullen.

The legislation has a wide variety of unrelated measures that fall well outside the expertise of the finance committee. Some examples are compensation to veterans for previous clawbacks, which ought to be evaluated at the veterans committee. Rules on workplace hazardous chemicals ought to be dealt with by the health committee. Rules for suspended MPs ought to be dealt with at the procedure and House affairs committee. Titles and ranks in our military probably are for the national defence committee. For imported goods, I would suggest the public safety committee or whoever is responsible for the CBSA. Transfer of authority within the heritage portfolio should go to the heritage committee. Rules around setting food inspection fees would probably go to the agriculture committee. Transferring authorities connected to the temporary foreign workers from the immigration minister to the employment minister should be for the immigration committee or the human resources committee.

Ideally, the committee responsible for the study of the subject matter ought to also be the committee voting on that section of the bill. It is still better to refer these matters to those committees for their input than to exclude them completely from the process, but it is not even close to a half measure, so I would like to move an amendment. Would this be the appropriate time?

The Chair: This would be the appropriate time, yes.

Hon. Scott Brison: That the report be amended by adding in paragraph (a)(i) after the words “175-192”, the words “clauses 206-209”; in paragraph (a) (iii), after the words “212-233” , the words “clauses 308-310”; and after paragraph (a) (iii), the following: “(iv) the Standing Committee on Veterans Affairs, clauses 102-107; (v) the Standing Committee on Health, clauses 110-162; (vi) the Standing Committee on Justice and Human Rights, clauses 164-165 and 376-482; (vii) the Standing Committee on Procedure and House Affairs, clauses 166-167; (viii) the Standing Committee on National Defence, clauses 168-171; (ix) the Standing Committee on Public Safety and National Security, clauses 172-174; (x) the Standing Committee on Canadian Heritage, clauses 193-205; (xi) the Standing Committee on Agriculture and Agri-Food, clauses 234-236 and 252-253; and (xii) the Standing Committee on Citizenship and Immigration, clauses 299-307”.

Mr. Chair, could I speak to this amendment.

The Chair: You can speak to the amendment, yes.

Hon. Scott Brison: This is consistent with the government's intent that we divide the bill for study at appropriate committees. It simply extends the study of more areas of the bill to the appropriate committee. It's entirely consistent with the government's intention in the main motion proposed by Mr. Saxton.

The Chair: Thank you, Mr. Brison.

I will proceed in this manner. I will take discussion on the amendment and I'll have a vote on the amendment, and then we'll take a discussion on the main motion and then vote on the main motion, amended or not.

Mr. Saxton.

Mr. Andrew Saxton: Chair, I want to comment on some of the remarks made by my two colleagues on the other side of the table.

First of all, Mr. Cullen talked about compromise. I want to remind him that there was a significant amount of compromise on this. For example, we doubled the length of time that we're going to be studying FATCA. We extended the number of hours of the study of this report. We've increased the number of committees that will be studying the report along with our committee. There has been a significant amount of compromise. I hope he will see that.

With regard to the amendments, we don't think the amendments are worthy. We think the recommendation of the subcommittee is clear. The committees that it recommends should also study this bill are made clear and the number of hours of study are clear.

Therefore, we do not support the amendment.

● (1720)

The Chair: Thank you.

Monsieur Caron, s'il vous plait.

[*Translation*]

Mr. Guy Caron: Thank you, Mr. Chair.

In fact, that is in line with the comment I wanted to make before the amendment was proposed.

Part 6 has 30 divisions. Without the amendment, the committee would probably consider 23 or 24 of them. Three groups of witnesses have been proposed. Considering the number of witnesses that the opposition parties might suggest, we are probably talking about five to eight witnesses for about 20 or 25 separate divisions that deal with very different topics.

For a committee that is supposed to oversee government spending, this approach is not responsible. There are circumstances where omnibus bills are appropriate, but if they are used systematically and if almost everything is buried in one single bill, this committee cannot do its job properly.

The opposition and the government want to hear from witnesses in order to ask them questions and to carefully examine the strengths and weaknesses of each of the proposed items. Given how much time we now have, there is no way we can do so properly.

I think the amendment brought forward by my colleague is a way to ensure better oversight of what the budget bill is proposing, but it is not enough to allow us to do the work that Canadians expect us to do.

[*English*]

The Chair: Okay, *merci*.

I would like to move to the votes, and I'd like to move to testimony as soon as possible.

Mr. Cullen.

Mr. Nathan Cullen: Again with apologies to our guests, because we have some important things to hear from you, yet I'm sure folks from the Parliamentary Budget Office also appreciate what we're trying to do here, which is to understand complex legislation.

To Andrew's point about compromise and time, I'm a bit confused only in the sense that I thought Scott's amendment was quite reasonable. It doesn't extend, it doesn't cause any harm to the Conservative government's agenda or timing of the pacing of votes. It simply allows the complex sections, as my friend Mr. Caron has said, to be studied by groups, to actually hear witnesses. As the Conservatives will find, when we prepare our witness list, if you have 30 individual sections but only one or two panels, obviously there are whole elements that we will not hear about. I don't argue this solely for the purpose of the opposition, Mr. Chair, but committee members on both sides will be looking at legislation, the impact of which we will not understand simply because we don't have the time as is outlined.

I appreciate that FATCA is going to get some attention. I would imagine that everybody will be interested in that attention because it's a major tax treaty with the United States, our major trading partner. One might argue it could be a stand-alone bill, but the fact of the matter remains—and I'll stop at this, Mr. Chair—that this entire process is of the Conservatives' own creation. To get at all frustrated or unwilling to do the best job possible is not understandable simply because it was choices that were made when designing a bill of this size. Those choices have consequences. We're trying to remedy those consequences as best we can so that we can understand the legislation that's in front of us. So if veterans affairs should see it, then veterans affairs should see it.

We will be supporting the amendment from Mr. Brison. I am a little surprised that the Conservatives will not be joining us on that.

The Chair: Thank you.

I will call the vote on the amendment.

(Amendment negatived)

The Chair: We'll call the vote on adoption of the first report of the subcommittee.

Mr. Nathan Cullen: A recorded vote, please.

The Chair: Okay, it's a recorded vote.

(Motion agreed to: yeas 5; nays 4 [See *Minutes of Proceedings*])

The Chair: The first report is adopted and the calendar will be updated, colleagues.

I want to quickly move to our next set of witnesses.

I thank you so much for your patience. We did have to deal with that. We were supposed to deal with it before the break, but we had a very unfortunate passing of a friend and colleague.

Pursuant to Standing Order 108(2), a study of the economic and fiscal outlook, we are very pleased to welcome the Parliamentary Budget Officer, Mr. Jean-Denis Fréchette, and a number of colleagues from the Library of Parliament.

● (1725)

[*Translation*]

Welcome to this committee.

[*English*]

Mr. Fréchette, you'll have an opening statement. Perhaps I could ask you to introduce your colleagues at that time. We will then have questions from all the members.

Mr. Jean-Denis Fréchette (Parliamentary Budget Officer, Library of Parliament): Thank you, Mr. Chair.

No apology is required. You know that I am very familiar with committee business. It's still music to my ears, and it's a very good introduction actually.

Thank you again for the invitation.

I am here with my colleagues: Mostafa Askari, who is the assistant PBO; Peter Weltman, who is the assistant PBO as well; and with the authors of this fabulous report, Scott, Randall, and Helen.

We are pleased to be here to present the PBO's economic and fiscal outlook, which we released yesterday. Since our last appearance before your committee, the PBO team has published 15 reports, and we continue to be very attentive to Parliament's needs that fall under our mandate.

Regarding the economic outlook, global economic activity picked up in the second half of 2013 and is expected to continue to improve in 2014 and 2015 as more modest fiscal tightening is complemented by still highly accommodative monetary policy in advanced economies. That said, downside risks remain with risk related to low inflation in advanced economies coming to the fore more recently.

In the United States, growth in the second half of 2013 was much stronger than expected in October 2013. Despite the stronger than expected growth, PBO has left its outlook for U.S. growth in 2014 unchanged at 2.7%, in large part due to weather-related weakness in the first quarter of the year. Growth over the remainder of the projection is broadly unchanged from the October 2013 economic and fiscal outlook update.

Based on the Bank of Canada's commodity price index, the PBO outlook for commodity prices is modestly stronger than the October 2013 update projection. That said, PBO's outlook for the price index remains higher over the projection than futures prices would suggest, but below the no-change projection assumed by the Bank of Canada in its April 2014 monetary policy report. These developments have led PBO to revise upwards the outlook for the Canadian economy relative to its October 2013 economic fiscal outlook.

Currently, PBO projects Canadian real GDP to grow by 2.1% this year, 2.7% next year, and 2.5% in 2016.

As the economy reaches its potential level of economic activity, PBO projects real GDP growth to be below 2% annually in 2017 and 2018. PBO's outlook incorporates both stimulative and restraint measures introduced beginning in budget 2012. PBO projects that the level of real GDP will be 0.5% lower in 2016 than would have been the case in the absence of these measures.

Further, this economic impact translates into about 46,000 fewer jobs being created by 2016. Just to be clear, it doesn't mean a decline of 46,000 jobs, but in the absence of these restraints, employment would have been higher by 46,000 jobs.

PBO's outlook for nominal GDP, the broadest measure of the government's tax base, is, on average, $17 billion lower than the projection based on average private sector forecasts. PBO judges that the balance of risk to the private sector outlook for nominal GDP is tilted to the downside, likely reflecting larger impacts from government spending reduction, as well as differences in views on commodity prices and their impacts on real GDP growth and GDP inflation.

However, based on its projection of nominal GDP, PBO judges that the downside risk to the private sector outlook for nominal GDP is broadly in line with the government's $20 billion annual adjustment for risk.

● (1730)

I will continue in French.

[*Translation*]

I will now talk about the fiscal outlook.

Prospects for budgetary surpluses are higher over the outlook than in PBO's October 2013 update, due to a combination of an improved economic outlook and measures in the Update of Economic and Fiscal Projections 2014 and budget 2014, in particular further planned restraint in direct program expenses.

PBO estimates that the deficit will be $11.6 billion (0.6% of GDP) in 2013-14 and will return to a surplus in 2015-16 ($7.8 billion), maintaining a surplus of $8.6 billion (0.4% of GDP on average) over the remainder of the outlook.

PBO estimates that the likelihood of achieving a budgetary balance or better is approximately 50% in 2014-15, 70% in 2015-16, 60% in 2017-18 and 65% in 2018-19.

While PBO projects budget surpluses over the medium term, these are primarily attributable to the economy growing faster than trend, rather than revenues being structurally higher than expenses. Therefore, there is limited room to implement new policies that reduce tax revenues or increase spending without re-introducing structural deficits. That said, PBO has identified several risks to the fiscal outlook.

First, the PBO projection of the commodity price index assumes that, after two years, real commodity prices will remain broadly unchanged. In contrast, the projection using energy and non-energy futures prices suggests that the commodity price index will decline over the projection. Were this to occur, the level of nominal GDP would be $26 billion below PBO's baseline projection in 2018.

Second, the discretion granted to the Governor in Council for setting employment insurance rates introduces considerable uncertainty in the outlook for revenues. Were the government to set rates to balance revenues with forecast expenditures, it could decrease the revenue outlook and the budget surplus by $2.2 billion in 2015-16 and $2.8 billion in 2016-17.

Third, PBO currently takes Finance Canada's projection for direct program expenses as given, as the government has refused to release the data required to assess if the current restraint is sustainable and to allow PBO to do its own projection of direct program expenses.

Such a prolonged period of suppressed direct program expenses growth has never occurred in the history of the modern public accounts. Historically, a year of reductions is typically followed by a year of increases in direct program expenses of around 6.4%. As a result, direct program expenses may face significant pressures following the 2014-15 cuts, as the most significant year-over-year reduction in direct program expenses is set for 2014-15. Were the typical rebound from a period of direct program expenses reductions to occur in 2014-15 or 2015-16, it would eliminate the projected surplus in 2015-16.

I and my colleagues will be happy to respond to questions you may have regarding our economic and fiscal outlook or any other relevant matter.

Thank you, Mr. Chair.

● (1735)

The Chair: Thank you very much for your presentation.

We will start with Mr. Cullen. You have seven minutes.

[*English*]

Mr. Nathan Cullen: Thank you for being here, Mr. Fréchette, with your excellent authors, as you called them, accompanying you today. Thank you for your report as well. It's interesting.

What work has your office done on the temporary foreign workers program and its impact on the Canadian economy to this point?

Mr. Jean-Denis Fréchette: Thank you for the question. It's clearly an interesting issue which is really

[*Translation*]

a hot topic these days

[*English*]

if I can say that. We did a report a couple of weeks ago on the labour market assessment. If you want to discuss the temporary foreign workers program a little bit more, I will ask Mostafa to discuss that issue.

Mr. Mostafa Askari (Assistant Parliamentary Budget Officer, Economic and Fiscal Analysis, Library of Parliament): We did a report on the labour market, with the intention of providing the status of the current labour market. We also looked at the issue of labour shortages and skills mismatch.

In that report, based on the data that we received from the Conference Board of Canada on the vacancies that exist in Canada, we could not really find any strong evidence of any kind of a labour shortage widespread in Canada, or even at the regional level at the professional level.

The only place that has any indication of a labour shortage was Saskatchewan. To find other evidence for that, we also looked at the wage growth for various professions in different regions, and we did not see any indication of abnormal wage increases, which you would normally expect if there was a shortage of labour.

Overall, our conclusion was that we could not find any evidence of a shortage of labour. Now we did not link that to the TFW, the temporary foreign workers. We haven't really done any kind of work on that, and I think the only way you can actually do credible work on temporary foreign workers is to have very credible data on the shortage of labour in Canada, which we do not have at the moment. That would be the first step. We would like to do that.

Mr. Nathan Cullen: That's confusing to me because I've heard the government, I've heard the Prime Minister, various ministers say that we have a labour shortage in Canada, and you're telling me that we don't have the data to support whether we do or we don't. You said that the evidence you looked at found no evidence at a national or regional level?

Mr. Mostafa Askari: At the regional or at the professional level for various occupations—

Mr. Nathan Cullen: You also looked for an indicator that wages within certain sectors and certain skill sets are changing?

Mr. Mostafa Askari: Changing.

Mr. Nathan Cullen: And that is an indicator that we typically see if there is a—let me just follow this through—skills shortage, a labour shortage in a particular industry, or in a particular sector. One of the indicators you would look for, economists would look for, is an increase in wages, because of the supply and demand factor, and that would be one of the signs you're looking for to indicate a labour shortage either at a regional level geographically, or at a skills level within a certain industry. Is that right?

Mr. Mostafa Askari: Absolutely.

Mr. Nathan Cullen: You could find neither of those things.

Mr. Mostafa Askari: No.

Mr. Nathan Cullen: I understand what you're saying in terms of attempting to understand the positive and negative impacts of a specific program, like temporary foreign workers, but without that background, without the understanding of what's happening in the labour market at that level, as the governor of the bank said earlier, we'd always like more data.

How critical is having that data to a government implementing a program such as the temporary foreign worker program, as employers are coming to the federal government saying they need this program to augment because they simply have a labour shortage available?

How important is the data in order to guide the effectiveness of a program like temporary foreign workers?

Mr. Mostafa Askari: We work with data and we do our analysis based on data. We cannot do analysis based on the assertions by employers associations. To us, that's not solid evidence.

Any program in order be designed well needs to have the data to determine whether there's a labour shortage. In fact, we have a lot of data on the labour supply in Canada, which the government actually uses to determine regional unemployment rates for the management of the EI program, but we do not collect any information on labour demand, which is really critical in this case because once you have that, then the program can be targeted to regions and professions that show that kind of a shortage.

● (1740)

Mr. Nathan Cullen: Where did you get the information for your labour market assessment, that approximately one in four new jobs in 2012 went to temporary foreign workers? How do you—

Mr. Mostafa Askari: It's based on the data that existed in terms of the number of jobs that were created during that period, and the number of temporary foreign workers that existed at the time. It's a very crude kind of estimate. It's very hard to develop that and look at the estimate of the temporary foreign workers program on their unemployment rate, or their rate of employment, for example.

Mr. Nathan Cullen: Back to that natural supply and demand that we would see between a shortage in workers and an increase in wages being offered. That's a typical thing we would see in a free-market economy. C.D. Howe, that left-wing think tank, has looked at this and raised the question about whether a program such as this, if misapplied in particular, could have a suppressive effect on wages for Canadians who are not at all linked to a temporary foreign worker program, but are impacted by that.

Has your office looked to do this? Has it undertaken such research?

Mr. Mostafa Askari: We have not done that. As I said—

Mr. Nathan Cullen: Could you?

Mr. Mostafa Askari: It is possible to take a look at that and get back to you. Other than having a need to have the data for the labour shortage, we also need detailed data from the government on the temporary foreign workers program.

Mr. Nathan Cullen: And you don't have that?

Mr. Mostafa Askari: We don't have that. We have not requested that, but we can.

Mr. Nathan Cullen: We'll make the request, too, and see if our combined efforts will actually get us the reality.

In this recent report, you talked about government spending as a restraint "acting as a drag on economic activity and job creation going forward."

How much of an impact...? I'll leave it at that.

Mr. Mostafa Askari: As we noted in the report, we looked at all the measures introduced by the government since budget 2012, both the stimulative measures and the restrained measures, and it combined the two. We have evaluated the impact of those, and based on that, there is an impact of about 0.5% at the level of GDP, and about 46,000 jobs. Again, it's just to stress that this does not mean we are going to see a decline in employment. This is relative to what would have been the case, essentially, had they not introduced those measures.

The Chair: Thank you, Mr. Cullen.

Mr. Saxton, please.

Mr. Andrew Saxton: Thank you to our witnesses for being here today.

When we conducted our pre-budget consultations across the country, we heard from employers across the country about their difficulties in finding skilled labour. There definitely were regions that had more difficulty than others, regions like Alberta, Saskatchewan, and Newfoundland, but it was generally across the country and across the board that employers told us over and over again that they had difficulty finding skilled labour.

I want to ask whether you have studied the skills gap here in Canada.

Mr. Mostafa Askari: As I mentioned in the labour report that we did, we looked at the skills gap based on the Beveridge curve that economists use. It's the relationship between the vacancy rate and unemployment rate, and as I said, the data does not support that.

I realize that some employers associations have been saying that, but even a survey by the Bank of Canada, where they talked to all the different businesses across the country, probably does not show any concern or an increase in concern by businesses in terms of hiring and the labour shortage. We have to work with numbers and the data. We cannot base our analysis on what employers associations say.

Mr. Andrew Saxton: Still, it's quite surprising how your data is so different from what we heard from people who are actually in the market trying to find skilled labour. Maybe there's data that you're not looking at or that you haven't included in your report. Obviously, there's a difference in opinion here. It's not just opinion, it's a difference in what people are finding and saying versus what you found in your report. I would encourage you to look at more data, because it's surprising to me that your report did not confirm what we found when we did our pre-budget consultations.

Furthermore, I want to follow up on your last appearance before the committee. You've noted that the "prospects for the Canadian economy are generally more positive, as a result of buoyant international economic growth and sustained domestic demand." Moreover, the G-20 has recently committed to increasing global GDP over the course of the next few years by 2%, by elimination of trade barriers.

With the international economic outlook improving, especially in the United States, can you expand on how Canadian exporters stand to gain from increased demand from lower trade barriers?

● (1745)

Mr. Mostafa Askari: Certainly, anytime you lower any kind of trade barriers of a free trade agreement, this would have a positive impact on the Canadian economy in terms of the level of activity and employment. Then one has to look at the details of that and see exactly how that is working out, but in principle, yes, of course.

Mr. Andrew Saxton: Since taking over the government in 2006, our government has negotiated free trade agreements involving over 40 different countries, most recently with South Korea and with the European Union. Would you say that as a result of these free trade agreements that have been put in place in the last eight years that Canadian exporters stand to gain, both in the numbers of jobs that would be created as well as economic growth?

Mr. Mostafa Askari: As I said, in principle, yes, but I think we do have an issue with the trade and exports in Canada. When you look at the trend in the contribution of exports to Canadian GDP since 2000, we have not actually seen any contribution from exports to the Canadian economy, which is somewhat odd because we are in a small, open economy and are highly dependent on exports. Many will look at the level of real exports from 2000 to 2013. In fact, real exports are almost at the same level now compared to the year 2000. Part of that is because we went through a very huge recession obviously, and we have not completely recovered from that yet.

Mr. Andrew Saxton: Since the onset of the recovery in late 2009, the PBO has noted that economic growth has modestly outpaced its potential growth rate, and as a result, the output gap has gradually narrowed with approximately two-thirds of the gap being eliminated since the second quarter of 2009.

What additional areas can the government make improvements in to continue this strong trend?

Mr. Mostafa Askari: We normally do not make political recommendations to the government. It's not part of our mandate to actually comment on policy and what the government can and cannot do.

Mr. Andrew Saxton: Okay.

Finally, I just want to ask you this. Some members of the opposition have suggested that we should not be focusing on balancing the budget at this time. However, the benefits of having a balanced budget are immense, including lower taxes, lower interest rates, lower borrowing costs, and lower interest expense for government, leaving more funds available for programs. Therefore, shouldn't we move as quickly as possible to balance the budget?

Mr. Mostafa Askari: What is really important in terms of the fiscal situation is the long-term sustainability of the fiscal structure.

The studies that we have done in providing a fiscal sustainability report—and the last one was issued in November—show that in fact with the government cuts, the current fiscal structure is sustainable. If nothing is done from now until 2040, the debt will be completely eliminated based on the current fiscal structure.

Whether or not we will see a fiscal surplus in one year or a small deficit in another year, it doesn't really have much significance in terms of the long-term sustainability of the fiscal structure. From an economic perspective, those kinds of minor fluctuations from one year to another do not really have any economic significance, because if the trend is toward a balanced budget and elimination of the debt, that essentially indicates that the fiscal structure is in good shape right now.

Mr. Andrew Saxton: When you say that if nothing is done we will pay off the debt, the accumulated debt, by 2040—and I think that's what you said—what you're basically saying is if the status quo is maintained, in other words, the current situation with low taxes, low business taxes, low taxes on middle income and in fact on all Canadians, if we maintain that tax regime, we will pay off the debt by 2040.

Is that what you're saying?

● (1750)

The Chair: Just a brief answer, please.

Mr. Mostafa Askari: Yes, based on a sustainability analysis. Yes.

The Chair: Thank you, Mr. Saxton.

Mr. Brison, please.

Hon. Scott Brison: Thanks to the entire PBO team for your work on an ongoing basis and those of you who joined us today.

In early May 2013, about a year ago, I asked you to analyze the closing tax loopholes measures in recent budgets. A year has passed now and I want to know what the fiscal impact would be. Has CRA provided you with the information you need to do this analysis?

Mr. Jean-Denis Fréchette: Thank you for the question.

I wasn't there in May 2013, but I followed the file. It is now under my leadership that we continue working with CRA to have access to this kind of information, and not only that one. We also received another similar request back in November 2012. We are working on that. We're making progress with CRA. I'm not saying that it's easy, but we do make progress. We have openness with them. We have a good relationship. Do we have to be patient? Yes, we have to be patient with that.

Before I ask Mostafa to talk a little bit about the details of it, I would note that we developed another approach. We developed another methodology to look at these data with the kind of information we can receive from CRA. We're building bridges there. I will ask Mostafa to maybe talk a little bit more about the details of the procedure.

Mr. Mostafa Askari: In order to do the study that you requested and also a study that a senator requested us to do on the tax gap, we requested information on the microdata from CRA. Essentially, we wanted to look at the taxpayer data.

CRA takes the view that it is not permitted to give us that information, because there is tax information there.

We do not agree with that assessment, because we believe that under the Parliament of Canada Act, we have the right to information that would allow us to fulfill our mandate, and given that doing a tax analysis is part of our mandate, we felt that would be permitted. In fact, the CRA uses section 241 to deny us the information, but in fact, section 241 of the Income Tax Act allows the CRA to provide:

> taxpayer information to...any person otherwise legally entitled to it under an Act of Parliament solely for the purposes for which that person is entitled to such information.

We believe that section 79.3 of the Parliament of Canada Act allows us to have access.

However, after about a year of back and forth and negotiations with the CRA, they recently informed us that they are willing to provide us data, but they are going to anonymize the data and stratify the data. They're asking for $141,000 as the cost of doing that and they need six months to provide that information to us.

Hon. Scott Brison: But given that you're covered under section 79.4 of the Parliament of Canada Act and you are required to keep any financial or economic data that you receive confidential, isn't it redundant for CRA to delay six months and to spend tax dollars to anonymize information that you are required by law to protect in any case?

Mr. Mostafa Askari: In our view, you are right, but we are taking a pragmatic approach, in the sense that we want to get the data one way or another to do the work for you and for Parliament. We have reached a point where we have essentially no choice but to agree to the conditions that they have proposed.

Hon. Scott Brison: In your view, the arguments made by CRA were contrary to the arguments by CRA. Your access is not contradicted by either the Income Tax Act or the Privacy Act.

● (1755)

Mr. Mostafa Askari: That's right.

Hon. Scott Brison: Do you have a legal opinion to that effect?

Mr. Mostafa Askari: We do not have an official legal opinion. We have done some legal analysis. Jean-Denis may want to comment.

Mr. Jean-Denis Fréchette: In our negotiations with the CRA, we in effect agreed to have an agreement with them, so that they will provide the information. At least it's going to be a beginning. We make clear in my discussions and the team discussions with CRA that it is a beginning. We can see what we will do with that. Then we clearly mention in the letter that we may go back and ask for more information to pursue that context.

I want to mention something. Tomorrow you will be called to vote on private members' business that was tabled in early April asking the PBO and the OAG to do that kind of study jointly. It's a long motion. I think the vote, according to the journal, is tomorrow.

I'm in discussion with the OAG about that as well. We do exchanges because we are kind of colleagues. We are looking at what he thinks about that. It's an interesting motion and we will see after that. We will see what will happen with that, but there is some interest from both sides, from both the OAG and the PBO.

As I'm saying, right now I'm kind of happy. That's a big word, but I'm happy with the CRA. I'm not saying that I will always be happy, but for the moment we have good progress with them.

Hon. Scott Brison: Given the size of the CRA team and resources, you have quite a skeletal organization. There's a delaying and a dragging out of providing information for you to do your jobs. That doesn't strike me as being a good use of your time.

Are you prepared potentially to go to court to defend your right to bring in timely information from CRA?

The Chair: A brief response, please.

Mr. Jean-Denis Fréchette: I would simply say my heart is bleeding, as a reference to the heartbleed bug.

The team, to be very short, will develop five strategic priorities over the next five years. Number four is exactly about defending the legislative mandate to have access to information, with all the means that will be required.

Hon. Scott Brison: Potentially going to court.

The Chair: Is that a yes or...?

Mr. Jean-Denis Fréchette: Yes. As a manager, I have to be careful to say yes to that. All the means, and it's going to be on the Internet, it's part of the priority.

The Chair: Thank you.

I'll go to Mr. Keddy.

Mr. Gerald Keddy: Welcome to our witnesses.

It's an interesting discussion. As you know, the Parliamentary Budget Officer's role is a complex and difficult one that is made more difficult, I suspect, because of requests that come to you from MPs and from political parties and for various other reasons. Those reasons can be political reasons. They can be anything, but they have an economic base.

I think it deserves to be mentioned that CRA is responsible under the Income Tax Act and under the Excise Tax Act. CRA members and officials are held criminally responsible for breaking confidentiality. That's not something to be taken lightly. It's certainly not something that is easy to deal with when you're dealing with personal information.

The other thing is the civic question on the tax gap that most G-20 countries don't follow up on, because you can't get good information on it, mainly because of confidentiality and the difficulty of handling it. I'm not asking for an answer on it, but I'm simply looking at your role and the difficulty of that role when you're trying to respond to questions with a limited budget. Even though you have a well-qualified team and a limited team, it's not an easy role.

I want to pick up on a comment that Mr. Askari made on the exports since 2000, because according to your information, really the exports since 2000 have not made a contribution to the Canadian economy. I'd like to explore that a little bit deeper. I don't think that's exactly what you meant, because I suspect if we took away the exports.... I mean, we are an export-driven economy and very much of that is commodity driven. If we took those exports out of the Canadian economy, I think we'd leave quite a gap there. Using rough numbers, 60% or 65% of our economy is export based. Of that, 72% or 73% is based on trading with the United States. I can't fathom that since 2000 it has really not made a contribution to the economy.

I'm going to give you a chance to explore that a little deeper.

● (1800)

Mr. Mostafa Askari: I'm glad you asked for a clarification. I think what I said was not that the exports do not make any contribution to the Canadian economy, but that exports did not make any contribution to growth in GDP since 2000. That's a completely different issue.

Mr. Gerald Keddy: Absolutely. Thank you for that.

In trying to follow up on that point, your office estimated that imports from South Korea are in the $5 billion per year range. If we look at the cost of the fiscal framework for removing tariffs, there's a cost to that without question. It's not all profit. There has to be a net in there somewhere, a net gain. Comparable to the cost of removing tariffs as part of the comprehensive European trade agreement, the fiscal impact will be somewhere in the $50 million range. Is that...?

Mr. Mostafa Askari: Scott, do you want to talk about that?

Mr. Scott Cameron (Economic Advisor, Analyst, Economic and Fiscal Analysis, Library of Parliament): We're working with fairly rough data, but in the absence of an official fiscal impact costing of the government, kind of what we've gone with is that $50 million, yes.

Mr. Gerald Keddy: Everything has a cost. Everything that government does has a cost. That doesn't surprise me, but I think the $50 million gets lost. People look at the $50 million cost and they forget the $4.95 billion left over. That's the difficulty of that estimate. I'm going back to the fact that we're a trading economy. We're based on trade, and we're trying to break down barriers worldwide. I think we've been fairly successful at that. Other governments have followed up, but not to the degree that we have. My fear is that people look at that number and say that there's a $50 million cost there but then they forget the $4.95 billion net gain.

Mr. Scott Cameron: I think our point was that it's a very small cost. There isn't much of a fiscal impact to that agreement.

Mr. Gerald Keddy: Part of the discussion we had with the Governor of the Bank of Canada was on the challenge that Canada faces, a challenge that you folks would be very familiar with, on the growth of the economy, on keeping inflation under control and at the same time controlling competitiveness, and on our ability to compete on an international scale. I think we do fairly well, but without question I think we can do better.

What's the role of government? We can open the doors and we can break the barriers down, but how do we actually have some influence on competitiveness? Can we?

Mr. Mostafa Askari: I can get into trouble by answering that question, sir.

Mr. Gerald Keddy: I might have got in trouble by asking it. I'm not sure.

Mr. Jean-Denis Fréchette: Just don't.

Mr. Mostafa Askari: I don't think I can make any comment. Again, it's a policy sort of question that we normally do not make any comments on.

Mr. Gerald Keddy: Okay. That's fair enough.

Based on that same line of questioning, if we look at the Canadian dollar, and part of the discussion we had earlier—

● (1805)

The Chair: You have one question, please.

Mr. Gerald Keddy: —being at that 91¢, if the dollar falls too far then we also get a windfall for some of our exporters, but we also tend to lose productivity.

Do you want to talk about how those two are interconnected?

Mr. Mostafa Askari: Certainly.

The Canadian dollar has a very important role to play, given that it impacts both our exports and our imports because it determines the cost of imports. One way or another, there has to be a rate at which it optimizes the impact on the Canadian economy. Nobody really knows what that rate is. There are some estimates of what they call the purchasing power parity of the dollar, which used to be around 89¢ or 90¢. I don't really know exactly what it is right now. That doesn't necessarily mean that's an optimum rate for the exchange rate.

The Chair: I'm sorry. I hesitated, but I want to be fair to all members here.

[*Translation*]

Mr. Caron, you have the floor.

Mr. Guy Caron: Thank you very much, Mr. Chair.

Thank you for joining us and for your presentation, Mr. Fréchette.

I would like to turn to the report you wrote about the main estimates. You came back to a problem that seems to me to keep happening. I am talking about the lack of accountability and the significant differences between what are called the main estimates and the budget announced by the government.

You pointed out that the two processes are moving further and further apart and that we are now in a situation where only 85% of the budget is explained in the main estimates, a percentage that is constantly going down.

You also pointed out the different accounting methods used in the main estimates, where general accounting per se can be clearly seen, and in the budget announced by the government.

Could you tell me what purpose parliamentarians currently serve? Is it possible for us to properly analyze government expenses or is this an exercise that is becoming more and more futile?

Mr. Jean-Denis Fréchette: I will pass that question to Mr. Askari, who can provide you with more details about the subject.

The PBO exists to help parliamentarians. Our purpose is to identify precisely that kind of situation. We try to provide parliamentarians with explanations as much as we can, but things can get difficult. We brought it up in a report so that parliamentarians can debate it.

In that sense, once we have given you the information, I assume that you have the tools you need for that debate.

Mr. Guy Caron: Mr. Askari, do you want to answer the question?

Mr. Mostafa Askari: You are absolutely right.

At the moment, the main estimates are not very useful in examining the government's financial situation because of the different accounting systems. Two years ago, we advised the parliamentary committee to change the system in the main estimates and we hope that that will eventually be done.

Mr. Guy Caron: You said that we have the tools we need, but I have here a quotation from your predecessor, Mr. Page. In the *Canadian Parliamentary Review*, he wrote this:

> One of the key principles underlying responsible parliamentary government is that the House of Commons holds the “power of the purse”. The House must be able to satisfy itself, as the confidence chamber, that all spending and taxation is consistent with legislation, Parliament's intentions, and the principles of parliamentary control. When this is accomplished, Parliament is serving Canadians.
>
> In my view, this is rarely accomplished.

I think he meant that we as parliamentarians do not have the tools we need to do the job adequately. The main estimates really are the most detailed report in which the government indicates what it wants to spend across all its programs. But rarely do the various committees, including the finance committee, analyze the government's intentions with any rigour.

This is about the budget and soon we will be studying the bill that is to implement it. We have already objected to the short amount of time we have to examine this bill in an appropriate and meaningful way. The same applies to the government's accounts.

How could we change things to make the government accountable to Parliament and to the House of Commons?

Mr. Jean-Denis Fréchette: First, I would like to say that I agree with my predecessor's statement. I remember having said at this committee that I remember fondly the committees—and this goes back 10 or 15 years—that used to go over the main estimates perhaps for two months. Each of the responsible committees did an in-depth review of the estimates.

I have no recommendations to make. As I said, I agree with Mr. Page. Some people talk about reform, others talk about different approaches. The Standing Committee on Government Operations wrote a report that was full of recommendations. It is really a committee of the kind that must make recommendations along those lines. The committee recommended, for example, using an idea from Robert Marleau, a former clerk of the House of Commons, that the old system be a model that would give committees more time than one month to review the main estimates.

Mr. Marleau went further. when he appeared before that committee, he recommended that the three principal committees, the Standing Committee on Finance, the Standing Committee on Government Operations and Estimates and the Standing Committee on Public Accounts should have not only a kind of parliamentary budget officer, but also highly specialized research officers to help them in their work.

With that, I will let you take a look at the deliberations of that committee.

● (1810)

Mr. Guy Caron: Thank you very much.

I have one final question for you, but I would first like to make sure that you will be sending the committee the information about the temporary foreign worker program that my colleague asked for.

Mr. Jean-Denis Fréchette: Is that an official request that you are making in public here?

Mr. Guy Caron: Yes.

Mr. Jean-Denis Fréchette: We will proceed as we usually do when we receive requests of that kind: we meet with the person making the request to discuss the parameters of the report.

Mr. Guy Caron: As I only have a minute left, I would now like to talk about the impact of the employment insurance operating account on the public purse.

Clearly, the government is trying to achieve a balanced budget. At the moment, the employment insurance operating account is accounted for by the government as part of its general accounting.

What impact will the decisions on the level of premiums have on achieving and maintaining a balanced budget for the federal government? Are we talking about a significant impact? If you are saying that the probability of reaching a balanced budget is 50% and that figure goes to 60% to 70% in future years, the impact of the account must be quite significant.

[*English*]

Mr. Mostafa Askari: If I may, I will answer this in English.

We have looked at the current rate, which is 1.88% and which the government has frozen for three years, but that creates a surplus in the account, which, based on the rules and the regulations that actually were introduced by the government, should not be the case. Based on a calculation, actually the rate could go down below the 1.88% that they have. That will eliminate the surplus in the account in 2015-16.

Overall, what we'll see is that there's going to be an impact of $2.2 billion on the budget balance in 2015-16 and $2.8 billion in the following year because of that change, if you follow the legislation for this.

The Chair: *Merci, Monsieur Caron.*

Mr. Allen, please.

Mr. Mike Allen: Welcome to the PBO staff.

I'd like to follow up on that last question on EI premiums. I'm looking at the chart that's in the 2014 budget. As you know, the 1.88% premium stays in place until 2016-17, and then at that point in time the EI operating account is projected to be at a surplus of 6.4%, but then for the next two years we're projecting benefit drawdown on that. Isn't it prudent that we keep the schedule to make sure that we're balancing over the seven-year basis, as we've said, and not run up a great big surplus in the EI account and have it taken like the Liberals did?

Mr. Mostafa Askari: In fact, on the issue that we have with that, if that rate could have been dropped much sooner without really creating any further deficit in the account—so a drop in the rate sooner—it would have actually provided that savings to Canadians without really creating any deficit in the accounts. This is where we have an issue, and we've provided an alternative scenario that would in fact show lower premium rates for EI without really creating any deficit in the account, and in fact, the account would be balanced over the seven-year period as the legislation requires the account to be.

Mr. Mike Allen: Did you project anything beyond 2018-19? Is there going to be a further drawdown on that?

● (1815)

Mr. Mostafa Askari: Yes, we do that, in fact.

What we do is we make sure that we follow the legislation so whatever premium rate we put in there would actually ensure that the account would be balanced over that seven-year period, which is in the legislation.

Mr. Mike Allen: I want to follow up on the labour situation. You indicated there's no credible data to say there is a shortage, but at the same time you can say that there isn't a shortage. I don't think you can say there's not a shortage if you can't determine if there is one.

I'll give an analogy, and I'm going to follow up on Mr. Saxton's comment. I have a pretty significant trucking industry in my riding, and they are constantly looking for long-haul truckers. Most of the stuff in western New Brunswick, because there are no train tracks in western New Brunswick, has to move on a truck. There is a lot of advertising; they are looking for temporary foreign workers quite often. I wonder if we can get into this, because there are a number of people out there who have the skills to truck but for various reasons do not want to do the long haul, or may not be able to meet the requirements of a long haul for crossing the border.

Do you believe that maybe there are some of those types of things in there, because there is an estimate, you think there are workers out there, but they are really not ones who can do the job?

Mr. Mostafa Askari: Normally in a dynamic labour market there is always a mismatch of skills. That's why the unemployment rate actually never goes down to zero, because there's always that kind of mismatch in the labour market. New people come in and new jobs are created, so part of that is normal. The issue is whether that kind of a mismatch is above the normal level.

As I mentioned, based on the existing data that we have from the Conference Board of Canada, we cannot really see any strong evidence that there is a widespread shortage. Certainly, there could be shortages in certain areas and for certain professions and in certain localities in the country, but there doesn't seem to be, at the higher level, any evidence that there is a widespread shortage.

Again, as I said, we looked at the ranges by different professions, but they don't seem to be moving much. If there is a shortage, one has to see that market signal, otherwise the market would not function if that signal is not there. That's how we do our analysis.

Mr. Mike Allen: I have to get some of my trucking firms to call you.

In one of your statements here you mention that as the economy reaches its potential level of economic activity, PBO projects real GDP growth to be below 2% annually in 2017-18.

Can you comment a little bit as to what the drag is in 2017-18, and what led to that more conservative forecast out in time?

Mr. Mostafa Askari: There are a couple of issues here. The way the projection is done normally, because we always look at the potential output as a sort of driving force for the economy because everything, in our view, has to go back to that.... Part of that is the economy cannot really operate above its potential for a long period of time. Eventually there are forces in the economy that will bring that back down. Also, during that period you see interest rates rising eventually, because now we are seeing the interest rates are going to be essentially constant until mid-2015, and then after that interest rates will start rising, as it's required for the Bank of Canada to control the rate of inflation once the economy reaches its potential.

That by itself will provide some kind of a drag on economic activity. It's consistent with that kind of a story that overall the economy is sort of moving towards its normal level of operation. From 2016 to 2018 we are actually moving above the normal level of operation of the Canadian economy. That cannot be sustained for a long period of time. Eventually it has to come down to its normal level of operation.

Mr. Mike Allen: In your projections when you talked about Mr. Saxton's question with respect to if everything stayed status quo, by 2040 we would wipe out over $600 billion in debt based on the current path we are on. That seems pretty impressive to me.

I wonder if you could reconcile the statement that therefore there's limited room to implement new policies that reduce tax revenues or increase spending without introducing structural deficits. It seems to me that if over 26 years you're able to pay off $600 billion in debt, you probably can do a few policy issues. Maybe you could reconcile that for me.

Mr. Mostafa Askari: Absolutely. If you look at the long term, based on our estimates, we have room of about 1.3% of GDP, about $25 billion, which the government can actually increase spending or reduce taxes without raising the level of debt-to-GDP ratio.

The statement that we have in the report is talking about the medium term over the five-year projection. If one does not want to see another deficit in those five years, then the room to manoeuvre within that five-year period is very limited and limited by the structural bounds that we are showing in our estimate. It is not very large; it is about an average of $2 billion.

● (1820)

The Chair: Mr. Rankin, please.

Mr. Murray Rankin: Welcome and thank you to the team and Mr. Fréchette for being here and for the excellent work you do.

As you mentioned, Mr. Fréchette, the NDP has been pushing for a CRA strategy on tax cheats and for the government to measure the tax gap, a multi-billion dollar problem as you know. Mr. Keddy says that other countries don't do this. Well the United States and the U.K. have found econometric models to do just that, and we, of course, asked that you take that on to get the data from the CRA.

As you mentioned, Parliament is going to vote tomorrow on a motion from our colleague Monsieur Dionne Labelle to order the government to order the CRA to provide the Parliamentary Budget Officer with the information necessary to provide an independent estimate of the federal tax gap.

If you had those tools, if you had that data, could you undertake the analysis?

Mr. Mostafa Askari: Yes we can.

Mr. Murray Rankin: I just hope that our colleagues will join with us and vote in favour of access. In fact, speaking of access, Mr. Saxton asked you to look at more data on a particular subject. I note that in your summary to us today you say:

> PBO takes Finance Canada's projection for DPE as given, as the government has refused to release data required to assess if the current restraint is sustainable and to allow PBO to do its own projection of DPE.

It looks like the government is not giving you, according to your statement, the kind of data you need.

Mr. Mostafa Askari: That refers to a request we had after the 2012 budget to have access to all of the cuts as a result of the operating review. We wanted to assess the impact of the cuts on the service levels by program. We did not get that information at the time. If you remember, we even went to court to get that information, but we have not received that.

Mr. Murray Rankin: I certainly do remember the government's unwillingness to give the Parliamentary Budget Office the data it requires to do its work, so it's somewhat rich to hear about you seeking more data.

Mr. Askari, you also have a quote here that I think is interesting. In your statement you say:

> PBO's outlook incorporates both stimulative and restraint measures introduced beginning in Budget 2012. PBO projects that the level of real GDP will be 0.5 per cent lower in 2016 than would have been the case in the absence of these measures. Further, this economic impact translates into about 46,000 fewer jobs being created by 2016.

In terms of billions of dollars, how much lower do you expect the GDP to be in 2016 due to Conservative budget measures?

Mr. Mostafa Askari: Well, 0.5% would be about, I believe, $8 billion, $9 billion—

Mr. Murray Rankin: Eight billion dollars to nine billion dollars.

Mr. Mostafa Askari: —I don't have all of the numbers in front of me, but....

Mr. Murray Rankin: Had the Conservative government not enacted their last three budgets, would there have been more job creation as a consequence, in your opinion?

Mr. Mostafa Askari: That's our estimate, it's 46,000 by 2016.

Mr. Murray Rankin: Right.

Could you describe the last time we saw direct program spending cuts of a similar magnitude to those that we're seeing in 2014-15?

Mr. Mostafa Askari: In terms of the growth in program spending, I think it's a historical low. We have not seen this in the past.

Mr. Murray Rankin: How much time do I have, Mr. Chair?

The Chair: You have three minutes.

Mr. Murray Rankin: I want to make sure I give my last two minutes to Mr. Caron for a question, if I could.

The Chair: Okay.

Mr. Murray Rankin: Could you comment on this government's behaviour surrounding lapsed funding? Is there a precedent for such a large degree of lapsed funding, in your experience?

Mr. Mostafa Askari: Parliament cannot exceed the appropriation level that is approved by Parliament. Having some lapse is normal in the operation because managers have to ensure that they're not going to exceed that, so they are obviously very prudent in managing their finances. Normally what happens is that at the end of the year some money is left over, but in the past few years we have seen a significant increase in the amount of lapse.

● (1825)

The Chair: Mr. Caron.

[*Translation*]

Mr. Guy Caron: I would like to ask for an update.

In 2012, before you took up your position, the leader of the official opposition made a request to the parliamentary budget office with three specific questions.

At the time, we were talking about budget 2012, but if you have done any updates for the budgets of 2013 and 2014, we would like to know that.

The three questions that the leader of the opposition asked were as follows. Were the savings outlined in budget 2012 achievable or likely to be achieved? Would failing to achieve those savings result in fiscal consequences in the longer term? He also asked for a calculation of the savings premised on staffing reductions.

Those are the actual questions that led to the reference to the Federal Court.

Have you had the chance to look at the matter since that time? We would like to get an update on the situation.

Mr. Mostafa Askari: To be able to conduct that study and to answer those questions, we needed detailed data. As I have already mentioned, it was not possible to do that study that would have allowed us to fully answer the questions you asked.

Mr. Guy Caron: Okay.

Mr. Jean-Denis Fréchette: If I may, I would like to add a comment.

That does not mean, however, that the matter of budget 2012 and the information we asked for is off our radar. We are continuing to work on it with our parliamentary partners, with the Information Commissioner and by continuing our discussions.

You will remember that the last time I appeared before the committee, last October, I talked about my parliamentary approach. The approach has to be parliamentary. This is about a situation that has to be solved at parliamentary level. What I still have to do now is meet with the Standing Joint Committee on the Library of Parliament. I have talked to the chair, to the clerk and to others. The joint committee has the right to ask for documents and to summon witnesses. This committee also has the right to do that. My approach is to do it through the joint committee because both Houses are represented on it.

Believe me, I have not given up on the principle or on the idea of getting the data on budget 2012, even though it is two years old now.

Mr. Guy Caron: Thank you.

[*English*]

The Chair: We'll go to Mr. Adler, please.

Mr. Mark Adler: Chair, will I have my full time, or am I splitting with Mr. Van Kesteren?

The Chair: There are two more rounds. There's your round and then Mr. Van Kesteren's, but I would like a little time, so if the two of you would be so kind....

Mr. Mark Adler: In that case should we split?

Mr. Dave Van Kesteren: You can split.

The Chair: Why don't you take as much time as you want, Mr. Adler.

Mr. Mark Adler: Thank you very much.

I would like to refer you to a recent study that was done by the Luxembourg income study database, which was reported in *The New York Times*. Based on 35 years of surveys, it now claims that notwithstanding what opposition parties in this House of Commons have said, the median income of the Canadian middle class has surpassed that of the United States. Would that not speak to the fact that what the opposition is proposing in their putative policy solutions to economic challenges that perhaps our country faces or may face in the future boil down to balderdash? Can you comment on that?

Mr. Mostafa Askari: Again, sir, this is a matter of policy, which we do not comment on.

I think one thing one needs to always be careful about is the time frame that they use for these kinds of studies. It is true that the median income in Canada has been increasing since the mid-1990s essentially, but that is after a significant drop in the median income from the early 1980s to the mid-1990s, and you're still catching up, essentially. I don't think we have reached the level that we had in 1980.

Mr. Mark Adler: Catching up to whom?

Mr. Mostafa Askari: To the level in the 1980s. I'm not saying they're catching up to anybody else. I'm saying there was a significant drop in the median income, and then we saw a gradual increase since the mid-1990s to the level where we are right now. It's true that recently there has been growth in median income, but when you compare historically to where we were in the early 1980s, I don't think we have reached that level. But that's just a casual comment.

● (1830)

Mr. Mark Adler: In all fairness, we should be comparing ourselves to existing data that's out there right now, in terms of where other median middle-class incomes are in other countries. That would be the fair assessment at this point.

Mr. Mostafa Askari: Compared to others, yes, but not compared to—

Mr. Mark Adler: Yes. We're doing really well, then, right? That would indicate that our policies have been very successful, because they have been increasing, as you indicated, since the early 2000s. Is that not correct?

Mr. Mostafa Askari: Based on that study, yes, it seems that we are above the Americans, but whether that's a good criterion or not, I don't know.

Mr. Mark Adler: I'm not asking this as a criterion, but it would speak to the fact that something seems to be working right in what we're doing.

I'll share my time with Mr. Van Kesteren, in the spirit of fairness.

Mr. Dave Van Kesteren: Thank you.

Thank you all for coming.

Mr. Askari, when you talk about the labour shortage statistics, what organizations did you contact to verify those numbers? I guess I can ask that question of anybody. Is that your own study or did you consult with other organizations?

Mr. Mostafa Askari: We look at the data that exists, and there are three sources of data. One is the CFIB, one is the Conference Board, and the other is StatsCan. We use the Conference Board data as the main data source, and then CFIB as a supporting database.

Mr. Dave Van Kesteren: Did they jibe?

Mr. Mostafa Askari: Very much so, actually.

Mr. Dave Van Kesteren: If my memory serves me right, when the CFIB came here, one of their biggest issues was labour shortage.

Mr. Mostafa Askari: That's a puzzle to us, actually, because their data does not really support that conclusion.

Actually, our report was reviewed by the chief economist of CFIB, and they didn't really have any issues with our methodology, our approach, or our conclusions. I'm sort of puzzled in the sense that, as Mr. Saxton suggested, we should look for other data, but there is really no other source of data.

Mr. Dave Van Kesteren: Let me just interject quickly.

When I look at the web page and the creation of your office in 2006 to assist the government, not to prop up the government—I think most members would be firmly against that—but to assist the government in finding their numbers, one of the statements of your original foundation is to gather information from other sources.

What sources do you use outside of the Conference Board? I think one of our colleagues talked about the Fraser Institute. Do you ever contact these folks as well?

Mr. Mostafa Askari: Sure. We look at every study that is relevant to our work. In fact, our analysts continuously review the literature, the recent literature, and recent studies by other organizations. We have really no bias in terms of whose study is better than the others. We look at the methodology and the—

Mr. Dave Van Kesteren: Okay. I don't want to be rude, but I have to cut you off because I want to get this point in.

I would think that you're going to have two schools of economists. Sir, I wouldn't dare even to suggest to get in a dialogue with you on the subject of economics. You obviously have a degree in that. But I would disagree with any concept that said that making significant cuts in government is going to cause the sort of predictions that your office has made. I probably wouldn't be the one to argue that. I would look at an institution like the Fraser Institute or something. Would they agree with that kind of a policy that says that the drag on the GDP resulting in a cutback in public workers, for instance, is going to result in a negative gain? Did I understand that right, because this, to me, is not something that I would accept.

Mr. Mostafa Askari: If somebody actually understands the principles of how the economic system works, and C.D. Howe would be—

Mr. Dave Van Kesteren: It works for me. This comes in. That goes out.

Mr. Mostafa Askari: Well—

Mr. Dave Van Kesteren: Sometimes they balance—

The Chair: Order.

Mr. Dave Van Kesteren: I know that's tough—

● (1835)

Mr. Mostafa Askari: In that sense, when government is spending, government consumption is part of the national GDP.

Mr. Dave Van Kesteren: I've heard that. But does everybody agree with that? I know that if I look at the Austrian school, they would totally reject that.

I recognize that you have a function and I support that. I think that's admirable and I think you need to do your job, but is ideology maybe sometimes getting in the way with some of our methodology, and possibly some of our solutions is what causes a problem?

Mr. Mostafa Askari: There is no ideology here. This is my training, our training, as economists, and the experience that we have had over 30 years working in this area which leads to our conclusions, and the studies. There is no ideology at all.

Mr. Nathan Cullen: Mr. Chair, on a point of order, I know Mr. Van Kesteren was trying to make a point, but the respect that we extend to our witnesses is important. I think there was a suggestion in the angle that somehow the reports and the effects of the reports are driven more by an ideology than by the numbers. I think that borders across that line of respect. I think the PBO has presented their facts as they are.

The Chair: That's a point of debate rather than a point of order.

Mr. Nathan Cullen: It's only that—

Mr. Andrew Saxton: It's not a point—

Mr. Nathan Cullen: —I'm allowing a certain discretion for you and there's no insult intended to Mr. Van Kesteren either. It's just that when we have—

The Chair: Okay. My sense is—

An hon. member: You're a vice-chair now.

Mr. Nathan Cullen: Did I say something to offend you, Andrew?

The Chair: Order, order.

My reaction is that Mr. Van Kesteren was asking questions respectfully. I don't know if the witness felt disrespect, but I thought he asked questions very respectfully, and using words like “ideological” and such are more points of debate rather than points of order.

I have a couple of minutes, and I simply wanted to follow up on a point. In an assessment of Canada's labour market performance, the 2012 report from the PBO says:

> In particular, labour market conditions were tighter in the Prairie Provinces (Alberta, Saskatchewan and Manitoba) than in the rest of Canada.

But in the labour market assessment 2014, it says:

> ...provincial data suggests that, with the exception of Saskatchewan, there are no other provinces experiencing more acute province-wide labour shortages or skills mismatches relative to before the 2008-09 recession.

Why the change in assessment?

Mr. Randall Bartlett (Economic Advisor, Analyst, Economic and Fiscal Analysis, Library of Parliament): We used a broader number of data sources when we did the analysis for the labour market assessment 2014 relative to 2012. What we used in 2012 was just StatsCan. Going beyond that, to use CFIB data as well as data from the Conference Board of Canada, based on Wanted Analytics information, what we found was that there was very clearly a labour shortage in Saskatchewan, but we found that data from the CFIB and from the Conference Board didn't support a labour shortage in Alberta or Manitoba at that time.

The Chair: The 2014 report says:

> ...no other provinces experiencing more acute province-wide labour shortages or skills mismatches relative to before the 2008-09 recession.

Was there a labour shortage or skills mismatch prior to the 2008-09 recession in Alberta?

Mr. Randall Bartlett: What we looked at was the relative relationship between the job vacancy rate and the unemployment rate currently and prior to the recession and how that evolved. We weren't able to find that it was more acute, per se. But that threshold, there's no—

The Chair: That's not my question. My question is, was there a labour shortage or skills mismatch before the 2008-09 recession?

Mr. Randall Bartlett: Oh, I'm sure there were definitely labour shortages in Saskatchewan, no question. In Alberta, I'm sure there were definitely pockets of labour shortages and skill mismatches, as there are across the country. How much larger it is now relative to before, we don't know.

The Chair: So there are skills mismatches and labour shortages in certain regions, like the prairie provinces currently, as there was before the 2008-09 recession.

Mr. Randall Bartlett: We don't have sufficient data, as they have in the U.S., to actually look at the steady state relationship between those two to determine whether or not we could say there is a threshold for a labour shortage or skills mismatch in those provinces. All we can say is that the vacancy rates are lower and the unemployment rates are lower, so it's not as acute as it was previously.

The Chair: It's not as acute as it was before the 2008 recession.

Mr. Randall Bartlett: That was the conclusion we reached in the paper.

The Chair: But the labour shortage and skills mismatch in Alberta in 2007 was as chronic as it ever was in Alberta's history.

Mr. Randall Bartlett: We can't do a steady state analysis; we just don't have the data.

● (1840)

The Chair: I appreciate both of the reports, but this is part of my problem when you say it's not as bad as it was in the worst part of Alberta's history. Your criticism of the labour report attached to the 2014 budget is that they're not using a longer time frame. With respect, I think you have to use a longer time frame than simply going back to the worst labour shortage in the province's history.

Mr. Randall Bartlett: That data is not available in Canada. We would like to very much, but the data is not available in Canada. CFIB data goes back to 2004, Wanted Technologies to 2005, and StatsCan to 2011. That's as far as it goes. There's no information on —

The Chair: Anecdotally, you can come to my riding and drive around and see the “help wanted” signs. I guess we could always use that as an analysis.

Anyway, I appreciate this very much. I wish we could continue this discussion. I thank you so much for all the reports you've produced and sent to the committee and all of your good work. Thank you for appearing here today.

Mr. Randall Bartlett: Thank you. *Merci.*

The Chair: This meeting stands adjourned to the call of the chair.

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