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Chair

Mr. Massimo Pacetti

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•(1005)

[English]

The Chair (Mr. Massimo Pacetti (Saint-Léonard—Saint-Michel, Lib.)): Good morning, everybody.

I want to get started, because we may have votes any time from 10:30 on.

We have Mr. O'Neill. Thank you for appearing. We're here for your expertise, or your analysis of the report you just prepared on independent fiscal forecasting.

I want to put on record why we're here. Our committee is studying this. We have an order of reference from the House on a revised Conservative amendment to the Speech from the Throne, "instructing the committee to make recommendations relating to the provisions of independent fiscal forecasting advice for parliamentarians including the consideration of the recommendations of the external expert."

Mr. O'Neill, I understand you have an opening statement. Then we'll allow the members to ask questions.

Thank you.

Mr. Tim O'Neill (O'Neill Strategic Economics): Thank you for inviting me back.

Yesterday I had two reasons; this morning, after reading the papers, I had three.

The first is that I enjoyed the opportunity I had to speak with you late last year. Some of the comments, questions, and suggestions you had were helpful in framing the report.

Secondly, my appearance now means that I'm finished with the report. It's completed. It's been tabled.

The third reason is related to some of the coverage this morning. There may be some misunderstandings about what the report actually says.

One of the reasons I carried out the report was to look at budget forecast inaccuracies and to offer recommendations to improve them. So it's partly diagnostic and partly an attempt to provide solutions or remedies.

On the diagnostic side, the single most important point to make is that if you're looking at the track record of positive budget surprises over the last decade, there's no single factor that explains that pattern. We've seen revenues under-forecast in seven of ten years, expenditures over-forecast in nine of ten years, service costs over-

forecast in eight of ten years, and the budget balance under-forecast in all ten years. That's a different pattern from what we've seen in other countries. So the question is, why did that happen? Certainly economic forecast errors played a part in some of the years, but it was a significant factor only in a handful of years, and mainly in its impact on revenue and service forecasts.

The second point in that regard is data revisions. I won't go into the technicalities of that, but data revisions have also played an important part in the contribution to the economic forecast errors. Even when you put those two together—the actual forecasts themselves and the data revision impact—you're only explaining in about four years a significant portion of the budget forecast error.

The expenditure forecasts are largely independent of the impact of economic forecast error, and yet we've seen them over-forecast in almost every year. This is a result of making adjustments for in-year initiatives, which allow you to get a better picture of how accurate the expenditure forecasts were. In no year until the last couple were the expenditure over-forecasts significantly large, but they were persistent.

What I conclude in the report is that something else has been a key factor, a persistent factor, through the period, and that is, the no-deficit rule under which the government was operating and under which the public officials who were responsible for providing the fiscal forecasts were operating. Unsurprising to economists—I don't know whether it is to anybody else—the consequence of having a rule that said "under no circumstances shall the government run a deficit" meant that the budget forecasts, the line-item forecasts, were bound to be and inevitably were going to be overly cautious. That is the nature of operating under that kind of rule. Not only is it inevitable, but it's actually quite appropriate for public officials, given any policy rule or any policy mandate, to make sure, as best they can, that it's implemented, and that leads to significant caution in the forecasting in this particular case.

I make this point in the report, and there's no direct evidence of this, but it can be inferred logically from all of what is available. If you look at the fact that there were a series of cumulative small errors—this is a point the IMF made in its own report—on both the revenue and the expenditure side, consistently over that ten-year period, the explanation that is most consistent with that observed pattern is, I think, the response to the rule under which the government was operating.

So what are the recommendations, then, that flow from this diagnosis? Let me divide them into three basic categories: the issue of forecast accuracy, the issue of credibility and transparency, and the issue of institutional change.

On forecast accuracy, there are a number of ways in which it may be possible to improve the quality of data, but even if those recommendations are followed, it will make the economic forecast and the fiscal forecast somewhat more accurate, if the attempt is successful, but it won't dramatically change the picture that we have seen over the last decade.

Secondly, there is no institutional fix, in my view, with respect to short-term forecast accuracy. We could create an institution, as the Netherlands and the U.S. has, which is responsible for doing short-term economic forecasting. I think your own experience with the four forecasters you've had in and the range of forecasts that you've had—even for the current year when it's almost over—suggests that this is not the fix. So I've recommended in the report that the committee discontinue the use of the four forecasters who have been hired.

There's nothing wrong with the work they're doing. I'm simply saying that the consequence of it is not providing you with more accurate information. You're getting four forecasts, one from each of them, and then you're getting the forecast from the department, so now you've got five instead of one.

I think the key is to change the fiscal rule. Perhaps this is the recommendation, at least to this point, that has received the most attention, and it requires some careful explanation. Let me make it absolutely, unequivocally clear that I am not advocating that the government go back into the kind of deficit position that it found itself in in the seventies, the eighties, and the first half of the nineties. That's not what is being argued here. What's being suggested is that if the rule under which the government is operating has led to inaccuracies in fiscal forecasting, then change the rule. There are other good reasons for doing that. Let me offer a couple of them.

One of the challenges with continuing to operate under a no-deficit rule is that you're going to have to accept—and it doesn't matter what party you belong to or who happens to be running the government—that as a consequence of this there has to be a lot more cushion in the forecasting to ensure, over the business cycle, that there will never be a deficit. You simply have to accept that fact. So there's going to have to be, explicitly and/or implicitly, a fairly large cushion.

If the rule is retained, I think you also have to provide for—and the government will have to provide for—dealing with fiscal surprises in a more structured way, and I've got suggestions for that. If you move to averaging a surplus over the business cycle, that can be, depending on how it's done, actually more disciplined, although it seems paradoxical to say that, and require more vigour and more rigour than the current no-deficit rule.

Right now, under the current system, \$3 billion on average is what is targeted for a surplus in order to provide the cushion required, in a formal way. The government could very easily make that \$5 billion or \$6 billion, or it could follow Sweden's example and make it 2% of GDP, which would make the cushion \$22 billion. The government

can decide what it wants the surplus it averages to be. What changing the rule to a “surplus over the cycle” one allows you to do under dire economic circumstance, like those we saw in the early nineties and in the early eighties, under a severe recession, is to let the budget go into deficit. In fact, I would argue, and most economists would argue, that it would be irresponsible not to do that.

● (1010)

If the economy were in a severe downturn, the only way the government could then ensure there wouldn't be a deficit would be to either cut spending or increase taxes, or both, and you'd actually be worse off. You'd make the economy worse off, and I'm not sure any government would want to envisage that possibility. So you get more flexibility. The other thing you get is a much more significant focus on the medium term. We've had a lot of focus on short-term forecasting accuracy.

The challenges facing Canada over the next 15 to 20 years have little, if anything, to do with whether the budget is in surplus by \$5 billion or \$6 billion or \$7 billion next year. They have to do with the fact that people like me are going to be creating an increasing burden on the health care system as we get older, and therefore the costs of social programs, notably health care, are going to increase fairly significantly, or the cost pressure is going to increase. What I'm suggesting is that's where the focus ought to be—how we deal with those medium- to long-term problems.

In the report, I've made suggestions for improving transparency. I won't go into details; I think they're pretty obvious ones and ones that most people would reasonably agree with. One for the committee to note in particular would be the suggestion that there be at least one additional formal briefing from the minister to the committee, probably in the late spring or early summer of the year.

Regarding institutional changes, I've made reference already to the need to focus more extensively on longer-term trends in the economy and particularly on the demographic pressures that will have a significant bearing on the budget 10, 15, or 20 years out. The other long-term economic issue is productivity growth. It has a huge impact on fiscal capacity because it has a major impact on economic growth and therefore on revenue generation.

I think the government has already tacitly acknowledged the need to focus more on the medium to long term. It certainly has done that in setting a debt-to-GDP target, and if you look at the fiscal commitments that have been made in the last eight to ten months on equalization, the health accord and the individual provincial agreements, and the timeframe for fiscal commitments, many of them have certainly lengthened. It's for that reason that I've suggested the government establish an independent agency within government, responsible to government, with a focus on analyzing and providing policy advice on medium- to long-term issues. And secondly, I have suggested that the government set a more aggressive debt-to-GDP target, perhaps as low as 15%. New Zealand just moved from 30% to 20% as their debt-to-GDP target, and I think given the kinds of fiscal consequences of the two factors that I've specifically made reference to, building a more long-term cushion into the process makes sense.

The final point I'll make is, I suspect, something the committee may have questions and comments on. Why wouldn't it be appropriate to have an agency also focusing on short-term forecasting? I've certainly had that question put to me by many people. Partly it's because, I think, the size of the agency required would be fairly large. Certainly the CBO is in the U.S. context. Secondly, it does what I would regard as redundant work. The structure we have now is unique among the OECD countries in that we involve outside experts in the generation of economic forecasts and use those forecasts formally in the budget process.

But far more importantly and perhaps more arguably or more controversially, in my view it's inappropriate to develop a parallel process that risks diminishing the accountability of the government of the day. The government of the day is accountable for the budget. They're accountable for their forecasts. They're accountable for the accuracy of those forecasts. I think the process we're going through is evidence of that. I think to in any way diminish that accountability, or risk diminishing it, would be the wrong direction in which to move.

●(1015)

Mr. Chairman, thank you for your indulgence in allowing me to explain what's in the report. I'd be quite happy to answer any questions people may have.

●(1020)

The Chair: Thank you, Mr. O'Neill. And I want to thank you publicly for accepting our invitation on such short notice. That was very kind of you.

I have Mr. Solberg, Monsieur Loubier, and then Mr. Hubbard.

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

Mr. O'Neill, thank you very much for being here.

I want to tell you off the top that I appreciate some of the revelations in your report. You point out that really a systematic bias has been going on for a number of years. This bias of ensuring that we stay in the black has of course resulted in constant situations where the government obviously lowballs the size of the surplus. So this no-deficit rule has really become a lowball-the-surplus rule. You've revealed that, and I appreciate that. I think it's very important.

As a result of your work, you've raised some issues. But I have to say, I think in some respects you've gone beyond your mandate when you talk about an agency that looks at the medium- to long-term challenges. I think you've probably gone beyond your mandate when you talk about a debt-to-GDP ratio. As important as those things are, they're really not quite in your mandate, I would argue.

I just want to set that aside for a moment, Mr. O'Neill, because you said something at the very end of your comments that I think is really important. You said that independent forecasters would take away our ability to hold the government to account. But isn't it precisely the reverse? In your report, what you're saying is that the remedy to the problem we have today is really to get rid of the no-deficit rule and to have the Department of Finance continue to provide the numbers—albeit perhaps on a quarterly basis—which would somehow produce better results. But aren't many of the same incentives to protect the government still in place? The same people who are providing these new forecasts, the Department of Finance, are the same ones who have to manage the government, have to manage the finances of the nation. They still have an incentive to run things in the black, so you still have this built-in incentive to run surpluses.

The one way to ensure that we have some scrutiny is for Parliament to have its own set of numbers that aren't run through the Department of Finance filter, that don't answer directly to the finance minister, who also has a political interest, a political incentive, to ensure that the numbers flatter his or her position.

So while I appreciate some of the things you've done here, with respect, I don't understand your argument that somehow having independent forecasters as a check on the government's numbers would in some way make it harder to hold the government to account. Can you explain that?

Mr. Tim O'Neill: Sure. What I was saying was that... I mean, you can draw on, as anyone can, a whole range of forecasts. You can go to the website of any of the major banks and you can find their economic forecasts there. You can talk to those economists, as the journalists regularly do, and ask, "So what does that imply about your expectations for the budget in the future?" You don't have to hire them to do that. But the problem you're going to face is the one you've already faced, which is that you don't get one set of numbers, you get four sets of numbers.

Mr. Monte Solberg: You get a range, yes.

Mr. Tim O'Neill: And you get a range that, for the in-year... And I'm talking about the March appearance. The range from low to high was \$4 billion, and for the next two years about \$7.5 billion.

It's not clear to me how that range gives you more information than you could have gotten—

Mr. Monte Solberg: Can I help you with that, then? For one, it gives you more information because sometimes there's a legitimate disagreement about future risks, for instance.

Mr. Tim O'Neill: Sure.

Mr. Monte Solberg: So don't you take that into account?

Mr. Tim O'Neill: Of course you do, but my whole point is that the process of forecasting has inherent risk built into it. What you've already experienced is a reflection of precisely that kind of risk. But the question is, would you change that risk, would you change that level of uncertainty, would you reduce that level of uncertainty by setting up a separate agency within government whose responsibility it is to create a forecast parallel to, but different from, possibly, the finance department's?

Mr. Monte Solberg: But the finance department provides one set of numbers, so even though you may have a big disagreement about what the future holds, the government produces one set of numbers, which does not imply that there's a real disagreement about what the future may hold. Isn't it appropriate for the country to know that there is that disagreement? Isn't it appropriate for the country to know this so that this committee can say to the government that there is a disagreement about where the future goes, and therefore your plans for the future need to take this into account, and maybe in this case they don't take that into account? Why wouldn't that make sense?

• (1025)

Mr. Tim O'Neill: It does, and this is exactly what I suggested in the report, that one of the things that ought to happen, at least in the budget document, and arguably you could put it into other documents as well, is a more explicit and more extensive discussion precisely of those risks.

For example, one of the things I've suggested is that in the budget there be—let's use the technical term—“scenarios” set out. This is what many governments can do and do internally. What I'm suggesting is make it explicit.

Mr. Monte Solberg: But you're talking about the department that answers directly to the minister, and what we're talking about is people who are not beholden to the minister. Doesn't it make sense to you, as an economist who's been talking about incentives, to have both competition between the department and these independent forecasters in terms of them finding out, coming to a conclusion about what the most likely scenario is, but also taking into account the incentives the department has in ensuring that they please the minister?

Mr. Tim O'Neill: I think you can get the same result you're looking for—that is, independent outside numbers if you wish—as I suggested, by simply calling up any of the economists who are involved in forecasting and asking, what do you think is likely to happen?

Mr. Monte Solberg: So you're saying we could get a better deal in terms of spending some money on this. Because we ask people to come and address particular parameters. They are asked to work with the Department of Finance to determine the assumptions the department works with. They come really with a very specific mandate when they come to this committee; they come with the mandate to make sure they're working in unison with the department,

not buying everything the department says hook, line, and sinker, but to challenge the assumptions. That's not something you would get if you just called up a bank economist who may or may not have had that conversation with the Department of Finance.

Mr. Tim O'Neill: You could find out very quickly by asking them if they had the conversation, and whether they've been tracking. And you currently have two chief economists in the system who are actually former finance officials, so presumably they would have a pretty clear idea of how the system works, and would be more likely to be following the numbers.

What I'm suggesting is you can do informally what you're moving towards trying to do in a formal way, and my concern, and people can disagree on this, would be that if you go to the next step, which is to set up something like the CBO in Canada, what you're creating is precisely not only a competitive forecasting arrangement but a competitive political structure, and I don't see that as appropriate to a parliamentary system. I don't know of any parliamentary system that has that kind of structure, and I don't see that it's going to get you what you want, which is more accurate economic and fiscal forecasts. It will get you another one, but given the inherent uncertainties in this whole forecasting process, could you be absolutely confident this is a better forecast than the one we're getting from the Department of Finance?

The Chair: Thank you, Mr. Solberg.

Mr. Loubier, then Mr. Hubbard, and then Ms. Wasylycia-Leis.

[*Translation*]

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

Mr. O'Neill, I have no choice but to agree with my Conservative colleagues. I will let you connect to the interpretation because I do not want you to miss out on anything that I have to say.

I was extremely disappointed when I read your report yesterday. I believe that it contains conclusions and recommendations that are of a political nature, rather than technical ones that would serve to improve forecasting and ensure that this is done free of the political process.

I was extremely angry when I read recommendation number 13. It reads, and I quote:

That The House of Commons Finance Committee discontinue the hiring of economic forecasters to provide quarterly fiscal projections. A separate organization responsible for forecasting, such as the Congressional Budget Office of the United States, should not be established.

With all due respect, sir, I wondered what you were butting into. I will tell you why I say this. The process that led to the hiring of four forecasters was a parliamentary process. I believe that you have trouble making the distinction between the executive and legislative powers. The executive power does not hold the absolute truth, it has committed a lot of mistakes over the years and has undermined democracy, because in actual fact, the executive power has deliberately, in my opinion, hidden major mistakes, for example the true amount of the annual surpluses. We are parliamentarians and we have the leeway to determine what is good for democracy on behalf of the thousands of people we represent. We decided to hire four forecasters who would produce forecasts that were independent of the government's, a government that couldn't care less about transparency and the validity of the data, a government that has been laughing in our faces since 1998. Now, you have just told us that this is not a good idea.

I was listening to you earlier. Once again, I have a lot of respect for you as an economist. However, I myself also have training as an economist, I've met hundreds of economists throughout my life and I have worked with dozens of them. When forecasts are made, out of four forecasts, if there is one very optimistic one, and one very pessimistic one, the average of the two middle forecasts is taken. That gives us a very good idea of what the future holds in store. That serves as a good basis for comparison that is free of all partisan politics. It allows us to study the department's forecast with a critical eye and to get a different picture, thus allowing us to do our job properly.

The mistake that has been made since 1998 is that we did not insist enough on an independent process. Each one of our political parties—the Conservative Party, the NDP, the Bloc Québécois, committed this mistake by making its own forecasts. They may have been more accurate than the government's forecasts' and provided a more intelligent analysis of the data. I'm talking about the data and forecasts collected by the parties. However, these forecasts were partisan. Even if at the end of the exercise all forecasts were more accurate than those of the government, which committed such ridiculous mistakes in forecasting that I would rather not bring it up again, the forecast came from a party, and we forgot that forecasts were made the previous year.

I am looking at your report. You do not suggest improving the technical process nor increasing the independence of the data. You propose rules to underpin government policy. I found that disappointing, because the title of your report and your mandate are very clear. In fact your document says the following:

The primary objective of this report is to assess the basis for the persistent forecast errors of the last 10 years and to determine what changes to the budget process might improve the accuracy of those forecasts and ultimately improve the conduct of public policy.

Firstly, I don't see any recommendations to improve the degree of accuracy. Secondly, if you want to improve public policy, you must bear in mind that there's a difference between the executive power and the legislative power.

• (1030)

In addition, I believe that you were very kind towards the Department of Finance. Indeed, Mr. O'Neill, despite all of your honesty, I cannot believe that you failed to point out that there were

exaggerations, alterations, inflated expenditures or underestimated revenues, leaving us with, in the final analysis, totally artificial and ridiculous forecasts. Above all, I find it completely inappropriate that you would without any hesitation sweep aside the Congressional Budget Office, an independent organization that operates in the United States. In fact, that section of your report is not very well documented.

In short, I am disappointed with what you have presented to us. I was expecting something with much more substance. I want to come back to your fourth recommendation. You suggest that we provide details on results in the budget over a period of ten years, for example. These people have trouble making forecasts for the next six months, whereas you are asking them to make forecasts for the next ten years. In any case, we have never requested such a thing: we simply want annual forecasts that make sense. I believe that your report does not address the issues. I am truly disappointed. For our part, we will continue to push for independent forecasting. You can be certain of that.

• (1035)

[English]

The Chair: Mr. O'Neill, would you like to comment? You've got two minutes.

Mr. Tim O'Neill: There are several recommendations that are specifically related to improving the accuracy and quality of the data. I didn't go into them in my presentation, but if you look through the report I think you'll see them: data revisions, work on the analysis of the relationships between various revenue areas and the economy, and so on. So those are there.

But the overarching argument was that if the primary reason for a persistent underestimating of what the balance would be is a result of the rule under which the government was operating, then clearly I'd have to spend some time making a recommendation and explaining the recommendation for changing that rule. That's why there's so much emphasis on that in the paper and in the media coverage.

With respect to an independent body, let me just make the point that a lot of people focus on the possibility of importing the CBO model into Canada. Leave aside for a moment the issue of whether that's appropriate in a parliamentary system—that's a reasonable debate to have—but let's just look at the track record. The CBO's track record on fiscal forecasting is that the size of the errors in their forecasts are actually larger than we've experienced in Canada.

A voice: In absolute terms.

Mr. Tim O'Neill: Yes, in absolute terms.

My point is that if you're looking for forecast accuracy, changing the model and the institutional structure by which you get those forecasts doesn't guarantee that you're going to get more accurate forecasts.

On the second point—and this goes to the intervention—what is unusual about Canada's case is that the forecast errors were so persistently on one side. I think that has to do with the fact—and this comes to your question—that if you have a rule under which a group of public servants are operating, and you have a mandate under which they are supposed to function and implement policy, it is perfectly reasonable and quite appropriate to expect them to behave in a way that's consistent with that rule.

[Translation]

Mr. Yvan Loubier: Mr. O'Neill, you are telling me that essentially, according to your analysis, officials are so worried that they must...

[English]

The Chair: Mr. Hubbard.

Mr. Charles Hubbard (Miramichi, Lib.): Thank you, Mr. Chairman, and welcome, Mr. O'Neill.

I guess the opposition have never really agreed with a lot of things that have been brought forward and have been a success of this government. Of course, we've been very lucky as Canadians over the last dozen years that our economy has been strong, that our surpluses have been there. It's not been the historical pattern of our western civilization, whether it be in North America or around the world, that we've had so much consistency of good times.

I was glad to see you're talking here about cycles, because most of the world economy is based on cycles, whether we get back to the days of Franklin Roosevelt or the work Keynes or Galbraith did or we're bringing it forward. I'm also quite taken with your concept of having a better debt-to-GDP ratio, which I think is very important for us in terms of servicing that debt in the long run.

This committee has heard so much about the problems in forecasting, and many members of the committee, Mr. Chair, seem to have some aversion to having a surplus. They think that the surplus is too much and that somehow as parliamentarians we've had a major failure and we as a government haven't addressed the real concept of the economy. From my perspective, as in your writing, having a surplus is a very good thing.

We also have to recognize, Mr. Chair, that in terms of our government's balance sheet for any given year, we only control, really, a very small part of that balance sheet because of the mandatory spending we do under transfers. So in the single-year approach, if we do encounter a major downturn.... We weren't affected very much last time by the American downturn. We in Canada were quite successful, even though we're a major trading country, in that our economy did continue to be quite strong, with low unemployment, with definite expansion, and with a good system of government.

Perhaps, Mr. O'Neill, just for your comments in terms of this cycle.... I'm quite impressed with the idea of cycles. Probably your Minister of Finance doesn't necessarily agree with that, but I know that in terms of a study of the history of economics, back in the Egyptian days or wherever it might be, there are good years and bad years. I would be concerned about having a program where there always has to be a balanced budget, or hopefully a surplus. Mr.

O'Neill, perhaps you can comment on this overall Keynesian approach to economics.

• (1040)

Mr. Tim O'Neill: I'd be happy to, and I'll do it briefly, Mr. Chair.

I think it would be fair to say that most economists who focus on what the appropriate approach is to fiscal policy today—and I stress that it's economists taking this position—would argue that it is appropriate to achieve balance over the cycle.

I thought about in fact making that precise recommendation, the argument being that in good times you build up a surplus and in very bad times you allow the economy and the budget to go into deficit passively. I chose not to make that recommendation because I thought it would be too significant a departure from the current environment and the current set of rules under which we're operating. A far more reasonable transition to a more flexible but no less disciplined set of rules would be to move to one in which the government is committed to achieving a surplus over the cycle. There are two countries, New Zealand and Sweden, who currently do that. They specifically target surpluses.

The argument is that if there is a concern that fiscal discipline might be loosened by our moving too significantly away from the current rule, this is a good transitional approach to use. I think the consequence of it is the government ends up with more flexibility in its planning, irrespective of which government it is, and has a more significant focus on the longer-term planning process. Instead of planning year by year, you can very effectively say, well, over the cycle this is what we expect to see in the way of fiscal performance; this is what we're planning for, and we can start to make policy in the medium term on a more effective and a more transparent basis.

I think it increases discipline and transparency, which are two of the things I was assuming most people were concerned about.

Mr. Charles Hubbard: I guess what we've learned from all these forecasters is that it's like the weather. Every radio station has a little different view on what might happen this weekend. We've had five different groups, and I'm not sure we've learned anything significant.

I'm pleased to see your recommendation. You question the need of having all this activity. It was certainly an activity we went through this winter, and I'm not sure we learned all that much. But I certainly appreciate your point of view that one forecast, or perhaps two, is as good as a dozen. All you have is the average of the dozen, rather than anything specific.

The Chair: Thank you.

It's a half-hour bell, so we'll try to go until 11 o'clock.

Ms. Wasylycia-Leis, then Mr. Pallister, and then Monsieur Côté.

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

With all respect to Mr. Hubbard, the problem we're dealing with is not that the opposition thinks there is something wrong with having too much surplus. The issue at stake is that we agreed as a Parliament, and as a committee, to get better information so we could decide what to do with the surplus. When you don't know how much surplus you have until the very end, and all that's left to do is put it against your debt, you're tending towards something anti-democratic, something inappropriate in respect of parliamentary debate and scrutiny.

I would say to Mr. O'Neil that the one good thing about his report is that he has brought the opposition back together again. He has played a role in uniting us around a particular issue. In fact, I cannot disagree at all with Monte Solberg or Yvan Loubier, when they say

• (1045)

The Chair: You're on record, Ms. Wasylycia-Leis. You know that?

Ms. Judy Wasylycia-Leis: I'm on record, yes.

I don't think we got what we asked for. I think—

Hon. John McKay (Scarborough—Guildwood, Lib.): What was it you asked for?

Ms. Judy Wasylycia-Leis: What we asked for, in terms of the purpose of Mr. O'Neill's study.... My understanding is this flows from the amendment to the Speech from the Throne that calls for our committee to make recommendations relating to the provisions of independent fiscal forecasting advice for parliamentarians, including the consideration of the recommendations of the external expert. We, as a committee, developed some very detailed terms of reference for pursuing the need to have more accurate forecasting.

What I think we're getting from Mr. O'Neill in this study is that we don't have a problem of inaccurate government forecasting—the government's been prudent and responsible. You don't, Mr. O'Neill, identify the real issues we have to grapple with as a committee and that Canadians are concerned about.

The fact of the matter is that while you may be somewhat dismissive of the \$80 billion or more that this government has been out in terms of its forecasting, that's a lot of money when you're dealing with some difficult issues in Canadian society. When you put that in the context of other organizations that could actually do proper forecasting, such as the Centre for Policy Alternatives, which has been able over all these years to be almost on par with the actual outcomes.... I reference again Jim Stanford's work. I know you touch on it in your report, but I think no one has refuted the fact that a good \$6 billion out of the annual \$8.5 billion in forecasting error is a result of errors in fiscal forecasting, not errors in macroeconomic performance estimations and so on.

It seems to me that we had reached an agreement that there's a problem, so how do we fix the problem? Now we're back to square one, with you basically saying there isn't a problem. And instead of helping us sort that problem out, you're giving us recommendations that have nothing to do with the problem at hand. It seems to me that all you're doing is being a mouthpiece for current government policy and giving us what the government wants, which is—and I refer specifically to your recommendation on page 118—that “the federal

government adopt the fiscal rule of achieving a surplus, on average, over the cycle. This target represents a less dramatic departure from the current rule and can be clearly linked to the long-term fiscal...”.

You go on to recommend that we look at a much lower debt-to-GDP ratio of 15%. Well, as far as I'm concerned all you're doing is exactly what was the problem all along. You want the government to set a much lower debt-to-GDP ratio. You don't criticize the inaccurate forecasting, which by implication means you have the means to achieve your lower debt-to-GDP ratio without the debate, without the Canadian input, without the discussion.

So how are we any further ahead? Can you tell us how you've met your mandate—and I have it here—to analyze the differences between economic and fiscal forecasts presented in federal budgets, to analyze the fiscal forecasting by selected countries in the OECD? Tell us how you've met the overall objectives of the concern and how we can use this.

Oh, I have one last question.

How in the world can you say that an independent budget office is contrary to responsible government or parliamentary democracy? We have other independent parliamentary officers: we have an Auditor General, we have a Privacy Commissioner, we have an Official Languages Commissioner, we sort of have an Ethics Commissioner. We have independent offices to supplement and make our parliamentary democracy more effective. What academic arguments can you make to suggest that an independent budget office is contrary to parliamentary democracy?

• (1050)

The Chair: All that, Mr. O'Neill, in a minute, please.

Mr. Tim O'Neill: I don't think that I actually said it was contrary to parliamentary democracy. I said that I thought it was inappropriate in the context of a parliamentary system, where you would be setting up a parallel system of forecasting. It is quite different from having a structure for an Auditor General, which every parliamentary system has.

With respect to my suggestion that there wasn't any problem, I've said in the report and I've said here that I was trying to diagnose why the forecasts were off as much as they were. I suggested that it was irrespective of which government was operating within that rule. Whether it was a Liberal government, a Conservative government, an NDP government, or a Bloc government, if that was the rule, there were inevitable consequences to it. I think that the suggestion of changing the rule therefore requires more transparency.

The fact is that if you're going to run a no-deficit rule, you're going to need to have a large cushion. People can disagree on how that cushion is used, when it's acknowledged. Whenever it's acknowledged, it's a perfectly legitimate debate to have. That's not what we're having here.

The question is this. How can you ensure that you know what the surplus is going to be? My answer is that you can't know with absolute certainty. The forecasters that you've had here have given ranges for the current year that are \$4 billion apart. At an absolute minimum, you're talking about that kind of variance in expectations. I think it's inevitable that you're going to have that kind of range anyway. So if that is fine, then let's make it explicit. That's all I'm really saying here.

I've made suggestions on how the actual accuracy of the forecast can be improved, but it's not going to give any of you an absolute spot-on forecast, within a result of 1%. You're not going to get that.

I don't care what kind of system you set up to create the forecast. You can have two or three or five parallel systems. But the end result is that in a world of uncertainty, in a world where things happen that you don't expect, the consequence is you get results that you don't expect on the fiscal side.

The Chair: Thank you, Mr. O'Neill.

Mr. Pallister, and Mr. Côté.

Mr. Brian Pallister (Portage—Lisgar, CPC): Thank you, Mr. O'Neill.

I'm positive that the government will be happy with your report and your recommendations, sir. But I think what you've made clear is that a political agenda has trumped the economists' ability to provide accurate forecasts to Canadians and to the government itself. You've made this clear in your early assertions.

What surprises me is that as an economist, you seem to have jumped on side with the politicians on this one. I am also sure that you don't understand fully.

In your recommendation number 4, you say that if members of the finance committee don't trust the information provided currently by the department, it's not clear why they'd trust the same information filtered through the independent economists hired by the finance committee. Let me explain to you why.

You're familiar with that fable of the mirror on the wall, and the ruler of questionable beauty asking the mirror how she looked. And you know that the mirror always replied, quite confidently, "You are the fairest in the land." What we've got is a "mirror, mirror, on the wall" system here. We've got a system where a political leader asks the economists and the finance department to provide him with the answers that he wants. Then the finance department provides the answers that he wants according to a political agenda, which is to say that they're not going to provide anything less than a balanced budget. That's the problem.

It should be self-evident to you why we don't trust the figures from the finance department, and it should be self-evident to you why we would require an independent assertion to be made by other observers. You've repeatedly referenced the fact that there's a range in those observations, just as there would be a range in the observations of an honest person responding to the person standing in front of the mirror. There would be a range of observations because people would be less encumbered, less restricted in their responses, and more likely to give an honest and objective answer than would be the case if they were forced to reply in the affirmative

every time they were asked how fair the government was in its dealings on financial issues.

You seem to have missed the point, and it's grievous that you've missed it, because the fact is, when you reference threats to accountability in the system, independent observers and auditors making observations could hardly be construed as a threat to accountability. When you make that observation, I think you weaken your case very severely.

Tinkering with a system, as you're proposing here, that is essentially flawed.... And I certainly agree with your observation that there should be more specific targets, something other than just a floor, but to suggest somehow that dispensing with the observations of others outside of the system who might just not reply exactly to the government that it's the fairest in the land all the time is a threat to accountability, or a threat to honesty in government, is quite a stretch. And invoking parliamentary accountability, as if this is somehow a threat to the parliamentary system we have, is hilarious as an assertion.

You also say we should balance the books over a business cycle. Perhaps you could just illuminate us, because I was part of a number of discussions about that "business cycle" phrase in terms of the employment insurance program. Some asserted that we should balance the intake premiums and the benefits over a business cycle. The government, of course, continued to not do that and took more than \$40 billion in extra premiums out of the system.

How would you define a business cycle?

• (1055)

Mr. Tim O'Neill: In the report there's a fairly technical discussion of it, and I'll refer you to that. Basically, it's from the point where you initially are at full employment, and you go through the cycle to the next point at which you're at full employment, with neither excess capacity nor excess demand, to use the technical terminology. So it turns out to be something in the range of, on average, five to seven years.

Mr. Brian Pallister: But you wouldn't know how long it was until that period had been defined. Based on that definition, how could you average out a surplus over a time period, sir, when you don't know the end point of that time period?

Mr. Tim O'Neill: First of all, you'd have to estimate it. Secondly, there are several countries that seem to have successfully done so, the U.K. and Australia being two current examples. They have balanced things over the cycle and have actually achieved their fiscal objectives fairly effectively.

I guess the point is that you're going to have uncertainty no matter what set of rules you operate with.

Mr. Brian Pallister: Sorry, just to assert the contrary here, yes, there will be uncertainty; but the certainty we've had since 1997 is that the numbers would be lowballed. We've had a certainty of sorts, you must admit.

Mr. Tim O'Neill: And what I've said in the document is that when you look back at it retrospectively, you see there's a fairly obvious reason for it.

Let me give you a quite different example. Let's suppose you have to fly to Guatemala and you know there's only one flight a week. You're far more likely to give yourself a big time cushion for getting to the airport than if you're flying to Toronto, where you know there's one from Ottawa every hour.

The environment, the structure, and the rules under which you're operating are inevitably going to affect the behaviour you see, and there's nothing inappropriate about that. In fact, I think most parliamentarians would agree that it would be considered inappropriate behaviour on the part of public servants serving the government and serving the ministers if they didn't respond to the rules they were given by saying, "Minister, here's my advice, but you've decided on this policy, so that's what we're going to follow; that's what we're going to implement"

What I'm suggesting is, the behaviour we've observed is exactly what you'd expect under the rule given. If that's not considered acceptable, if the results are not acceptable, then it seems to me you have to change the rules, and I suggested that.

The Chair: Thank you.

Monsieur Côté, and then we're going to suspend.

[*Translation*]

Mr. Guy Côté (Portneuf—Jacques-Cartier, BQ): Thank you, Mr. Chairman. Mr. O'Neill, you won't be surprised if I tell you that I want to discuss independent forecasts once again, and the possible creation of an office that is independent of the finance department.

At the beginning of your speech, you said that the context was changing right now, and that it is relatively less important, in the short term, to know whether the surplus is five, six or seven billion dollars. Mr. O'Neill, it is important, because as parliamentarians, it is our role to have an idea of what tools we have at our disposal, and to have the most accurate overview possible of the government's budgetary situation. Our fellow citizens demand this of us. For seven years, we have been dealing with a systematic underassessment of budgetary forecasts.

According to your report, in keeping with what Mr. Pallister said earlier, officials fear upsetting the minister, and so they systematically underestimate. If I understand correctly, it is not the fault of the minister.

The current situation can be compared to that of someone driving 60 kilometres per hour on the highway. There's nothing illegal about that, but it is extremely dangerous, Mr. O'Neill. It is essential to have forecasts that do not come from the political arena. The Minister of Finance and his department have political choices to make in the process of making budgetary choices. These are political choices. For proper analysis, we also need forecasts from outside of the political arena. This is what is missing today.

In your report, you talk briefly about the International Monetary Fund, which ranks Canada as one of the worst countries in terms of making budgetary forecasts. It is a bit strange that in your report, you also seem to be making excuses for the analysis made by the International Monetary Fund. Once again, one has the impression that you are playing the government's game. Either officials from the Department of Finance are being controlled, or the IMF did not paint

an accurate portrait of the situation in Canada. We are talking about huge sums of money.

The Conference Board of Canada forecasts a surplus of \$166 billion over the next ten years. If memory serves me correctly, since 1998, an amount of \$66 billion has been excluded from public debate. I have some trouble following you. I do not want to show bad faith, far from it, but it's difficult to see where you are going when you say that the department officials should look more towards long-term forecasts. Currently, they are not able to make short-term forecasts because they are obsessed by the Liberal government's budgetary policy.

A few months ago, a representative from the Department of Finance explained to us the department's difficulties in making long-term forecasts. One of the reasons he cited was that the government's priorities were constantly changing. Therefore, it is clear that political choices are made in the government's budgetary forecasts. That is why it is essential that an organization similar to the CBO be put in place, because as you said, it provides checks and balances.

I agree with you when you say that the different levels of government are currently much more distinct here than they are in the United States. But over the course of the last few years, the executive power has been taking over more and more power to the detriment of the legislative power. We need a tool to recreate a system of checks and balances, where everything is not placed in the hands of the minister nor the Department of Finance. I do not agree with you at all on this: the creation of such an organization would be conducive to a more healthy democracy in Canada, especially with respect to budgetary estimates.

• (1100)

[*English*]

The Chair: You can respond. You have 30 seconds, and then we're going to go.

Mr. Tim O'Neill: I've made most of the points already, I think, on the CBO. The track record suggests that making that kind of institutional change is not going to really make much of a difference to your forecast accuracy, and I pointed to the CBO's record already.

[*Translation*]

Mr. Guy Côté: That is not true, Mr. Chairman. In absolute terms, yes, but not in terms of percentage. They are much more accurate.

[*English*]

Mr. Tim O'Neill: Well, I can show you the IMF report that indicates the difference in forecast accuracy, but I think the key point is that institutional fixes, institutional changes, don't eliminate the uncertainties that are inherent in forecasting, whether it's economic or fiscal.

What's really critical, which I address at several points in the recommendations in the report, is that there be as much transparency as possible about what's actually happening and what the likely range of outcomes is going to be in the future. Armed with that kind of information, parliamentarians of any party can certainly make their own minds up about what the likely path of the budget is going to be over several years. Then they can act accordingly or debate accordingly.

The last point I'll make is I think it's a bit inaccurate to suggest that there has been a complete exclusion from debate. At budget time, it has been my understanding, any provisions that are made for the use of surpluses are included in the discussion and are open for debate, so it's not clear to me that debate is in any way prevented. It may be that the amount of information upon which the debate is carried out is inadequate, and I think that issue is addressed in the document.

• (1105)

The Chair: Thank you, Mr. O'Neill.

We're going to break to go for a vote. We'll be back at 11:30. When we get back, I have Mr. McKay, Mr. Penson, Mr. Bell, and Ms. Kadis. I don't think there's anybody else.

The meeting is suspended.

• (1105)

(Pause)

• (1135)

The Chair: Order, please.

Mr. O'Neill, from what I understand, you can stay until about 12:15.

Mr. Tim O'Neill: Yes.

The Chair: That's fine. Thank you.

So if we can continue on our list, I have Mr. McKay, Mr. Penson, and then Mr. Bell.

Mr. Monte Solberg: A point of order.

The Chair: Yes, Mr. Solberg.

Mr. Monte Solberg: Just before we begin, we're going to hear in a moment from the parliamentary secretary, Mr. McKay. I just want to emphasize that this is symptomatic of the problem we're talking about. We're talking about a closed system with respect to forecasting. Now the representative of the Minister of Finance will be quizzing the very person they've commissioned to do the report, which we argue flatters the government position. I just want to say I think this is inappropriate—

The Chair: I don't hear it so far.

Mr. Monte Solberg: —and probably debases the credibility of this committee.

An hon. member: It is a point of order.

The Chair: Yes, it's a point of order, but I haven't heard the point of order.

I just want to allow the parliamentary secretary—he is a member of the committee—to ask questions like any other member, so just let it be.

Mr. McKay.

Hon. John McKay: I think it's somewhat symptomatic that Mr. O'Neill hasn't given the opposition exactly what they wanted in the report, so as a consequence they'll shoot the messenger rather than deal with the message itself.

Let me deal with a couple of things that I think are problematic in your report, Mr. O'Neill.

First, on this balancing over the business cycle, you say the built-in bias is because the government has said do not have a deficit under any circumstance. That's the bias you identify in your report. You propose another formulation, which is no deficit over the business cycle.

Technical issues aside, how do you know when you're in a business cycle? How do you where you are in a business cycle? Do you know in advance where you are in a business cycle? How does a business cycle parallel the parliamentary cycle? After 27 years of running deficits—which is a little like 27 years of being a drunk—why in heaven's name, after 10 years of sobriety, if you will, would you go back to letting the drunk anywhere near a bottle of alcohol again? It seems to me it's almost an invitation for disaster to adopt that particular recommendation.

Second, you mentioned yesterday that the average error is somewhere in the order of \$10 billion over the 10 years. The \$4 billion presumably is explained by prudence, contingency, and that sort of thing. How much of the balance of the “error” of \$6 billion is attributable to economic forecasting?

I was noticing in your chart on page 121 that Mr. Orr, in table 1, section C, seems to be way more right than wrong in predicting just where the errors are going to be. Mr. Stanford, in table 1, section D, seems to be way more wrong than right, which is quite the contrary to what we've been led to believe.

I just wonder if you could comment on those two or three questions, please. Thank you.

Mr. Tim O'Neill: I can deal with the second one first, because I think it may be just how the table is explained. This is a table of retrospective examination of the size of the gap. The reason for putting it in the document is just to make the point that even *ex post* you can have disagreements about what the actual size of the forecast differences or forecast errors were. That was the only reason for putting it in. Part of it had to do with asking, for example, whether there were appropriate adjustments made for changing. There were changes to accounting rules that occurred through that period. Is that reflected in the work? Were the estimates done with or without the contingency reserve formally added in? So without getting into the technical part of it, that's all that does.

On the actual forecasting issue—who got it right and who didn't—I clearly wasn't attempting in any part of the document to examine whether the track record in the budget forecast or everybody else's track record compared to it. The IMF did that in a sense, and what they found was that the average economic forecast was slightly better than the economic forecast in the budget. However, they didn't make an adjustment for the fact that for six years in the budget there was a deliberate underestimation of growth—in other words, more caution built in quite transparently and quite explicitly.

With respect to your first point, there's an interesting paradox here, I think, when you're looking at any rule. Let's take the fiscal rule, in particular. If a government or a series of governments is committed unequivocally to fiscal discipline, the specifics of the rule are almost irrelevant, because they're going to be disciplined. They're not going, to use your metaphor, to take a drink anyway. They have no interest in doing that, or if they have an interest, they're not going to satisfy it. But we've also seen countries where the rules are quite explicit. They're hard targets: this is the maximum percentage of GDP that the deficit can be, and you're supposed to balance over the cycle. Those are the EU countries that are part of the Euro zone. If governments aren't committed to following the rule, then they won't. And it doesn't matter what rule you write, they're not going to be fiscally disciplined.

So in that respect, it strikes me that the issue is whether we ought to continue with a rule that quite inarguably, I think, in the early years of dealing with the deficits and ensuring that we didn't go back into deficit was absolutely essential. I think it's almost impossible to find an observer—especially any economic analyst—who would disagree with that statement. The key question is—and I would refer you as well to Jim Stanford, who's made exactly that comment publicly—what is the most appropriate rule to follow? What I've suggested is not dramatically different from what we're currently operating under; it just provides some downside flexibility if really bad times hit.

You asked how you know where you are in the cycle. Even in a given year, do you know a year ahead precisely how the economy is going to function, let alone how it's going to function over four or five years? The answer is no. How do you know where you are in the cycle? Reasonable people can differ, but you do have institutions, for example, like the Bank of Canada that make an estimate, essentially, of how much, if any, excess capacity is in the economy. That gives you a measure of how close you are to being, if I can use the term this way, in balance in the economy: you're at full employment; you don't have excess demand; you don't have excess supply.

So there are agencies or institutions that already do that work, and there are economists like myself and others who try to monitor that as well and provide an estimate that may be somewhat different from the Bank of Canada's. Have we got it absolutely right? No. But have we got it “order of magnitude” right, and is that information useful in setting policy? I think the answer is yes.

• (1140)

The Chair: Thank you, Mr. O'Neill.

Mr. Penson, go ahead, please.

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

I'd like to welcome Mr. O'Neill here today.

Mr. O'Neill, you will know that our committee is also studying this important question. I think it's important to put on record again that your report was commissioned by the Minister of Finance, and essentially it was designed to provide him with information on your analysis for his purposes. But our committee has had some hearings on this, and we've heard contradictory evidence from other people. I suggest that we continue on and get a reaction to your report from witnesses as well. Your report is one important component.

I see in the study you've done that you have talked to a lot of different people, including Dr. Elizabeth Robinson from the CBO in the United States. Mr. O'Neill, one thing we heard when we interviewed Dr. Robinson was that in 1973, I think it was, when they first introduced the Congressional Budget Office, they felt that they weren't getting accurate information. It's eerily similar to my job here as a parliamentarian on the finance committee. I feel that I've been spun by my own Department of Finance, and I don't appreciate that. I take my job very seriously. I want pure numbers. I want to know what we're dealing with. If the department wants to have a bias, that's fine, but I want to have a source so that I can find out what the pure numbers are that we're dealing with so we can deal with it from there.

In order to ensure that happened in the United States, you will know, Mr. O'Neill, there was legislation introduced at the same time that made the executive provide pure, accurate information to the CBO. I think that's an important component. We need that. And if each party wants to put their own spin on it from there, I suppose that's fine, but I don't appreciate having the department put their spin on it before we get it. I don't think that's very helpful.

First of all, I want you to verify that. I'm wondering, Mr. O'Neill, whether... I know the IMF has provided information to you that you contracted out, so is it possible to provide us with the study that was done by the IMF for you so that we can have a look at that? Those are my two questions to you. In the United States, they found it necessary to ask for legislation to provide pure numbers. Would that not be helpful to us as well?

• (1145)

Mr. Tim O'Neill: The second one is very easy to deal with. The IMF study is actually an article, or an appendix effectively, in the regular Canada report. It's a public document. It was released in February. I can certainly help to indicate where one can find that. So it is a publicly available document.

On the issue of the CBO, the CBO was created in a context where there was a perception—I can't comment on the reality of the perception—by Congress that it had lost, over the years, power in the setting of the budget by the government. Therefore, they created the CBO structure as a way of countering what they saw was a significant de facto transfer of power, insight, and so on, to the executive branch in the White House. The CBO's creation was not just related to getting more accurate information; it was really designed, quite explicitly, as a structure in which Congress could establish its own budget-setting process.

I'm virtually convinced that this is not what the committee had in mind, that it would, in parallel with and in competition with the government, try to create a budget process. That's what the CBO was designed to do. I don't think that's what you have in mind here.

Mr. Charlie Penson: I'm not so sure that's the case, Mr. O'Neill. It may be your interpretation of it. Certainly it's not mine. I think that what our committee wants are some checks and balances.

I agree with you that it might have been part of the backdrop in the United States, but Dr. Robinson also told us that parliamentarians there didn't have confidence in the numbers that were coming out of the administration during that time—I think it was during the Vietnam War. They were concerned about the accuracy of the numbers. That's similar to what our concerns are here, where we've been snowed every year for eight consecutive years. It might be a good bias or bad bias, but it's a bias.

Mr. Tim O'Neill: If the interest is not in creating a budget but in getting more accurate information, there are several recommendations in the document that deal with this matter. That's what I meant by saying that I thought it was different from the CBO system. There are six recommendations on transparency. I think two in particular relate to what we're talking about.

First, I recommended that the department create, within its current reporting and publishing structure, a quarterly update of the current fiscal year. You get the *Fiscal Monitor* on a monthly basis, but for many people it's a rather difficult document to decipher, if I'm not understating the issue. That's fair enough. It's not designed for average public reading. But I've recommended that they produce an accessible quarterly update that provides a more accessible and understandable picture.

Second, I've suggested that there be an increase in the number of formal briefings to this committee. For example, in the fall, when they have the economic and fiscal update, after the estimates and the projections in that document are released by the minister, it would be useful to have the committee call in not four but a dozen economists and say, "Could you give us your views on the reliability and accuracy of the economic forecast and the fiscal forecast?" This is really the precursor of the formal budget process. I think this might be helpful for you.

• (1150)

Mr. Charlie Penson: Mr. O'Neill, that would be helpful, it's true, but isn't it just taking the place of more accurate information out of the department? Why don't they just give us the pure numbers? They have biases built in, as you've identified. But if the committee had its own source, if the Department of Finance had to provide pure numbers to an independent budget office, then we wouldn't have to call in a dozen economists and ask, "What's your interpretation of this? Are they setting aside a certain condition for no deficit?" We could go down the road you're talking about, but we wouldn't need to if we had an agency that would give us those pure numbers.

Mr. Tim O'Neill: My concern would be that there's no such thing as a pure number, if by "pure number" you mean an accurate number.

Mr. Charlie Penson: No, I don't mean that. I know that the forecasting process is always going to be out one way or another, but it isn't always out one way. It will be inaccurate in its prediction of higher or lower surpluses. We know that; it's not an exact science. But it takes away the biases. You may not even want to have contingency reserves—just pure numbers and no factor for things like no deficit.

Mr. Tim O'Neill: It's been shown that to ensure over the business cycle that there is no deficit or a very small one, you'd have to build in a cushion of somewhere between \$5 billion and \$10 billion. It doesn't matter if you do it formally or informally, explicitly or

implicitly. These figures come from the research of academics. So \$5 billion would be the absolute minimum, and \$10 billion would probably be safer if you were worried that you might run into a serious downturn in the economy.

This prompts the question, is Parliament prepared to agree that in the budget process each year there will be something between \$5 billion and \$10 billion set aside as a cushion to ensure that there won't be a deficit? That's open to debate. All I'm suggesting in the document is that if you're going to retain the rule, you have to recognize that you're going to have to have that cushion to be able to follow it. Then you may be able to engage in more formal medium-term planning. As for the certainty you're looking for, though, it just isn't available.

• (1155)

The Chair: Thank you, Mr. O'Neill.

Mr. Bell and then Ms. Kadis.

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

Mr. O'Neill, I'm interested in at least three of your recommendations. Well, I'm interested in them all, but I've already heard the comments on others.

I'm talking, first of all, about recommendation 8, and the reference to the issues on the federal revenue sources, and then following up with recommendation 9, which is really the monitoring of crown corporations. That includes your reference, at number 8, with respect to revenue, and the problems: one has been the crown corporations and the other would come under surpluses. I'm wondering to what degree some of that may have been the result of write-offs, which are common in business but not so much, I guess, in crown corporations in the past.

As well, in recommendation 9 you talk about the lapses, or the unexpended funds in programs, and being able to better define that. In number 10, you talk about shifting over the economic cycle to achieving a surplus, on average. You talk about how long that cycle could be—five to seven years, depending on certain indicators. You talk about a full employment cycle coming through.

But isn't there a potential problem in linking that cycle to political accountability? By that I mean, for most of the political bodies I'm aware of, their budgets and their forecasting have long range, but they tend to look in the shorter term to the political cycles. If you try to average something over five to seven years and you find that the term of the government in fact is four or five years, on average, if it's a majority government, isn't there logically going to be a feeling for political accountability within the shorter term, and therefore doesn't the policy of having every year a balanced budget, if that's the goal of that party or that government, make accountability sense and transparency sense?

Mr. Tim O'Neill: If I understood your question correctly on the last item, inevitably the political cycle and the economic cycle are not going to perfectly mesh. So I think you're right in the sense that there is an issue of what happens when you go through an election and you change governments.

I'm assuming what you're asking is whether the new government—

• (1200)

Mr. Don Bell: Well, if they say, "Don't worry about the fact that we haven't had a surplus for three years, because we're going to make up for it in the last two", they may not get a chance to prove that.

Mr. Tim O'Neill: One of the checks on that, if you will, is the reaction of the market to that. Let's suppose you said the cycle is starting next year, and in the next economic cycle we're going to have...we're at full employment, so we're starting a new economic cycle. It would not be terribly wise for a government to decide that they could run a deficit for three or four years and then worry about it at the far end. That's certainly not the experience of what we saw in the U.K. It's not what we saw in Australia. You have to be constantly concerned about whether or not you are going to be on target. And if the economy is generating a kind of economic performance in which you'd normally expect a surplus, but you're running a deficit, there will be no shortage of analysts who will point that out to the government of the day.

So I'm not so concerned about that mismatch between the political and economic cycle. Of course, a government always has the option of going further than just saying this is their rule; they could actually pass it into legislation, which would then bind any future governments. I didn't get into that kind of discussion, because I think that's much more a political issue than an economic issue.

On numbers 8 and 9, I'd just make the point that what I'm really talking about in 8 is that all of us operate with rules of thumb, and finance is no different in that regard. One of the rules of thumb about an extra dollar of output and how much revenue that generates, depending upon the source of revenue, is that the number may be different. All I'm suggesting here is that because we've seen changes in those relationships over time, it might be useful to have a more formal analysis of how they've changed, why they've changed, and how they might change in the future. That will help improve accuracy, I think.

As far as crown corporations are concerned, I think we've just had several years of surprises in earnings. What I'm suggesting is that we ought to take a look at why that might have happened so that we have a better handle going forward of what those earnings might be. But that was not a huge issue; it had a moderate impact on the revenue projections.

The Chair: Thank you, Mr. Bell.

Ms. Kadis.

Mrs. Susan Kadis (Thornhill, Lib.): Thank you, Mr. Chair.

Mr. O'Neill, I'm particularly interested in recommendation 12. You're advocating what appears to be the consideration of lowering the debt, how big of a role the debt is playing in the surplus versus

the deficit, and how any potential changes in interest rates have an impact on this.

Mr. Tim O'Neill: Certainly the higher the debt level for any given interest-rate environment, the higher the debt-servicing costs are going to be. Obviously, the point of view on how much of the budget is devoted to paying down or paying off those debt service costs is a matter of some interest in the budget-setting process.

I think the challenge here for economists is that nobody can tell you what the right debt-to-GDP target ought to be. What should you aim for? Should it be 25%, should it be 10%, or should it be actual net assets so that you actually have a negative debt? I've simply suggested that the target of 25% is a perfectly reasonable one.

But in this country, if you're going to be faced with uncertain and potentially significant challenges on fiscal capacity, from demographics and possibly even from weaker productivity growth than most of us hope and many of us are forecasting that we'll see, then we ought to make some additional provision for that. I'm not necessarily suggesting that the level of debt be reduced faster, but simply that we must aim farther down the road to meet a lower target.

I mentioned in my comments that New Zealand actually did that recently. They had a 30% target, and they lowered it to 20%.

Again, it's obviously a debatable point as to how aggressive we ought to be on lowering debt and how we ought to allocate any surpluses that are generated. That is the stuff you're debating. I'm suggesting that as a precautionary measure we should simply make the target lower than we have currently set it.

The Chair: Thank you, Ms. Kadis.

Mr. Solberg.

Mr. Monte Solberg: Thanks very much, Mr. Chairman.

Thanks again to Mr. O'Neill.

Mr. O'Neill, I want to try to bring this back to where we started, which is the analysis of forecasting and trying to understand why the government has been out, I think, to the tune of \$90 billion since we started running surpluses in 1997.

When you commented to me during my first set of remarks, or else it was in your opening statement, you said that having independent forecasters would undermine accountability. A little later, you then went on to say that maybe we could have independent forecasters who weren't hired by the finance committee bring some light to this subject. Could you explain that? Can you tell me why having an independent check on the finance department would undermine accountability, but only if they're hired by the finance committee itself?

Mr. Tim O'Neill: I think I was trying to indicate that if you are advocating, as many people are, a formal CBO-like structure within government to provide a formal fiscal forecast independent of the Department of Finance, what you are in effect creating is a parallel, at least for budget forecasting, if not for the budget-setting process, which I don't see as—

Mr. Monte Solberg: We don't want to do that. We're talking about forecasting. We don't want to set another budget.

Mr. Tim O'Neill: Okay. If all you're doing is looking for better information and more accurate information, you don't need a formal structure to do that. If you want additional information—

Mr. Monte Solberg: But it's one that's free of bias. Isn't that right? We want one that's free of government bias.

Mr. Tim O'Neill: As I said earlier, I don't know whether you are in agreement because I haven't asked you, but if you're in fundamental agreement with the fiscal rule under which the government is operating, it's an inescapable result that whether your party or another party is in government, you're going to have overly cautious forecasting. That was my point.

• (1205)

Mr. Monte Solberg: I accept that. But isn't it also true that if you're getting the numbers from the Department of Finance there's another incentive at play, which is the incentive to make sure the person you work for, the Minister of Finance, gets numbers that help him or her with his or her political agenda? That's a very real incentive as well, and isn't it true that to ensure that this incentive is taken out of the mix, we have another set of numbers that's produced as well, a set of numbers that doesn't contain that bias?

Mr. Tim O'Neill: The concern I would have with the way you've stated that is that it suggests—by implication, at least, though I don't know if you were meaning to imply this—that there's somehow a politicization of the process by which budget forecasts are created.

My observation, after probably more years than I want to count of being involved with public servants across the country at provincial levels, municipal levels, and the federal level, is that by and large they perform exactly as you would hope they would perform; that is, they provide the best advice and information to their minister and to their government. If the minister says “Thank you very much; this is what we're going to do”, then they have a responsibility to implement that.

Mr. Monte Solberg: Fair enough. I accept that there are limits to how far they would want to spin information; I think that's true. But as an economist you also understand that incentives matter. Public choice theory, all these things would suggest to me they have exactly the same interest as somebody else in the private sector when it comes to ensuring that they do things that please their boss, and one thing that would greatly displease their boss, I would argue, is if all of a sudden numbers came out that contradicted something the finance minister had been saying in the past, or took some control away that the finance minister has had with respect to laying out the size of surpluses, opening up a big political debate about where that money should go.

Until now, because there have been \$90 billion of surpluses hidden, the government has been able to really control that debate, and I'm sure you can see the temptation for the minister to want to perpetuate that. The department, by extension, wanting to please the minister would help produce those figures.

Mr. Tim O'Neill: One of the things I tried to address in the report.... Let me make first the point that I'm not a forensic specialist and I didn't try to delve in great detail into who said what to whom. It

would have taken two years to do the report, and I don't think it would have ended up yielding much in the way of different results.

The key point is, in the typical public service structure, where you have individuals operating in good faith, and I think they do, they have to provide—if they don't, they're not doing their job—the minister with information even if it disconfirms what he thinks he would like to hear or actually wants to hear. That is their job.

Let's distinguish that from the case where a policy decision is made: this is the rule we're going to operate under; this is the policy we're going to follow. Whether I, as a public servant, agree or disagree with that, my job then is to implement that policy as best I can. I don't think that's inappropriate behaviour.

Most of the public choice literature, by the way, talks more about the incentives for politicians than it does about incentives for public servants. We can get into that debate some other time.

The second point I made in the document is.... It's an interesting question, this question of hiding money. I raise it in the document only to talk about what the possible rationale for it would be. If it's, for example, to prevent spending, that clearly is not what we've actually seen happen over the last number of years. So it's not clear to me why there would be an incentive to actually hide money.

I would say what we've seen is a responsible reaction to a set of rules under which public servants are operating. I don't question their motives. I simply observe that what they're doing is exactly what you'd predict would happen. Irrespective of what government was in power, irrespective of what its fiscal policy inclinations were, you would see overly cautious forecasting in an environment that encourages that caution.

• (1210)

The Chair: Thank you, Mr. O'Neill.

Mr. McKay.

Hon. John McKay: I thank you, Chair.

On Mr. Solberg's line of argument here, which is the “blame the bureaucrat” line of argument, the underlying assumption is that somebody is going around the government trying to hide money and to keep it from elected officials so that they can get scrutiny. Yet previously the Conservatives have argued, well, you have your numbers mixed up. You had a 1.9 predicted and it turns out to be 9.1, and there's some devious purpose behind that, so we'll blame the bureaucrats.

From a credibility standpoint, 1.9 would have been, in the final number, a much happier number for the minister. The truth of the matter is that the bureaucrats gave the best possible information they had, based upon the information they had at the time. Then when the final numbers came in some six months later, well, it turned out to be a larger number than the minister would have appreciated.

So I hardly think that the basis for Mr. Solberg's line of questioning bears any relevance. And I'd be interested whether in your report you detect any of that kind of “let's hide the money so that we can look better at the end of the day”.

Mr. Tim O'Neill: What I concluded was inferred from the patterns of behaviour and the evidence as I saw it. The only context in which I might reasonably have expected to get information that would have suggested people were in any deliberate way trying to hide money was from the consultations.

I can say quite unequivocally that there was nothing in any of the consultations, and there were many former senior public servants who were interviewed. I found nothing in any of their statements that would suggest that there was a deliberate attempt to manipulate the numbers or to deliberately hide money from public scrutiny.

The Chair: Thank you, Mr. O'Neill.

What we're trying to get to is better forecasts. You mentioned the independence factor. If we go and we use different people, for example, bank economists, are they really independent? Don't they have an agenda of their own that they want to promote? When they're contracted by us they'll technically be independent because that's what we're asking them to be. Or are all economists just preconditioned to think in a certain way?

Mr. Tim O'Neill: Well, I can tell you from my own experience of almost 12 years as a chief economist of a bank and of more years than that meeting with colleagues who had that function, it's exactly the same as any group of economists. They have different views; they start out with different biases. There are some economists who think that the only way to solve the world's problems is to lower taxes. Others think that the only way to solve them is to invest in various programs, and there are others who think that the way to economic salvation is through using all the surplus to lower the debt.

I'm overstating a little for effect here. My point is that I don't think it would be appropriate or fair to suggest that any group of economists, wherever they may be working, clearly have a single and comparable agenda.

One of the wonderful things I enjoyed about my job was that I was seen, both outside and inside the bank, as having a fairly independent role to play in providing information and advice to my colleagues in the bank and to the public at large, outside the bank. I think the rest of the bank economists function in the same way. If that were a concern, I don't think it is.

•(1215)

The Chair: Don't the economists and the Department of Finance feel that same way, that they're pretty well independent?

Mr. Tim O'Neill: Well, I think the kind of independence is somewhat different. Economists, perhaps by their training, think differently and therefore perhaps act differently. Not everybody thinks they should think differently, but that's another matter for another day.

I think the roles are somewhat different. By and large, I think there are similarities in the way economists, wherever they work, look at issues, but they all have different social and political philosophies. As a consequence, I don't think you can make a blanket statement that this group is unreliable or relatively unreliable because they come from a particular sector of the economy. If that were a concern, and I don't think it should be, but if it were, there are a lot of other people who can be called, as you already know, to appear before the

committee to offer their views. In some cases you know exactly what their agenda is.

The Chair: When do we draw the line in terms of saying that this is an independent economist? Or when does the economist have the expertise to provide information? Does it have to be an outfit with many employees or with computer models that are able to spit out numbers under different scenarios, or an academic who works for a university, like the committee hired? How do we draw the line from that perspective?

Mr. Tim O'Neill: I don't think there's a simple line to draw. I'm an independent economist now with one employee: me. You might feel free to call me for my views on economic forecasting, or you may not.

The point is that it depends on what information you're looking for. If you're looking for a highly quantitative forecast with lots of detail and so on, by and large, an independent consultant is not going to have the capacity to generate the kinds of numbers you're looking for. But certainly you can look outside the bank economists to find people who work with economic models. You've got forecasting companies that do that, for example, and you have individuals who do that who have their own small models. There's no shortage of people available.

As to the judgment regarding their value, I don't think there's a simple way to determine that in advance. The way you're going to be able to determine it is by asking them piercing questions, and if they can't answer them, then maybe they're not providing you with very helpful information. If they can, then maybe they are. I don't think there's a simple test or diagnostic you can use to figure out if this person is helpful or not.

The Chair: Okay.

As a final question, in your experience—and I know you mentioned Australia and New Zealand, and you mentioned a few countries, but obviously I didn't read the whole report yet—what are the other countries doing for independent fiscal forecasting? We looked at the United States, but doesn't the U.K. also have an independent...?

Mr. Tim O'Neill: There are several countries, including the U.K., where they will in a less formal way than we do in Canada call on views from private sector economists. We're the only country in that group that actually formally utilizes those private sector forecasts as the foundation for the fiscal forecast in the budget-setting process. The U.K., all the European countries, such as the Netherlands, Australia and New Zealand—the ones that are listed on a chart in the document—all have the economic forecast and the fiscal forecast responsibility formally housed in either a department of finance or a treasury, whatever it may be called.

So we actually are unique in that regard in the formality with which we use the private sector forecasts in the budget process.

The Chair: Thank you, Mr. O'Neill. Again, thank you for your time. We appreciate it on such late notice. We may have you back. We'll see where this goes.

I just have one housekeeping issue. Last week the Liaison Committee approved \$172,250 for our travel budget. It's about \$40,000 more than what we had expected. Is that okay with the committee?

[*Translation*]

Does the committee wish to adopt it?

[*English*]

An hon. member: Is this the pre-budget—

The Chair: It's the pre-budget consultation. Our budget went from \$132,000 to \$172,000.

•(1220)

Mr. Monte Solberg: What was the...?

The Chair: We had requested on our original submission \$222,000, and we got it down to \$200,000. Then they cut us to \$132,000 because there were too many requests from all the other committees.

Mr. Charlie Penson: Then it's back up to—

The Chair: Yes, it's back up to \$172,000 because there were some transfers of unused moneys from the first trimester—because we use it by trimester—and then there was some money taken from the third trimester back into the second trimester. So \$172,000 is what we have, and we should probably decide what we're going to do with that \$172,000. I'll call a meeting about that later on. Okay?

Thank you.

The meeting is adjourned.

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