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Chair

Mr. James Rajotte

Standing Committee on Finance

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● (0845)

[*English*]

The Chair (Mr. James Rajotte (Edmonton—Leduc, CPC)): I call this meeting to order.

This is meeting 77 of the Standing Committee on Finance. The orders of the day, pursuant to Standing Order 108(2), are to study the report of the Bank of Canada on monetary policy.

I want to welcome our two witnesses here this morning.

First of all, we have the Governor of the Bank of Canada, Mr. Stephen Poloz. Welcome back to the committee, Governor. I am glad to have you with us.

We have the senior deputy governor, Ms. Carolyn Wilkins, back to the committee as well. Thank you so much for being with us this morning.

We understand you have an opening statement, and then we'll have questions from members. Please begin.

Mr. Stephen S. Poloz (Governor, Bank of Canada): Thank you.

Good morning, Mr. Chairman and committee members. Carolyn and I are happy to be here for one of our twice-yearly meetings on the monetary policy report. Today we'll outline for you the bank's latest economic outlook, published in the MPR on April 15.

[*Translation*]

In this volatile and uncertain environment, it is helpful to maintain a historical perspective. When we appeared before this committee a year ago, the price of Brent crude oil was at $100 per barrel. It had risen steadily for a decade, from $25 in 2002 to a peak of just over $110 in 2012.

By November, when we last met with you, oil prices had fallen to what was then their lowest level in four years. The average price of Brent was $90 per barrel. It was clear to us that while lower oil prices would benefit consumers, the net impact on the economy would be negative. Lower oil prices would reduce Canada's terms of trade and domestic income, and have a material impact on investment, activity in the oil sector and the associated manufacturing supply chain.

All of that happened quite quickly over the next two months. By January, Brent prices had dropped to an average of $60.

[*English*]

Oil prices are an important component of Canada's terms of trade and one of the key drivers of movements in the Canadian dollar. As oil prices rose over the 2002-12 period, so did the value of the dollar, increasing from around 63¢ to above parity. For the convenience of the committee, I've brought my favourite chart. It's a chart of the Canadian dollar with the price of oil—an undeniable relationship in both directions.

Now, the fall in oil prices has set in motion complex dynamics, including sectoral and regional adjustments, which will take time to work their way through the economy. The negative effects of lower oil prices hit some sectors of the economy right away. For example, the impact of lower prices on income and wealth has already led to a fall in household spending. The various positives—more exports because of a stronger U.S. economy and a lower Canadian dollar, and more consumption spending as households spend less on fuel—will arrive only gradually, and they're of uncertain size. Therefore, in January we faced a risk that returning the Canadian economy to full capacity and stable 2% inflation would be delayed significantly. Accordingly, we took out some insurance against that risk, in the form of a 25 basis point reduction in the policy interest rate.

Our interest rate cut occurred in the context of widespread easing in financial conditions around the globe. No fewer than 25 central banks eased their monetary policies in the early months of 2015. All of this monetary policy easing led to lower rates across the entire yield curve.

Now, what was behind this easing? Well, many central banks were adding stimulus in response to persistent economic slack and below-target inflation. This easing, coupled with the positive implications of lower energy prices for world growth, should help the global economy pick up through the year. The bank expects global economic growth to strengthen and to average about 3.5% over the 2015-17 period.

● (0850)

[*Translation*]

Here in Canada, we saw that some of the effects of lower oil prices, such as the lower household spending I mentioned earlier, were clearly being felt in late 2014 and early 2015. Our updated forecast in the April MPR suggests that the Canadian economy saw no growth in the first quarter. While the impact of the oil price shock is happening faster than initially expected, it does not appear to be larger than we anticipated in January.

Outside the energy sector, other areas of the economy appear to be doing well. The segments of non-energy exports that we expected to lead the recovery are doing so, and we expect this trend to be buttressed by stronger U.S. growth and the lower Canadian dollar.

The results of our Business Outlook Survey suggest that capacity constraints are beginning to emerge for exporters, which is promising for new investment. And, although we still have material slack in our labour market, the market fundamentals have begun to improve. Even so, companies remain cautious about new investment and hiring intentions.

[*English*]

Weighing these various forces acting on the economy, we anticipate a partial rebound in growth in the second quarter and a move to above-trend growth thereafter, for annual growth of about 1.9% this year. This projected growth profile gets us back on track to absorb our excess capacity around the end of 2016, at which time inflation will settle sustainably at 2%. We see the risks around this projection as roughly balanced, but they will be reassessed continuously as new data become available.

The main risk to our outlook is the size and duration of the negative impact of the oil shock, weighed against the positive forces that are building in the non-energy sector. Our outlook is for the positives to begin to reassert themselves during the second quarter, and to do so clearly in the second half of the year. The interest rate cut in January and the lower Canadian dollar are working to speed up this transition.

Inflation, as measured by total CPI, is running at about 1%, well below our 2% target. This is largely due to the drop in gasoline prices, which is a temporary effect. Total CPI inflation would in fact be quite close to zero were it not for exchange rate effects and some additional one-time factors. Core inflation is a little over 2%, but is also being boosted by the exchange rate effects and other one-time factors. In our projection, total inflation and core inflation converge on 2% as these temporary factors dissipate and the economy reaches full capacity around the end of 2016.

Meanwhile, financial stability risks remain front and centre in our deliberations. These risks are evolving in line with our expectations. The level of indebtedness, as measured by the ratio of debt to disposable income, continues to edge higher. It is likely to rise further as the decline in gross national income caused by the drop in oil prices works its way through the system. On the surface, lower interest rates would be expected to promote more borrowing, which would increase this vulnerability. However, in the near term, lower borrowing rates will actually mitigate this risk by reducing payments for mortgage holders and giving us more economic growth and employment gains. We believe that the best contribution the bank can make to lowering financial stability risks through time is to help the economy return to full capacity and stable inflation sooner rather than later.

With that, Carolyn and I would be happy to take your questions.

The Chair: Thank you very much, Governor, for your opening statement.

Colleagues, we'll do seven-minute rounds. We'll keep to those tight rounds, if we can, and we'll start with Mr. Cullen, please.

● (0855)

Mr. Nathan Cullen (Skeena—Bulkley Valley, NDP): Thank you very much, Chair.

Thank you, Governor, and thank you, Ms. Wilkins, for being here today.

Let's start with your favourite chart, Governor. You talk about an undeniable relationship between the price of oil and the Canadian dollar. Let's go back 40 or 50 years. Those within the energy sector say about $50 a barrel is the historical average. Is that your understanding from the bank?

Mr. Stephen S. Poloz: I don't know that number. It sounds like a high number, actually, because—

Mr. Nathan Cullen: Oh, I see. Yes, some estimate it a little bit lower adjusted for—

Mr. Stephen S. Poloz: It depends on what period you pick, obviously.

Mr. Nathan Cullen: Correct.

In terms of this undeniable relationship, typically when oil then fell, and the Canadian dollar—as in your chart—for the last 15 years, but even going back further, also fell, manufacturing would pick back up. One of the things we've heard from some of the Canadian manufacturers is that since having lost 400,000 manufacturing jobs in the Canadian sector, which is acknowledged by StatsCan, the pickup in manufacturing hasn't been realized as it has in previous downgrades in the oil sector.

What's the bank's view on that?

Mr. Stephen S. Poloz: Our view is that this is in fact connected to the export story that we put a lot of time into both publicly and in this committee last year. Over the course of this prolonged period of low global growth, we had a large number of exits from the export sector, thousands of companies, something like 8,000. It's very difficult to measure, but it was a large number of companies. This of course means that when conditions return to a more normal situation, the U.S. economy strengthens, and they begin to order those exports again, some of the companies are no longer there, and so it's not a case of just re-expanding in order to meet that demand.

What happens, in fact, in these episodes, historically speaking, is that the situation is very fertile for the creation of new companies and the expansion of the ones that remain.

Mr. Nathan Cullen: But we've seen the Canadian dollar slide. You talked about business still remaining with a certain level of uncertainty. There's a lack of confidence. You said the first quarter had atrocious growth, and, in fact, outside of recessions, we've had the longest and most prolonged period of low, less than 1%, growth in the Canadian economy in four decades. That's worrisome to me considering what Canadians are looking for right now, which is an answer to those fundamental questions. You mentioned very high personal debt rates.

You took action. You talked about stimulus measures that you and 25 other central banks took. Could you name the one or two global risks that you're identifying? You talked about international risks that remain. Could you very quickly give me one or two that come to mind when you mention international risks?

Mr. Stephen S. Poloz: In fact, we've been living through a period of slow and repeatedly disappointing growth at the global level. That's why the G-20 is so preoccupied with this issue and is taking about a thousand initiatives across the 20 economies to try to boost growth by about two percentage points in GDP over five years.

Mr. Nathan Cullen: To be clear, do you mean a thousand from central banks or including governments?

Mr. Stephen S. Poloz: I mean governments. In the G-20 context, the G-20 communiqué is all about coming up with those new policies. They are primarily structural policies such as free trade agreements and those kinds of things that actually improve the growth prospects of an economy.

Of course Canada, being in that sense a small economy relative to all of that, has been heavily influenced by those external events and so our growth has underperformed at the same time. This is primarily because of our major trading partner, the U.S., struggling with the after-effects of the crisis.

Mr. Nathan Cullen: Your predecessor and you, somewhat less, have talked about dead money in Canada. We've had the manufacturers and the large corporations in Canada come in and tell us why they are not spending—a very low research and development rate and very low reinvestment rate despite having had many years of relatively large corporate tax cuts.

What is the current status of this productivity conundrum and this conundrum of debt and so-called dead money in the economy? Is the bank at all concerned about the lack of reinvestment in the Canadian economy coming from the private sector?

Mr. Stephen S. Poloz: The way we would view this is that corporate balance sheets are in good shape and are ready to be deployed as the expansion unfolds, but given what we have been through, and we are now in the seventh year since the financial crisis erupted, any business person is prudent about deploying that money. That's hard-earned money that could be wasted, in effect, if things don't prove out.

But confidence is growing both at the global level and, of course, domestically, and so our belief is that investment is actually under way, particularly in the non-energy export sector where these constraints are beginning to show up.

So we're quite confident in that recovery, and the good news is that the balance sheets are ready for it.

● (0900)

Mr. Nathan Cullen: I guess that's my question; they have been ready for some time. StatsCan is now reporting that figure at about $674 billion. It's been north of $600 billion for a couple of years. We've heard at this committee from corporate Canada, saying some of the same things you're saying, that, well, there's an uncertain market.

We want to challenge that. There are always uncertainties. Are the uncertainties and the risks so great that we're going to have to downgrade the growth prospects for the Canadian economy, as the bank has had to do several times over the last six months?

Mr. Stephen S. Poloz: Clearly, the uncertainties are very great. If we look at, say, the U.S. economy, that may be growing at, say, around 2% this year or a little bit more, it's doing so with a zero percent interest rate. We should bear that in mind. That means we're pushing a rock up a hill here.

Mr. Nathan Cullen: So those risks even south of the border remain.

Mr. Stephen S. Poloz: Those are what we call headwinds. Those are things that hold the economy back, and it requires a great deal of policy stimulus just to keep them at bay. In that environment, a business decision is real money, and it's real people; it's not a theoretical model. Of course, it performs differently from what our historical model would say. It's precisely because, given our experience, uncertainty is a little higher than it normally is at this stage of the business cycle.

The Chair: Thank you, Mr. Cullen.

We'll go to Mr. Saxton, please.

Mr. Andrew Saxton (North Vancouver, CPC): Thank you, Chair.

Thanks to the governor and deputy governor for being here today.

Governor, in your recent monetary policy report, you noted the importance of Canada's export sector on the economy; however, you also mentioned the issues around competitive challenges that our exporters have. Could you expand on what those competitive challenges are?

Mr. Stephen S. Poloz: The challenges for the sector are similar to the ones that we've just been talking about. In the past five years or so we have lost a number of exporting companies. Those who are still in the game find themselves running out of spare capacity and are at that trigger point where they need to either invest to expand that capacity and employ more people or ask their customers to wait a little longer for delivery. It's a balance point. Right now we are seeing more of those decisions: that it's now time to invest. It's a process that is gathering momentum. That's a very positive development. It's been long in coming.

Now, the challenges that remain are that none of us are truly certain about the outlook for the world economy, which is your main customer, and in particular the U.S. economy. We're living just after the first quarter where the U.S. economy appears to have wobbled or faltered, and some people think it has slowed down. We think it has got its momentum and has been interrupted by things like bad weather and a port strike.

But as a business person, you're basically waiting for the phone to ring. That sort of trigger takes time and is happening company to company. We're confident that all those fundamentals are very strong, so they will assert themselves.

Mr. Andrew Saxton: What impact do you expect the lower dollar to have on our export sector?

Mr. Stephen S. Poloz: That is a side effect of what we've been through. It's true that, on the one hand, we expect the lower dollar to provide a stronger export environment for your average exporter, especially a manufacturer. For example, the average profit margin in the manufacturing sector may be around 6% or 7% in a good year. The Canadian dollar moved five or six percentage points. That is almost like a doubling of profit margins. That gives the exporter the opportunity to compete harder for new contracts and be more competitive, and it's a very positive thing.

But the other side of it is that, if they need to expand and they need to buy a new piece of equipment, and that equipment is bought from another country, it will cost a little more today than it would have back when the dollar was stronger. That's part of the calculus, but in my experience what counts is whether the demand is there for your products. Is it predictable, and something that you can feel confident about? If so, these things will happen.

● (0905)

Mr. Andrew Saxton: Is the lower dollar a net benefit, then?

Mr. Stephen S. Poloz: Oh, absolutely. Historically, it's been a significant net benefit.

Pointing to the possible minor, if you like, negative side effect, which is, of course, the cost of capital equipment, that's important. It's not just capital equipment, but imports through the supply chain obviously go up in price at the same time. The entire calculus of the firm is affected by that exchange rate, but the most important thing is that it makes those companies more competitive when competing for new contracts. Existing contracts, which are already negotiated in U. S. dollars, yield a big increase in Canadian dollar revenue in those early months of that lower dollar.

Mr. Andrew Saxton: How do you expect the strengthening U.S. economy to impact our export sector?

Mr. Stephen S. Poloz: Typically that's been the most important variable driving our exports, the strength of the U.S. economy. What matters also, what we discovered during this cycle, is not just the strength of the U.S. economy, but the areas of the U.S. economy that are expanding. The most important area, which was the last area to begin expanding, was investment in U.S. companies. That is a very trade-intensive segment of both of our economies. That's why we're starting to see—it's getting close to a year now—a good up-tick in all the things we export that are related to what businesses buy as opposed to what consumers buy. That is our strongest signal that this thing is going.

We're being cautious on this forecast precisely because over the last five years Canadian exports have not risen in lockstep with the U.S. economy. There was a growing wedge, and it was because of what we were talking about earlier, about companies that had exited the space during the weakest period. That disconnect is something that we assume for now is permanent, but we hope that by the creation of new sectors what happens in the next phase is that companies or products you've never heard of become the new leading exporters, and some of those other ones that were there before have disappeared.

Mr. Andrew Saxton: Thank you.

We have a growing economy, we have a lower dollar, and we have easier credit. What impact do you expect these factors to have on the non-energy industries?

Mr. Stephen S. Poloz: The non-energy economy, the export-oriented economy, is growing today approximately twice as fast as the domestic economy. That's just a broad measure of performance, over 4% growth, so we have a very good sign from that. All the ingredients that have strengthened over the last three months will add to this as we go forward. We are looking at growth rates for those non-energy exports in the 6% and 7% range. This is very significant growth for any company. It's not something we've seen in the last five years, so it's going to feel a lot different for those companies.

Mr. Andrew Saxton: Thank you.

Chair, how's my time?

The Chair: You have 30 seconds.

Mr. Andrew Saxton: Very quickly, Governor, as you know the finance minister recently presented a balanced budget. Can you explain the benefits of a balanced budget for the Canadian economy?

The Chair: Very briefly, please.

Mr. Stephen S. Poloz: It's really not our role to comment on fiscal policy. Since we're the central bank, I would decline that.

Mr. Andrew Saxton: Could you comment on the balance... [*Inaudible—Editor*]...have on the monetary policy?

Mr. Stephen S. Poloz: It's just something that we take into account. It's almost like arithmetic. We need to know what is the net effect of the budget on the economy before we can figure out what everything else will turn out to be.

The Chair: Thank you, Mr. Saxton.

Mr. Brison, please.

Hon. Scott Brison (Kings—Hants, Lib.): Thank you, Chair.

Welcome, Governor and Deputy Governor, to the committee.

A lot of Nova Scotians, a lot of Maritimers, in fact people across Canada, work in the oil patch in Alberta and Saskatchewan. EI claims in Alberta have grown by more than 20% for the last two months in a row.

You've said that the impact of lower oil prices will be front-end loaded in terms of the negative impacts. How long do you think it will be before the labour market impact of the oil shock will hit its peak?

Mr. Stephen S. Poloz: That's a very hard question. We know that typically labour market indicators are the slowest of all of our economic indicators to show these things. There's quite a lag between when you identify an event and when it's all over in the labour market. Anecdotally, we've seen less commuting. We can see that the Fort Mac airport has slowed down and so on. We know these effects will show up at some point.

At the same time, what we have to bear in mind is that the economy is actually quite strong in other sectors. The interior labour market indicators, the labour market performance, are improving and that suggests that it's easier to find a job today, another job, than it was a year ago, and that's encouraging. We have to take all of that into account, and in that context, I'm afraid it's not possible to forecast when that might peak.

● (0910)

Hon. Scott Brison: Given that, and given Credit Suisse's recent report on the Canadian economy—Mr. Marino and Mr. Lang believe the oil shock effect will be a drag on growth for a longer period of time—are you still optimistic for economic growth resuming after a slow first quarter?

Mr. Stephen S. Poloz: I am. It's important to understand that we're not suggesting that the oil shock was just a three- or four-month event and then suddenly it's over. The investment in that sector in particular is going down by some 30% this year compared to last year. So that's an important drag for the economy, which persists. But we're suggesting that there are other areas of the economy that are actually really strong and will be buttressed by the lower dollar and the stronger U.S. economy, and those positives overwhelm the negatives starting in the second quarter.

Hon. Scott Brison: Another negative would be that sales in Alberta's housing market have taken a really big hit. In most housing busts there's about a six-month lag between a fall in sales and when prices really start to fall. Are you concerned about Alberta's housing market and, particularly in some of the overheated markets, what's going to happen in the coming months?

Mr. Stephen S. Poloz: The housing market is one of our key financial stability risks; it's the headline risk in our financial system review. So the first answer to your question is, yes, of course we are concerned. Now that we have the shock that we're dealing with, we're watching very carefully how that's unfolding.

Perhaps Carolyn would like to elaborate.

Ms. Carolyn Wilkins (Senior Deputy Governor, Bank of Canada): Sure. Thank you, Governor.

Of course we're looking quite closely at the housing market regionally, and as you would expect, the housing market slowed in Alberta, although that seems to have stabilized in the most recent data. But at the same time we see signs of a soft landing in many other areas of the country. I think the exception to that would be Toronto and Vancouver, where those two markets are continuing to grow quite robustly. As the governor said, overall we see the housing market headed for a soft landing. When we look at previous crashes, we don't see that regional crashes tend to spread to other areas, and so we think that, for us, the most likely thing is a soft landing.

Hon. Scott Brison: Do you predict a soft landing for Calgary's housing market, for example?

Ms. Carolyn Wilkins: I would say that we don't do any prediction for any particular market.

Hon. Scott Brison: But you're predicting the housing market for Canada—you're saying a soft landing for the housing market—so you do.

Ms. Carolyn Wilkins: We’re not expecting whatever transpires in Alberta to create spillovers that would be, from a financial stability perspective, worrisome for the rest of Canada.

Hon. Scott Brison: Are there potential policy actions that agencies, for instance CMHC or others, ought to be considering in anticipation of a potential regional housing crash in, say, Calgary?

Ms. Carolyn Wilkins: I think what we've said before is that there are many lines of defence. Policies that the Minister of Finance might find appropriate could be deployed, but certainly that would be the decision for the Minister of Finance.

Hon. Scott Brison: With regard to manufacturing, many manufacturing plants already face capacity constraints currently. Adding capacity takes a lot of time. It's complicated by the fact that the low dollar makes importing the kind of equipment required to increase productivity to be more competitive actually more expensive.

Many companies ramped up capacity in the late nineties to take advantage of the low dollar, and then they got burned in 2002. Given that experience, are you still confident that manufacturers will naturally ramp up enough to save the economy in the face of lower oil prices?

● (0915)

The Chair: Make it a one-minute response, please.

Mr. Stephen S. Poloz: Well, we are confident; the fundamentals are very strong—stronger, I would say, than what we are putting into our forecast. We're being purposely cautious on this issue, precisely because of what we've been through. Our models will naturally not work as well as they have historically, because there's been a structural change in the sector. In that respect, our confidence is very strong and of course confirmed by conversations with real companies.

Hon. Scott Brison: You also said that the weakness of the Canadian economy is not necessarily indicated by top-line figures—the employment figures, for instance. The job market may be softer than actual employment figures. Do you have any comments on that?

The Chair: Make a very brief comment, please.

Mr. Stephen S. Poloz: What we think is that for the economy, because we have lost some capacity during the downturn, indicators of capacity show that we're almost at capacity at this stage... production. But we know that when you lose your job permanently from a closure of a company, you're part of the excess capacity in the labour market. There is more capacity in the Canadian economy measured through the labour market than there is through the production side.

That's the ultimate determiner: how much room we have to grow as those people get re-engaged in the workforce over the next two years.

The Chair: Thank you.

We'll go to Ms. Bateman, please.

Ms. Joyce Bateman (Winnipeg South Centre, CPC): Thank you very much, Mr. Chair.

Thank you very much, Governor and Deputy Governor, for being here this morning.

I want to get a little more clarification on one of your comments, sir. You indicated that oil will be negative in the short term, but in your comments you said that would be offset by other sectors that are doing quite well. What are those other sectors?

Mr. Stephen S. Poloz: Those sectors are the export sectors that we identified last year as being intimately connected to the U.S. investment story. They are things that companies buy for investment in their companies. It's machinery and equipment primarily. It's building materials. It's packaging materials. It's metal products, in a wider range. It's aerospace. As well, one that doesn't fit that is pharmaceuticals, which is another strong growth sector. These are what we call the leading export categories. They account for over 50% of the non-energy export sector. These are the ones that are growing fast. The other half or so are growing moderately.

Then, of course, on the other side we have the energy exports. They're okay in volume terms, but the lower price means that we get less money for each sale.

All of that taken into account gives us relatively slow growth in overall exports this year, but underneath that will be very positive growth in these sectors which are selling to U.S. companies.

Ms. Joyce Bateman: In some specific sectors.

Mr. Stephen S. Poloz: Yes.

Ms. Joyce Bateman: It would appear, then, that our government's focus on creating more trade deals, exploring other opportunities, is congruent with growth and achieving that.

Mr. Stephen S. Poloz: Yes. These are the kinds of fundamentals that are not demand but are structural, and can potentially raise your trend growth rate because you capture more of the total global growth that's going on. For instance, in the context of the G-20 that I mentioned earlier, a couple of Canada's commitments are around those trade agreements, such as Korea and Europe.

Ms. Joyce Bateman: Now, you're talking about the G-20, and I just want to focus on that. You will be familiar with this, of course; I mean, it was in our throne speech in 2013, and our Prime Minister has said that he is targeting a 25% debt-to-GDP ratio by 2021. We're working on bringing that down.

How important do you think it is for G-20 countries to manage their debt?

Mr. Stephen S. Poloz: That's a very difficult question, because the debt depends so much on what's going on in each individual country. As I said before, the whole global economy is pushing against these headwinds, which are the aftermath of the financial crisis.

The growth we see is not natural growth; it's happening because policy is stimulating that growth. We have not reached the stage where it's all escape velocity and everything is happening. The U.S. economy is the first, and may be there. The U.K. economy may be there. We may be approaching it. These are the sorts of things.... But other countries are still working hard at it.

Turning that into a pure fiscal question, I'm sorry, is just not my—

● (0920)

Ms. Joyce Bateman: But clearly there are some unintended consequences for world economies such as ours when certain countries have debt that is problematic.

Mr. Stephen S. Poloz: Again, that is a complicated question, because it depends on why the debt is being incurred. If it strengthens growth, let's say in Europe—because they are running a deficit—that will unambiguously help us sell more exports and make our economy stronger.

It's a mixed question. I'm saying there is no clear answer to that.

Ms. Joyce Bateman: Fair enough.

Maybe this one's a simpler question, because we're working very hard as a government to reduce the tax rate on our small businesses. We are pushing it from 11% down to 9%, and by the time we're done, we will have cut the small business tax rate in half. Does this make Canada more competitive in world markets? Will that help make Canada more competitive in world markets?

Mr. Stephen S. Poloz: Yes. That's the sort of thing that can make Canadian companies.... Anything that changes the cost structure in a company can provide a net edge, if you like, in competing for the next contract. It means translating that into a lower price for the foreign buyer so that another company or some other country doesn't get the transaction.

Of course, the Canadian dollar looms large in that arithmetic, because with a lower dollar you're able to decide whether to offer a 5% lower price, say, or a 3% lower price, and have a 2% higher profit and hire more people. All those things are complicated decisions. It varies a lot from company to company.

Ms. Joyce Bateman: We spoke about the growth underlying certain sectors in the economy and their growth potential and, in fact, in export markets. I'm just curious. Obviously the energy market is not one that is growing, but lower oil prices do mean a break, if you like, for consumers at the gas pumps. Is the Canadian consumer a winner with this? Are they losers? Are they winners? How does it impact income levels? Also, how does it impact consumer confidence?

The Chair: A brief response, please.

Mr. Stephen S. Poloz: I'll be very brief.

In any economy globally consumers benefit from lower energy prices, so there is the next step: do they spend the money they save, or do they save the money they save? That determines how it affects the economy, which makes it complicated.

In Canada it is doubly complicated, because some people lose their jobs—they're no longer on a project in Alberta or what have you—and their consumption goes down.

So we have to analyze the total effect, which is what is so complex about that question.

Ms. Joyce Bateman: [*Inaudible—Editor*]

Mr. Stephen S. Poloz: We don't know yet.

The Chair: Thank you.

[*Translation*]

Mr. Caron, you may go ahead for seven minutes.

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

[*English*]

Thank you, Governor and Deputy Governor Ms. Wilkins.

I want to get back to the housing market. You've said that you are expecting a soft landing in the housing market. Back in December, you said that you estimated the overvaluation in the housing market to be in the order of 10% to 30%. There have been many estimates coming from other banks. I know that the Deutsche Bank reported that it was about 35% relative to income. *The Economist* said in January that it was at about 25%.

When we talk about a soft landing, it means that the overvaluation can actually be deflated slowly, to the point where we can actually have a more normal market. On the other side, the Bank of America said that Canada seems to be experiencing something like “a classic bubble”.

The question really is, if we have to have a soft landing, we really need to be outside of the bubble mode, don't we, in the sense that the bubble can actually explode if it's really something more...?

● (0925)

[*Translation*]

It's more of a situation where the bubble can deflate more slowly. Is your view more or less optimistic than the private sector's?

[*English*]

Mr. Stephen S. Poloz: Just to go back to the first premise, first of all, we don't believe we're in a bubble. There are many other characteristics of a bubble situation that are not present: highly speculative behaviour, people buying multiple houses just because they can sell them later, and that sort of thing. We have in fact been building houses very much in line with demographic demand in Canada, so there's no excess, if you like. Those are important things to bear in mind.

Our modelling, which is based on not just Canada but on something like 40 or 50 housing events globally, did suggest that the extent of overvaluation was around 20%. The “around” is a very important word, because statistically it says it could be as low as 10% or it could be even higher than 20%. That's a statistician's way of describing a range of possibilities. What this means is that our modelling is reasonably consistent with all of these different statements that are taken much less cautiously, if you like.

It would be unusual for us to have a cycle like we've had where housing did most of the work of keeping us out of recession. People buying houses sooner in their lifetimes because of lower interest rates is why we did not have a recession, plus the oil sector. Those are the two things that were really keeping us going. So it would be very unusual to come through all that and not have a degree of overvaluation; one has that in every business cycle like this.

When we talk about “a soft landing”, it's not necessarily the case that it's prices that do the adjusting, because the economy is below where we expect it to be, it's going to converge on its capacity and create a lot more jobs over these two years. What that does is it boosts the things that go into that model—incomes in particular—that make the housing market more sustainable from beneath. That's an important and complicated set of dynamics. It's in that environment that we look at the data and we say that macro-wise we feel that all those ingredients are coming together about as expected. It's later than we expected, but it's happening, so we're comfortable.

Mr. Guy Caron: In that regard, I've seen some economic pundits and some media actually talking about possibly, as a prescription, decreasing the maximum term of publicly insured mortgages from 30 to 25 years. This is not the direction that you would go towards? You would advocate basically the status quo at this point?

Mr. Stephen S. Poloz: If I had some advice to offer in that domain, I would offer it privately with the minister, but it's not really our policy prescription, it's something that is determined by a broader set of actors. The bank acts more or less as an adviser in that context.

Mr. Guy Caron: I'll move to last March in the same report where we heard about “atrocious” growth. You seem to actually have suggested—and we talked before about the tools and tool box—that the Bank of Canada could, if needed, launch its own version of quantitative easing, a “made in Canada” version.

I was intrigued. I would like to know, if we were to go in that direction eventually, what would make it “made in Canada”? What would make it different from what we've seen in Europe, the U.S., and Japan, for example?

Mr. Stephen S. Poloz: Fortunately, we have not been driven there. That tool kit would be opened up if we ended up having interest rates at zero. Indeed, what we've seen in a number of countries now is that we've discovered that zero may not be the actual lower bound, which...of course, again, this has never been done before so now we have negative interest rates in some countries.

Quantitative easing as a general concept means building up the central bank's balance sheet and putting more of those funds into the marketplace, and then watching the system use them. But every financial system is different, and so “made in Canada” might mean that we would choose specific types of assets to buy because we're trying to do what we call “qualitative easing”, which means asking where the problems are, which the U.S. did some of in order to try to make credit move faster in areas where there was a gridlock, if you like.

Quantitative and qualitative easing make for a wide range of possibilities in any situation. As I say, quite fortunately we have not been anywhere close to that need.

● (0930)

The Chair: Mr. Cannan, please, you're on.

Hon. Ron Cannan (Kelowna—Lake Country, CPC): Thank you, Mr. Chair.

To Mr. Poloz and Ms. Wilkins, thank you very much for being here.

I'm from the west coast in British Columbia, and I appreciate the great leadership you've provided over the challenges we've seen across our country. Especially, being born and raised in Alberta, I'm seeing lots of uncertain times.

In your opening comments you talked about the significant drop in the oil prices in just a few months, the tenderness in the market, and the fluctuating currency rate, yet Canada was the first of the G-7 nations to be able to have a balanced budget.

I was just wondering if you could elaborate, from your experience at the Bank of Canada, on what monetary policies have helped Canada achieve a balanced budget.

Mr. Stephen S. Poloz: Monetary and fiscal policy are conducted independently. As I said before, monetary policy must take into account whatever the fiscal plan is for government, because it's an important driver of what the economy will look like.

Our policies, in monetary policy land, have to look pretty far out into the future, because they have their effects over a two-year horizon. Full effects go within six to eight quarters. We must know what is happening on the fiscal side, but of course there's no actual interaction between those two.

In terms of outcomes, any time monetary policy helps bolster economic growth, which I firmly believe it does, that, of course, all other things equal, means that government revenues are stronger and so on. That's what you get when an economy is closer to balanced than far away from balanced. There's interaction in that sense.

Hon. Ron Cannan: People from the Parliamentary Budget Office are our witnesses in the next hour. They've been predicting and taking estimations out to 2080 on health care and tax-free savings accounts. From your experience, how far can you actually estimate into the future when you're doing economic forecasting?

I know you predicted growth averaging 3.5% over 2015 to 2017. I was just wondering, is that what kind of modelling, with some sort of accuracy...is it a few years out, and how accurate can you go out to 50, 60, 70 years?

Mr. Stephen S. Poloz: The answer is that once we get beyond, I would say, about a two-year horizon, you're at the point where it's only long-term structural things that are in the forecast tool kit.

For an economist, it would be asking what the demographic picture looks like, how many people are either arriving as immigrants or being born here and therefore how much the labour force is growing, and what companies are doing to the capital stock. That analysis, for us, given that we're at the back end of the baby boom and people are retiring, is that we believe that the Canadian economy is capable of long-term growth, a little below 2%, for a long, long time.

That's where that kind of analysis comes from. To go out 50 years or something, you would have big demographic-type cycles, perhaps, superimposed on that, which I have not done for you.

Those kinds of long-term determinants we can think of almost as constants. They only move very, very gradually. For us, what we want over the next two years is to be above that 2% growth so we can close the excess capacity gap. That will give us all the job growth and get people who may have lost their jobs back reintegrated into the workforce. When we get there, everything settles there at around or a little below 2%.

Hon. Ron Cannan: Thank you for that.

Looking at the next two to three years, you said that the economic growth is going to strengthen and average about 3.5%. Where do you see inflation?

Mr. Stephen S. Poloz: Just for clarity, that 3.5% number I gave you was for the world economy, which of course has a mixture of very fast-growing economies like China and India and so on. It's higher than our average. Our growth rate is a little less than 2% farther out. Between now and then we're going to grow above 2%, around 2.5%.

In that context, the reason we need to have growth in Canada above our potential growth rate is because we have the excess capacity. If we don't achieve that, then the excess capacity will persist and inflation will continually be pushed down below our target.

This is why our interest rates are what they are: to speed the economy up, to fill up that excess capacity gap, and to get inflation to sustainably land on 2%. For right now, my best estimate of inflation, as I said in my opening remarks, is complicated because prices are moving because of oil prices and because of the exchange rate depreciation. Those are temporary things that we look through.

We believe that, taking out all the temporary effects, inflation is running at around 1.6% or 1.7%. If nothing else happens, that's where we'll stay. But under our forecast, it creeps up to 2% because the economy gets back to full employment.

● (0935)

Hon. Ron Cannan: What price of oil are you using for modelling?

Mr. Stephen S. Poloz: We use a constant assumption with an average of around $60.

What is the latest one...?

Sorry, it's $5 less.

Ms. Carolyn Wilkins: It's okay, we have a couple of prices. For Brent it is $60 a barrel. For WTI it's $55, and for the WCS it's $40, and the last two I mentioned are the ones that are the most important for Canadian producers.

Hon. Ron Cannan: Thanks.

Switching gears to the employment issue, in your monetary policy report you stated that the "labour market conditions appear to have improved modestly, on balance, over the past six months" and that long-term unemployment rates have eased.

I have a couple of questions. Would you say it is a result of action taken to boost the employment sector since the depths of our recession, and what was the balance of opinion on hiring in the latest business outlook survey?

The Chair: You have about 30 seconds to respond on that one.

Mr. Stephen S. Poloz: Okay.

What we're expecting, as I described before, is a good upturn. We do have some very encouraging signs. Long-term unemployment is edging lower. We are seeing better turnover, more job vacancies. The unemployment-to-vacancies ratio has improved. So we're feeling quite positive about the underlying dynamics of the labour market. When we talk to companies in the BOS, they're positive, yet they're expressing prudence, because we've been through this before, where there are sort of false dawns in the world economy and then we get ratcheted back. But this time it feels the most real that it has up until now, so confidence is growing.

I can't be very precise about that, because it is an uncertain outlook, but it's a positive outlook.

The Chair: Thank you, Mr. Cannan.

[*Translation*]

Mr. Dionne Labelle, you may go ahead for seven minutes.

Mr. Pierre Dionne Labelle (Rivière-du-Nord, NDP): Thank you, Mr. Chair. I'd like to thank the witnesses for being with us.

I want to stay on the topic of excess capacity in Canada's economy.

In your January report, you talked about long-term unemployment. You said that it was continuing, still close to its post-crisis peak. You also mentioned involuntary part-time workers. In your current report, you say the long-term unemployment situation has improved. But the report doesn't mention unstable employment. In your Business Outlook Survey, you indicated that, in terms of intentions to increase employment, opinion had decreased to its lowest level since 2009.

That's a worrisome environment for those who are unemployed or currently looking for work. Has the situation really changed since January, or are we more or less in the same boat?

Mr. Stephen S. Poloz: It's clear that things have changed since January. The first quarter held a lot of uncertainty for many companies. I think my colleague may be able to elaborate on that.

Ms. Carolyn Wilkins: As we indicated, labour market growth is still possible. Since January, the numbers show an improvement in certain indicators. That gives us a bit of hope, pointing to an underlying improvement.

As you mentioned, the long-term unemployment rate has dropped. We're also seeing a decline in the number of part-time workers who would rather be working full time. That's a good thing. In addition, the ratio of available jobs to unemployed workers is increasing. That's very positive since it means that someone who is unemployed has a greater likelihood of finding a job.

● (0940)

Mr. Pierre Dionne Labelle: Fine, but I'd like to come back to the opinion of business owners.

According to them, their confidence is at its lowest point since 2009. That means a fairly significant grey area persists when it comes to the job market.

Ms. Carolyn Wilkins: Yes, you're correct. These are underlying improvements. But, because of the oil price shock, the situation may deteriorate in the short term. In the second quarter and throughout the rest of the year, however, we will see more significant improvements.

Mr. Pierre Dionne Labelle: I'd like to pick up on the investment rate.

We talked about the 30% drop in oil sector investment. Where do things stand in the non-oil sector, the manufacturing sector, specifically? When the dollar was quite high, we know that companies invested very little in production capacity, robotics, IT and so forth. Where does the sector stand now, versus four months ago? Has investment in the manufacturing sector picked up or is it still flat?

Mr. Stephen S. Poloz: That's another very complex question.

We compiled the figures, and they show that the unemployment rate will clearly rise in the oil sector and perhaps in other sectors of the supply chain, as well. These examples come from the manufacturing sector, given that we're dealing with the supply chain.

During the first month of the year, we saw mainly a negative impact. At the same time, we observed positive things. Two parallel economies exist, one that is affected by the shock and another that is picking up speed because of the shock. And both of those elements have a push and pull effect when it comes to the figures.

In the second quarter, the positive effects will be clearer, but not 100%. They will be much more visible in the third and fourth quarters.

Mr. Pierre Dionne Labelle: I'd like to raise another point, regarding the level of household debt, which has reached record highs. You are still expecting the debt to income ratio to increase.

In your view, are banks assuming too much risk by lending people money so easily? Right now, is there a risk that banks are going too far in supporting household credit?

Mr. Stephen S. Poloz: Households are certainly vulnerable to changes of that nature. We're talking about a vulnerability, which is not the same thing as a risk. In order to have a risk, you need a catalyst. In certain regions of the country, the oil shock is providing the catalyst. As for banks and other financial institutions, we believe the system is functioning properly. It worked well during and after the crisis, and continues to work well today.

Carolyn, did you have anything to add about household debt?

Ms. Carolyn Wilkins: Yes.

Clearly, banks have ways to verify the loans they grant. More tangibly speaking, the IMF reviewed our banks as part of its FSAP work. The review simulated extreme pressure on the banks, caused by a recession similar to the one in the U.S. during the economic crisis. That had never before been seen in Canada. It showed that the funds are strong enough to withstand that kind of pressure.

● (0945)

The Chair: Fine. Thank you.

Thank you, Mr. Dionne Labelle.

[*English*]

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

Mr. Dave Van Kesteren (Chatham-Kent—Essex, CPC): Thank you, Chair.

Thank you, Governor and Deputy Governor, for being with us. We always enjoy your visits, and they are always informative.

We have spoken about what I would think we all agree are solid fiscal policies that have been carried out in Canada and that have resulted in a strong position, relatively speaking, compared to so many of the other countries in the world, specifically the G-8 and most G-20 countries.

You touched upon some of the policies. We remember our former finance minister, the late Jim Flaherty, who used to talk about the conversations within the inner circles about what was necessary, and governments participated in a program that certainly saved us in 2009 from fiscal ruin. I am hearing cautious optimism as your approach to how you see the Canadian economy. What are the things on a global scale that keep you awake at night, things you see as something that we, as a government here in Canada, can do very little about but that will affect our economy? Is there anything particular in Europe at present? I wonder if you could just elaborate on that.

Mr. Stephen S. Poloz: That's fertile ground. There are a lot of unknowns in the world. I began with the premise that in the post-crisis period, the global economy has continually disappointed us. The forecasts from such organizations as the IMF looked for recovery, and then it was delayed a year, and it was delayed another year, and each year there's a series of downgrades for the outlook. It's precisely because we're in an environment that we've never really been in before.

There have been crises, or what we call balance sheet recessions, in the past. What that means is that it's not just a typical recession where there's a shock, and interest rates move, and we're down for six months, nine months a year, and then we go back. It's one in which people go bankrupt, or banks must rebuild balance sheets, or companies must rebuild balance sheets before they're back to where they can behave normally again. That process takes an undefined amount of time. By the way, it applies to governments, too.

The good news is that, as you allude, everybody got in gear in 2008-09. The G-20 acted in concert, and that really made a big difference. Certainly the policies in the U.S. made a big difference.

This is what concerns me: is the job done? Have we done everything? In Europe we can see they've made some very positive steps this past year, so that's good, but we're not sure yet if it's working or how well it's working. So Europe remains an area that concerns us, but with something to watch, if you like.

China is decelerating. It's a very natural process as they restructure their economy. They're even bigger than they were five years ago, so 7% growth is a lot of growth, yet every time a new number comes out, someone will say, “I think it's slowing more”. That makes you concerned about commodity markets, what matters for Canada, and so on.

Brazil is having a slow growth period. Then there's India, the bright light.

All those uncertainties come up. We want to make sure that you understand that what we try to offer is a balanced risk forecast. We have to be able to tell you that there's something on the upside that we're worried about, too, as a forecaster. That would be the U.S. economy. The U.S. economy appears to be firing on all cylinders. It's had a questionable first quarter but it has a very good momentum. So it has the potential to surprise us on the upside.

Yes, there are negatives, but there are always positives, too, and that's why we can offer it up and say that we think we've balanced the judgment around these numbers we give you.

Mr. Dave Van Kesteren: You mentioned China, and I'm glad you pointed that out, because one of your remarks talked about the impact that demographics have on an economy. Of course, China has a one-child policy that was enacted probably 20 or 30 years ago. When most of us visit China, this is something that they point out. Is that going to become more of an issue in China as well, their slowing birth rate, and the drag that would result on their economy?

● (0950)

Mr. Stephen S. Poloz: Yes, it is gradually slowing its potential growth rate. But that, as I said, is a natural process. We've seen it happen in previous economies such as South Korea. You start off way below the standard of living that's perhaps 15% or 20% of the leader, and over time you make your way up there. The same thing happened in Japan. If you go back to the early 1970s, say around 1970, Japan had a much lower standard of living than the U.S., and it caught up in about 20 years' time.

Those things happen at the same time that these demographics are working their way out. It has to do with technology, productivity, and what upgrading your economy does. Think what agricultural reform could do in a place like China where you amalgamate a lot of smaller farms. It's the same thing in India. You get these kinds of reforms that can unleash a lot more potential capacity in terms of GDP, even with the same number of people. These things are highly unpredictable.

Mr. Dave Van Kesteren: There's another point I guess I want to touch on. There have been a number of measures that we've enacted as a government that have proven positive. I wonder if you can maybe share with the committee how you feel the push for free trade agreements around the world will impact our economy in the future.

Mr. Stephen S. Poloz: Well, without commenting on specifics or on policies themselves, I mean, most economists would agree that freer trade is unambiguously good for a trading nation such as Canada. We have observed, over this past cycle, a significant amount of diversification of Canadian companies to non-U.S. markets, which is exactly that kind of mentality in motion. That's made an important difference as we've come to rely less on the U.S. economy for the growth of the Canadian economy. We still rely, and always will rely very much, on the U.S. economy, but adding more markets can of course help us in times of volatility and can also increase the total market size that we can see.

If we look farther out into the future, we know that economies such as China and Brazil and India will be truly massive economies, and massive amounts of trade will be happening between them and their neighbours. Canada's challenge in this space is to find the entry points to participate in that very big phenomenon. Those things will bear fruit, long term. As I said, it's more like an upgrade to your growth prospects in the long term.

The Chair: Thank you very much.

We'll go to Mr. Adler, please.

Mr. Mark Adler (York Centre, CPC): Thank you very much, Chair.

Thank you, Governor and Deputy Governor, for being here today.

Governor, I first want to talk to you about something that you have some experience in, and that's the export sector. As you know, the performance of our export sector is critical to our sustained economic performance. Can you talk a bit about some of the competitive challenges our exporters currently face?

Mr. Stephen S. Poloz: Certainly.

I guess we should begin with a little bit of history. We've mentioned a couple of times here this morning that in fact a number of Canadian companies were forced to exit the export sector over the course of the post-crisis cycle. Those who stayed, of course, did so by being very careful on their costs and actually becoming more efficient.

One of the byproducts we're seeing of this is quite a good increase in productivity. In the Canadian economy, this is a very positive sign. What it means is that our competitiveness is not just about a lower Canadian dollar but better cost performance among those companies that survived this very difficult period. Of course, now we're laying the groundwork for whole new kinds of sectors, high-tech things like environmental technologies—windmill blades, new jet engines, smokestack emission scrubbers, or robots that inspect metal parts. I mean, ten years ago we didn't even imagine these things, and now they're part of our exports. That is the phase of the cycle that we call the rebuilding cycle, which we believe is just in progress. It's not just about expanding companies who are now up at their capacity; it's brand new companies. We'll be watching those signs very closely.

There are challenges that we're facing, of course. Where are you going to sell? You have to have that kind of global perspective, because it's not just about the U.S. That costs real money; it's hard. There are language barriers, and all kinds of rules and regulations that one has to understand. We have people to help companies do that. It's also about the cost of capital equipment, which came up before. A lot of that comes from other economies.

So you have to take those costs into account, but I'm very optimistic that we have all of the ingredients there for a very successful phase in our cycle.

● (0955)

Mr. Mark Adler: I think about a year ago now *Economist* magazine had a cover story on the growing strength of diasporas in various countries, and what they would mean to a country's export potential. Canada, I think, is very well positioned on that front, given that people from all over the world come to this country and are in very large diasporas, in a lot of instances.

What advantages do you see in Canada's various diaspora communities in helping grow and sustain our export sector?

Mr. Stephen S. Poloz: I would agree with your premise. In my time with EDC I was continually meeting with various institutions or associations and there would be a very big community around that. Some of the barriers to trade are those kinds of softer barriers, cultural or language. A very active facilitation goes on. You can see the difference in areas where we have a diaspora and others where we don't where you just show up with a suitcase in a country to show people your stuff. People don't buy that way. They need to get to know you and they want to sit at the Chamber of Commerce lunch with you, those kinds of things because it's people-to-people. We think of it as country-to-country but it's not, it's a person-to-person business.

I think you're right that those diasporas serve us very well, and we're not alone in that. Other countries have that too. But I'm glad we have it.

Mr. Mark Adler: In terms of our lower dollar right now, we've heard a lot from people. Some members of the opposition are in favour of the lower dollar. Is there a risk that pinning an industrial strategy on a lower dollar could be a problem going forward?

Mr. Stephen S. Poloz: I would say that the dollar is what it is. No one, certainly not us, pins an industrial strategy on a weak currency. We know historically that countries that have tried to purposely depreciate their currency end up with a higher inflation rate. It doesn't pay off. As a company, if you have a lower currency, that sounds like a good deal until your costs are rising in the background and it just offsets it. It doesn't help you.

For us, the dollar is driven by markets. I just remind you of my favourite chart. There is no doubt at all about the main actor in this story: there's just zero doubt in this. What we have to do is take it as it is. No one around here can influence the global price of oil. For about 25 years or thereabouts oil has been significant enough in our economy that this becomes a key driver of our currency.

So what we have to do is take that as a given. That means there may at times be adjustments within the Canadian economy that are costly, slow us down for a while, but when they're over then we pick up again. Sometimes, like now, we expect they're going to speed us up, especially in sectors that have been in difficult times since the dollar started to rise so much due to the oil price.

● (1000)

Mr. Mark Adler: [*Inaudible—Editor*]...in your estimation—

The Chair: This is your last question.

Mr. Mark Adler: —any potential inflationary risks on the horizon that we need to keep an eye on?

Mr. Stephen S. Poloz: No, we're not seeing those. Because the economy has excess capacity our predominant concern is downward pressure on inflation. Yes, when the dollar goes down it causes some prices to rise and that gets built into our inflation number, but our inflation expectations are extremely well anchored at 2%, so that too is a temporary effect. It lasts about one year or a little longer and then it falls out of the numbers, which is why we talk sometimes about underlying inflation. That's an important concept.

The Chair: Thank you, Mr. Adler.

Governor, I wanted to follow up on a couple of points. First of all, with respect to the housing market your financial system review in December 2014 said overvaluation of the housing market was between 10% to 30%. But you said at that time and you said today it's not a bubble, so how do you define a bubble? What percent overvaluation would be a bubble?

Mr. Stephen S. Poloz: A bubble is something that is self-sustaining through speculative activity. We have big historical examples like the tulip bubble and these stock bubbles and so on where people are only buying that thing with the belief that it will be worth something more the next day or the next year, not because they actually want it.

As I said before, our housing construction has stayed very much in line with our estimates of demographic demand for housing throughout this entire period. It bobbles around but on average it's always on track. So that's an important ingredient that's missing. If we were all buying a second or a third condo with confidence that it was going to rise in price, and sell it to someone else, that would be one of the ingredients you'd expect to see in a true bubble. We don't see any of that, and furthermore we don't see truly runaway pricing. I mean, if we do see strong pricing, we look for other reasons, as economists.

The Chair: But an overvaluation of 30%, and I'm taking your upper limit, is fairly high.

Mr. Stephen S. Poloz: I understand that 30% is a big number. What we're very carefully saying is that actually our estimate is a fuzzy one and that it's centred on around 20%, which is still an important number. I agree with you. However, we think this is one of the byproducts of what we've been through. It's not something that happened by itself. It's happened as a product of the experience in the post-crisis period, and as the fundamentals catch up to it in our forecast it will be sustained.

The Chair: I want to move on. On January 21 of this year, you lowered the target for the overnight rate by one quarter of 1%, you said in response to the effect of the oil price drop. On March 4, 2015, you maintained the overnight rate. At the end of March you said, and I think I'm quoting correctly, “The first quarter of 2015 will look atrocious, because the oil shock is a big deal for us”, and on April 15 you maintained the overnight rate.

Why did you not lower the rate more given the statement you made at the end of March?

Mr. Stephen S. Poloz: When we lowered the rate in January, we were in an extremely uncertain situation. This is not an arithmetic exercise to decide what the economy will do. In fact, the day Carolyn and I did our press conference, oil prices were still falling and were already $10 lower than the assumption that we had embedded in our forecast. So at the time it felt like we needed to take out some insurance—and we use the term insurance very carefully—because we wanted people to understand that we didn't really know how this would all turn out, but we figured it was on the downside enough that we needed insurance against it.

Over the course of the next few months, oil prices stabilized. They recovered a little bit. Today that oil price of $60 is around $65 for Brent. Things are a little more positive in that sense. With that, plus the fact that after we cut rates other central banks cut rates, and the whole Canadian yield curve went down significantly, and the Canadian dollar went down noticeably—those things in combination allowed us to do a new forecast that shows that the economy gets back to full employment around the end of 2016, which was our hope, our plan. That means that the insurance amount was about right. Therefore there was no need for us to take further action to offset the shock that has occurred—on our current understanding.

● (1005)

The Chair: Do you regret using the word “atrocious”, then, at the end of March? It's a very strong word to use.

Mr. Stephen S. Poloz: What I was trying to describe was that over the course of these few months, the day-to-day data flow could look very negative. That would be not the first quarter number, which we won't know until the end of May, but data on things like manufacturing, shipments, data on GDP, data on spending. Those monthly indicators could look quite negative. We wanted markets to understand that we already believed that the quarter was going to look quite poor, so in that context that markets would not be therefore doubling up on their bets that the Bank of Canada would need to do further actions. At that time, we were redoing our forecast and we needed to do a full assessment to see if the amount of insurance was approximately right. In the end, we believe it was.

The Chair: But my understanding of the first quarter is that actually most economists predicted where it ended up. It was not a surprise to most economists. I think it was off by 0.1% in terms of the growth numbers, which shows that it was sort of an expected thing. I guess when you use words like that, or even with the housing situation....

Everybody follows your words very carefully, and I don't know if you're doing it by design, but the previous governor had his forward guidance policy but he was also extremely measured and aware that every single word he said was taken very seriously. Are you by design trying to shock the markets occasionally with these words or with the 10% to 30% overvaluation? Because I think it is having that effect. Even the January 21 change in the overnight rate caught an awful lot of analysts by surprise. Is that by design that you're doing that?

Mr. Stephen S. Poloz: It's certainly not our intent to surprise or to frighten people.

Just as a slight adjustment to your premise, nobody knows what the first quarter looks like yet. Our forecast is that it's zero. That seems to be reasonably in line with what others are saying. Since the numbers provided by private sector economists to the finance minister for the budget forecasted an average of 2% for this year and our number is 1.9%, it seems like we're quite well in line now with what the private sector is saying.

The number I think you're referring to is the fourth quarter, where we had 2.5% forecast and it turned out to be 2.4%, which was actually at that time much stronger than what the private sector was expecting.

The Chair: Okay.

Finally, you state that the interest rate cut in January is working. What specific evidence would you give to back up this claim?

Mr. Stephen S. Poloz: Well, the evidence we have at present would be primarily in the export sector. We also know that consumers, those with flexible rate mortgages, have already lower payments. This is important as a buffer to the oil price shock. Those who are renewing, who don't have variable rates—that block of people are already getting the benefit of lower mortgage payments.

We know that companies with existing export contracts receive a substantial boost in their cashflow immediately when the currency moves as it did. That would be not only in the non-energy export sector but in all export sectors. In the case of oil, it provides a partial offset to lower oil prices, but in other sectors where prices have been stable, it's an enormous effect on their cashflow, and then, of course, positions them for more competitive offerings in the next cycle of contracting.

The evidence we have is thin at this stage. It's an accumulation of fundamentals that we believe are there, and as we say in the monetary policy report, our biggest risk is that somebody surprises us. For example, consumers spent less in the first quarter—we believe because of bad weather. However, if it turns out that they've changed their minds about something, then that's something that would carry on longer. That's a risk.

In the case of companies, companies tell us in the non-energy export sector they're ready to invest. They need a little more time perhaps, or they need a little more assurance, and I think the numbers are proving that.

No one is claiming that we know exactly what's happening in the first quarter or the second. That's our job to continue to monitor all those things.

● (1010)

The Chair: Okay. Thank you.

Governor and Senior Deputy Governor, I want to thank you for being with us here today. Thank you so much for presenting and for responding to our questions. We appreciate that very much.

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

● (1010)

(Pause)

● (1015)

The Chair: I call this meeting back to order. This is meeting 77 of the Standing Committee on Finance. Our orders of the day, pursuant to Standing Orders 108(2), are for a study of the economic and fiscal outlook.

We're very pleased to have with us today the Parliamentary Budget Officer.

[*Translation*]

Once again, Mr. Fréchette, welcome to the committee.

[*English*]

As well, to your officials who have been with us here many times, welcome back.

I understand you will have an opening statement. Perhaps you want to introduce your officials to us, then we'll have questions from members as well.

[*Translation*]

Mr. Jean-Denis Fréchette (Parliamentary Budget Officer, Library of Parliament): Good morning, Mr. Chair, vice-chairs and members of the committee. Thank you for the invitation to appear and discuss our April 2015 economic and fiscal outlook.

Today, I am joined by Dr. Mostafa Askari, Assistant Parliamentary Budget Officer, Chris Matier, a senior director, and Scott Cameron, an analyst. They can also answer any questions you have regarding our outlook or other PBO analyses.

[*English*]

As you know, given the timing of this year's budget, we provided the committee with a pre-budget economic and fiscal outlook. This outlook was constructed on a status quo basis and was intended to provide parliamentarians with an independent point of reference that could be used to assess budget projections as well as the scope for new measures.

[*Translation*]

First, I would like to briefly highlight some key findings from our pre-budget report.

We have expanded on our January analysis of the impact of lower oil prices. Based on model simulation results, our estimates indicate that the impact of the decline in oil prices on the Canadian economy is ultimately negative, albeit relatively modest.

In preparing our pre-budget outlook, we assumed, based on recent future prices, that oil prices will increase gradually from US$50 per barrel for West Texas Intermediate in the first quarter of 2015 to a high of US$66 per barrel by the end of 2020.

PBO's pre-budget economic outlook indicated that real GDP growth would slow to 2% in 2015 and then average 1.8% from 2016 to 2020, which is in line with our estimate of potential growth in the Canadian economy.

Prior to accounting for Budget 2015 measures, PBO's fiscal outlook showed that the government's budget would be in surplus in 2014-15 and would be roughly balanced over the next five years.

[*English*]

We have updated our economic and fiscal projections to incorporate budget 2015 measures as well as revisions to the government's forecast of direct program expenses. There are some notable points of contrast between PBO's updated economic and fiscal outlook and the outlook presented in budget 2015 that I would like to draw to your attention.

The budget 2015 oil price assumption is that WTI oil prices will rise sharply to $67 U.S. per barrel in 2016 and continue rising, ultimately reaching $78 U.S. per barrel in 2018. You have the table and my remarks that were sent to the clerk prior to the meeting.

In contrast, PBO assumes that oil prices will rise only gradually to $64 U.S. per barrel in 2019, which is also in line with recent futures prices.

While near-term projections of real gross domestic product growth are similar, the budget outlook over 2017-19 is relatively optimistic, with real GDP growth 0.4 percentage points higher annually on average.

Reflecting differences in oil price assumptions and real GDP growth projections, the outlook for nominal GDP in budget 2015 is $20 billion higher annually, on average, over 2017-19 compared to PBO's updated projection.

Updating PBO's fiscal outlook for budget 2015 measures and for the government's new direct program expense forecast results in relatively small projected budget deficits over 2017-18 to 2019-20.

● (1020)

[*Translation*]

On balance, our judgment is that the economic and fiscal outlook presented in Budget 2015 is relatively optimistic and that there is downside risk to the medium-term outlook over 2017-18 to 2019-20.

[*English*]

Just before concluding, Mr. Chair, as you are aware, the joint committee on the Library of Parliament recently passed a motion supporting the PBO's access to government information. The motion instructs the PBO to report to your committee and some other committees when I'm unable to obtain the required information from departments. The motion also refers to the standing committee's considerable powers to send for papers and records.

I welcome this parliamentary remedy and look forward to establishing a correspondence with your committee.

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

[*Translation*]

Thank you, Mr. Chair.

The Chair: Thank you kindly for your presentation.

[*English*]

Colleagues, we'll do seven-minute rounds again.

We'll begin with Mr. Cullen, please.

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

Just to confirm something we raised with the Governor of the Bank, over the last 16 months growth of the Canadian economy has been less than 1% per month. That represents the slowest growth rate outside of the recession in the last four decades. Is that your understanding of our current fiscal situation?

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

I'll ask Mostafa Askari and maybe Chris Matier to answer that question.

Mr. Mostafa Askari (Assistant Parliamentary Budget Officer, Office of the Parliamentary Budget Officer, Library of Parliament): I'm not sure exactly about the average you are mentioning, but certainly we have had weak growth since the start of the financial crisis.

Mr. Nathan Cullen: In your estimate, are the government's projections in their budget document overly optimistic?

Mr. Mostafa Askari: Over the short term, in the first two years actually our projection is very close to what the private sector has, but over the medium term they seem to be more optimistic than what we are projecting.

Mr. Nathan Cullen: If we're having historically low growth in our economy, where we're increasingly having full-time jobs replaced by part-time precarious work and youth unemployment twice the national average, how we invest right now in this economy is important.

I want to get to projections on some of the tax measures the government has taken. We have in front of us, just released this morning, the Auditor General's report. I'll quote from some of the main conclusions from the Auditor General, that “information provided by the Department of Finance Canada on tax-based expenditures does not adequately support parliamentary oversight”, and they go on to say that, “The Department of Finance Canada does not systematically evaluate all existing tax-based expenditures.”

Do you have anything to say to those two conclusions from the Auditor General?

● (1025)

Mr. Mostafa Askari: The Department of Finance provides an annual report on tax expenditures, but those are just the current spending, current estimates. What we have done in the past is we have tried to provide a projection for the cost of those kinds of major tax expenditures over time. That's what we did with the TFSA and some other measures.

Mr. Nathan Cullen: Let's take up the TFSA for a moment. This is a program that's fully reached by less than 16% of Canadians who max out on their TFSA contributions right now?

Mr. Mostafa Askari: I assume 16% is the correct number, but I can't talk to that right now.

Mr. Nathan Cullen: The finance minister recently, in response to a question that.... We can't get them from the finance department and we can't get them from the federal government. They announce the program, but won't tell us what they think it will cost. You have this one TFSA program going in cost from a half a billion dollars in the immediate to $13.5 billion in 15 years and accelerating thereon to... and this is per year: $13.5 billion per year to $44 billion per year in cost to the government.

Is that correct?

Mr. Mostafa Askari: That's right. The cost will obviously increase as the contribution room increases over time. But also, one has to put the cost increases in the context of the size of the economy. In the long run, our estimate is that by 2080—which is obviously a very long period of time—the cost of the TFSA overall, the total cost for the federal and provincial governments, would be about 0.7% of GDP.

Mr. Nathan Cullen: So 0.7% of GDP is a lot for one tax initiative.

Mr. Mostafa Askari: Well, again, it depends on how you compare it with other programs. That is very close to what the cost of the RRSP is right now.

Mr. Nathan Cullen: We're not opposed to the TFSA at a $5,500 ceiling. Where our concern comes up is that when the ceiling is then raised, who gets the benefit?

According to your estimates, the wealthiest 20% of Canadians will get almost 10 times the benefit of the middle 20%—the middle class—and the top 20% by wealth will get nearly twice as much as the bottom 80% combined. The top 20% of income earners will get nearly 16 times more benefit from this one move than the bottom 20%.

On an equity level, is the top 20% in such trouble that they need initiatives that so overwhelmingly favour their bottom line?

Mr. Mostafa Askari: In the TFSA analysis, we tried to do the distribution allowances relative to income, relative to wealth, and also relative to age, and our conclusion was that overall most of the benefit of the TFSA over time, in the long run, will go to the middle and middle-high income group. But when you compare it on a wealth basis, then certainly those who have more wealth have more financial assets to put in TFSAs, so obviously the potential benefits for those people are much higher certainly.

Mr. Nathan Cullen: Right. So Canadians who have that extra $10,000 at the end of the year are going to be the ones who mostly benefit from this, and from your analysis that tends to obviously skew towards wealthier Canadians who logically will have more money to put into something like a TFSA.

Mr. Mostafa Askari: Over time.

Mr. Nathan Cullen: Over time. So when combining this with the government's choice to broaden out income splitting....

Again, we're in favour of it towards seniors. We see the equity that it goes across middle-, low-, and high-income seniors, but when income splitting is broadened out, 85% of Canadians receive no benefit whatsoever.

Now, we're also seeing that in the government's budget document, they gave us a preview of what the Conservatives think is a typical family. They've done this the last number of years. Interestingly, in this budget, the genders switched in terms of income. Previously, in the typical family, according to the Conservatives, the woman was earning more than the man, but not appreciably more, with only a $14,000 or $20,000 difference between their salaries. Now suddenly the typical family under the Conservatives' world view has the woman earning almost $50,000 less in order to achieve the maximum benefit under their income splitting. So she has to take a pay cut of $50,000 in order to get into that 15% cohort as a family. That's the Conservatives' typical family.

With income splitting, what is the general impact on the economy and what is the view of equity? Is it an equitable measure to apply to an economy that is not creating jobs right now and is overwhelmingly unfair?

The Chair: You have about 30 seconds for a response, please.

Mr. Jean-Denis Fréchette: Okay.

I just have a correction. The 15% household that you mentioned is related to the family tax cut, not to the TFSA.

● (1030)

Mr. Nathan Cullen: No, I'm talking about that.

Mr. Jean-Denis Fréchette: So 15% of the families will receive higher benefits. The fiscal impact of the family tax cut, or what you call the income splitting, is $2.2 billion in 2015.

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

We'll go to Mr. Saxton, please.

Mr. Andrew Saxton: Thank you, Chair.

Thanks to our witnesses from the PBO for being here today.

Let's continue on the line of the tax-free savings account. We introduced the tax-free savings account to help Canadians to save for the future, to save for their children's education, to save for that first down payment on a home, and also to save for their retirement. Eleven million accounts have been opened to date. It's the most successful savings vehicle since RRSPs. I'm also happy to note that the majority of those that have been opened have been opened by middle- and low-income Canadians.

Do you not think it's a good idea to give Canadians more choices in how to save for their future and to save for their priorities?

Mr. Jean-Denis Fréchette: Our report doesn't say anything about whether it's a good or bad idea. The report is essentially on the fiscal costs of such a measure and the long-term impact of it. I mean, saving is of course a good thing for everyone, depending on the capacity you have to save that kind of money.

But at PBO, we didn't make a judgment on the savings account itself or the validity of that account. We just essentially measured the long-term fiscal impact on government finances.

Mr. Andrew Saxton: Right. The opposition Liberals and NDP have both said that they would cancel the increase in the tax-free savings account. There are also RRSPs that are being underutilized. So following that same logic, they would also cancel the amount of RRSPs that aren't being utilized.

Does that make any sense to you?

Mr. Mostafa Askari: There again, as I think Mr. Fréchette said, we don't pass judgment on the policies. But on the point of savings, in fact, in our report we looked at the literature in terms of the impact of tax measures on people's savings behaviour. Our conclusion from reading the literature was that there isn't really any conclusive evidence that tax measures can actually significantly improve the savings behaviour of individuals.

Now, the way we did our calculation in our report was that we looked at what amount of savings people have, what financial savings they have, and our assumption was that those financial savings that were in taxable instruments will be moved to non-taxable TFSAs, and that's how we measured. So it's not an issue of increased savings, it's just how you allocate your savings to different instruments.

Mr. Andrew Saxton: In Canada we have a three-pillar system of savings. Have you looked in your report at the differences and benefits between mandatory—that's forcing people to save through things such as the CPP—versus voluntary savings, which would be the tax-free savings account and the RRSPs?

Mr. Mostafa Askari: No, sir, we did not.

Mr. Andrew Saxton: Have you looked at the cost to the federal treasury of the RRSP system?

Mr. Mostafa Askari: There are some measures; I don't have those measures right now, but there are costs overall as a percent of the GDP. The RRSP, I believe, costs around 0.6% of the GDP right now.

Mr. Andrew Saxton: Right now with RRSPs, that is money that goes in before taxes, so in fact the cost to the treasury is immediate, whereas for the tax-free savings account that is after-tax dollars. Those investors who have put money into tax-free savings accounts are putting in after-tax dollars. They've already paid taxes to the government, so therefore the potential cost to the treasury is actually down the road.

Mr. Mostafa Askari: Well, it's forgone revenue for the government, because if the financial asset moves from the taxable instruments to non-taxable TFSAs, that is forgone revenue for the government for that amount of money.

Mr. Andrew Saxton: Right, but it's not an immediate hit because the tax is already paid immediately on it.

Mr. Mostafa Askari: Well, costs will go up over time as the contribution room increases, and that potential forgone revenue will increase over time.

Mr. Andrew Saxton: Okay.

When it comes to income splitting, you've got a two-parent family where one works and one doesn't and then you've got a two-parent family where both work. Why would it be fair to tax them differently in the sense that the whole purpose of the income splitting is to level the playing field when you have one parent who stays at home? It allows the two parents to average the income over two people, which is what two-parent families who both work do as well.

So why would that not make sense for a family that chooses to have one parent stay at home?

● (1035)

Mr. Mostafa Askari: Again, sir, going back to what I said earlier, we don't really pass judgment on the validity of the policy. Policy is proposed and made, and we just provide an estimate of the consequences of those policies.

Mr. Andrew Saxton: Thank you.

Let's move on to oil prices for a moment here. I notice that you mentioned in your opening remarks that you expect the price of oil to range between $50 and $66 for the next five years, from 2015 to 2020. We all know that oil prices are extremely volatile. We've seen them move several dollars in a day and multiple dollars in a week and certainly in a month. You're talking about a five-year period when they're only moving a very small amount. Can you explain your rationale behind that?

Mr. Chris Matier (Senior Director, Economic and Fiscal Analysis and Forecasting, Office of the Parliamentary Budget Officer, Library of Parliament): Underlying our projection for oil prices is that they are really just based on futures prices. This reflects the beliefs of financial markets and people who are trading and betting on oil prices.

In comparison to the private sector average, yes, it is lower, but I think it's also in line with the Bank of Canada's assumption that assumes that oil prices will remain at their current level over the next three years, so it would be in between those projections.

Mr. Andrew Saxton: Now, am I reading it correctly that it shows pretty much a flat number over most of that period of time under review?

Mr. Chris Matier: It's a very gradual increase from about $52 on average over 2015 to $64 in 2019, and ultimately our end point would be at the end of 2020, which would be $66.

Mr. Andrew Saxton: Okay, thank you.

Then finally on your GDP growth numbers, how do you arrive at those projections?

Mr. Chris Matier: These projections are based on our macroeconomic model, and it requires a lot of assumptions on the U.S. economy, commodity prices, as well as monetary and fiscal policy—

Mr. Andrew Saxton: Do you take into consideration private sector economists' projections?

The Chair: We're over time. Just briefly answer that, and we'll come back to it.

Mr. Chris Matier: Okay.

No, our projection is an independent projection.

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

Hon. Scott Brison: Thank you, Mr. Chair.

Thank you very much for joining us again today.

Some time ago I requested that the PBO study Canada's federal tax gap. I think it was almost two years ago. Has the CRA provided you with the the necessary information to undertake this study?

Mr. Jean-Denis Fréchette: No. After several months of negotiations, because we made some offers...and we offered some protocol. If you remember, the last time we were here we mentioned that we even offered to pay for a certain series of data. At the end of the negotiations, we offered to go for a joint reference to Federal Court, and the CRA turned down that offer.

Now we are facing two things. There is a motion from a senator asking for a change to the CRA legislation, and we are continuing on our side. That's why in my opening remarks I mentioned the motion from the joint committee on the Library of Parliament. We will see, we will try that parliamentary remedy, and at the end of it, as I said before, going for a joint reference or a reference to court remains an option.

Hon. Scott Brison: So you're prepared to take the government to court if there's continued non-cooperation.

Mr. Jean-Denis Fréchette: As I mentioned to the CRA commissioner, I would like to clarify his interpretation and PBO's interpretation, legal interpretation, of the CRA's...about the taxpayers' data.

Hon. Scott Brison: Thank you.

On the oil price forecasts you referenced earlier, and Mr. Saxton referenced, your projections are much closer to the Bank of Canada's projections. The governor was with us earlier today and was saying WTI $55, Brent $60, but the government in the budget, as you know, is projecting an increase to $78.

Do you think it would be more prudent to assume a more conservative number in terms of growth, in terms of fiscal projections?

● (1040)

Mr. Jean-Denis Fréchette: I'll ask Chris, who is the expert on oil prices, to answer that question.

Mr. Chris Matier: Thanks, but I'm not an expert on oil prices.

I believe in the April 2015 MPR from the Bank of Canada, the assumption for WTI oil prices was $50 a barrel for the next three years, so out to 2017. As you know, oil prices are quite volatile and play an important role in the Canadian economy. I think in doing projections it's important to have probably a range of estimates, or at least a risk analysis around that.

Hon. Scott Brison: Given the impact of oil prices on of course GDP growth, and of course the impact of GDP growth on government revenue, the delta between where the government is projecting oil prices to go in the mid-term compared to where you're projecting oil prices, or the Bank of Canada, on the fiscal impact, are we more in a deficit territory in the mid-term if oil prices, in fact, on a go-forward basis stay where you're projecting them?

Mr. Mostafa Askari: As we said in our opening remarks, there is about $20 billion difference between the nominal GDP or our estimate and the government or private sector estimates. That roughly translates into about $3 billion difference in tax revenues. So yes, obviously when you have a different nominal GDP projection, you get a different impact on the revenue.

Hon. Scott Brison: That would put us back into deficit territory.

Mr. Mostafa Askari: That's reflected in our projection, which we show over the medium term as a slight deficit of about $2.5 billion over the last three years of the projection.

Hon. Scott Brison: That's going to make that new balanced budget legislation tricky, I guess. Rosy oil price projections aren't really a good budgeting practice.

Structurally, are we still in deficit territory, then? Based on your projections, would you refer to that as a structural deficit?

Mr. Mostafa Askari: We are showing the actual structural numbers and roughly over the period we are essentially roughly balanced. There's a slight structural deficit in 2018-19 and 2019-20, but it's not really that big; it's about $1 billion.

Hon. Scott Brison: It's still a structural deficit.

Mr. Mostafa Askari: It is a small structural deficit, yes.

Hon. Scott Brison: Okay. Thank you.

On the TFSA increase to $10,000, will this result in an additional OAS payment to TFSA-holders who would normally face OAS clawbacks because of their wealth?

Mr. Mostafa Askari: Potentially, yes. One of the benefits of the TFSA for the pensioners is that they can essentially protect the income they get from the TFSA from the income-testing programs of OAS and GIS. So yes, potentially, part of the cost for the government is the higher payments through those transfer payments.

Hon. Scott Brison: To what extent...? Mr. Cullen touched on this a little earlier. If you compare the relative benefits of the top 20% of Canadian families in terms of income to the rest, how does this compare to the bottom 20%? How would you compare the benefits of increasing the TFSA?

The Chair: A brief response, please.

Mr. Mostafa Askari: Overall, the income distribution or the distributional impact of the TFSA does not change significantly because of the increase in the contribution room, because a lot of it actually cannot be used over time since it is too big for most of the families, who will exhaust their savings by the time they get to that point.

But overall, yes, those who have higher wealth will certainly have the potential to benefit from the higher amount.

● (1045)

The Chair: Thank you, Mr. Brison.

Ms. Bateman, please.

Ms. Joyce Bateman: Thank you very much, Mr. Chair.

Thank you to our witnesses who are here today from the Office of the Parliamentary Budget Officer.

I want to refer to the remarks that you have made already, sir. In your remarks in response to another one of my colleague's questions, you said that savings is “a good thing”—we can check the blues for that—and I agree with you. I agree with you.

The other comment I would like to take issue with and build my question around is that Mostafa mentioned that policy won't increase savings. That's just a paraphrase. We can check the exact wording, but you basically said policies won't impact savings. Is that reasonable, sir?

Mr. Mostafa Askari: I said that tax policies on savings instruments would not—

Ms. Joyce Bateman: Okay, tax policies. What I would like to ask you then, in terms of your calculation, is, if it won't affect behaviour.... There are 11 million Canadians whose behaviour has been affected, so I want to ask you some questions on the analysis.

I'm a chartered accountant. When I worked at Price Waterhouse, if we did an analytical piece, we would endeavour to do both sides of the analysis for the client. I would like to suggest that you've only done half the job, and I'd love to get the other half of the analysis, because we have two tax models.

An RRSP has an immediate cost to the treasury. Take the example of a nice 24-year-old person who has just graduated from school. If they put $1,000 into a tax vehicle named the “Registered Retirement Savings Plan”, there is an immediate cost to the treasury. Further, given the time value of money—you can look up the algorithms, and there are a number of them—the reality is that if you defer the payment of tax for seven years, you've pretty well saved that tax dollar. This 24-year-old student is going to declare his or her RRSP perhaps 40 years hence, so the deferral is multiples of seven years. There's an enormous tax—as you would say—cost to the treasury.

You contrast that with the tax-free savings account. That individual has already paid the tax on that investment. He or she did not get any benefit from the government. What they did was pay the full tax—there was no cost to the treasury—and then put their $1,000 into a tax-free savings account. That's the basic difference.

The third piece of the missing analysis in terms of your work that I'm very fearful of.... You're so worried about the loss by 2080, but as time goes, that young man who has made that investment at 24 years old is going to actually contribute to a pool of capital. Whether it goes into mutual funds, investments of other kinds, the equity market, or the bond market, that is a pool of capital that future entrepreneurs will be able to draw upon and invest from, and it will strengthen the economy. That is the piece that I believe, sir, is missing in your analysis. Could you please comment on that?

Mr. Mostafa Askari: First, I think you're right on the number of people, the 10 million, I guess you quoted, who have invested in TFSAs—

Ms. Joyce Bateman: It's 11 million, actually. If I may just say, sir, 75% of those 11 million individuals earn less than $70,000 a year, and almost half of them earn less than $42,000. This is a vehicle that is helping people make a difference in their lives and take charge of their well-being.

Mr. Mostafa Askari: If I may make a couple of points, first, there is no indication that the amount of money that has gone into TFSAs is actually new savings. It's very likely that most of it is the money that was saved in other instruments and has been transferred to a TFSA.

● (1050)

Ms. Joyce Bateman: Sir, on what basis is that assumption in place?

Mr. Mostafa Askari: As I said, there is no indication that this is the case because we haven't seen any—

Ms. Joyce Bateman: There's no indication? Then on what basis are you making that—

The Chair: Let's have one at a time here. Let's pose the question and then have an answer.

Ms. Joyce Bateman: Mr. Chair, I'd like to query the basis of the answer, because it doesn't seem there's any basis for it.

The Chair: Okay, but I'm having a tough time following the discussion. Ms. Bateman, you posed the question and we'll have a response.

Mr. Mostafa Askari: We haven't seen any increase in the savings rates of Canadians as a result of TFSAs yet; it may happen over time. As I said earlier, the literature shows, from studies that have been done internationally and in Canada, that there isn't really a significant impact from changes like the TFSA tax changes on people's savings behaviour, and—

Ms. Joyce Bateman: Sir, perhaps you could clarify that for me: what literature internationally?

Mr. Mostafa Askari: There is a study by the OECD. There are studies by university professors in Canada and in other countries who have looked at the impact of tax policy on savings behaviours of individuals. As I said, the results are mixed. Those that actually show a positive correlation between lower taxes and higher savings show a very small elasticity, a very small impact. That's why—

Ms. Joyce Bateman: Oh, so there is some elasticity?

Mr. Mostafa Askari: Some could be; as I said, the results are mixed. Some show no impact, some show negative impact, and some show a very small positive impact.

Now, if there is a positive impact, that would be great: there would be more savings. But as I said, we haven't seen an increase in the savings rates of Canadians so far since the TFSA has been established.

Ms. Joyce Bateman: How long did you go back on this arithmetic analysis that you did? We only just created the TFSA in 2009.

Mr. Mostafa Askari: That's right, and that's where the study starts, yes, in 2009.

The Chair: You have 30 seconds.

Ms. Joyce Bateman: Anyway, I would like to suggest that you include the access to capital, clearly the elasticity. Perhaps with the doubling, there will be a greater impact. I really think it is important that your next analysis on this includes the impacts to the treasury and to the tax dollars that our opposition values so greatly, because there is an immediate impact to the government treasury on that.

The Chair: Very briefly, if you want to comment.

Mr. Jean-Denis Fréchette: Just to clarify, is that an official request? I mean, it is your privilege to ask these kinds of questions to the PBO.

Ms. Joyce Bateman: I'd love that information, but through the chair.

I think that's very important. I think you have half of the coin showing right now, and I'd like to see the full one.

Mr. Jean-Denis Fréchette: We'll clarify with the chair the real question, the exact question, that you're asking. We can check the blues, but—

Ms. Joyce Bateman: I think I've made my real question very clear, sir, with all due respect, and I would love an answer to it. I think you've done half of the analysis, and I would like to see the full analysis.

The Chair: Thank you.

Monsieur Caron, s'il vous plaît.

[*Translation*]

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

Mr. Fréchette, for the benefit of Ms. Bateman and the committee members, it would be helpful if you could send us the TFSA studies that have been done here and around the world. A number of studies have been done on the subject, and I've had an opportunity to read them. The government would benefit from having access to them, as well. That would be appreciated.

Mr. Saxton said that income splitting levels the playing field for families. Conversely, I would say that when one spouse—usually the man—makes $80,000 a year and the couple has two or three children, the other spouse can choose whether or not to work. But for a couple that has three or four children, with one parent earning $40,000 a year, the other spouse almost has to work just so the family can make ends meet.

As for whether the policy levels the playing field or not, you didn't want to comment, and I won't ask you to. My example contradicts the government's claim that the measure eliminates an unfair element in the tax system. What's more, couples benefit from economies of scale, as compared with individuals who don't have access to income splitting, even if they are single parents. The Carter commission raised that point at the time.

I'd like to pick up on something Mr. Cullen said about the Auditor General's report, something I find quite interesting. According to the report, the government doesn't provide Parliament with appropriate information on tax-based expenditures. That leaves Parliament unable to ascertain how much tax-based expenditures will end up costing the government in lost revenue. The report also mentions the fact that it's impossible to obtain a description or proper follow-up from the Department of Finance.

My first question is this. In a speech to the UN, Mr. Harper had previously said that it was impossible to manage effectively without the ability to measure data. And according to the Auditor General's report, we can't adequately assess tax-based expenditures.

Would you draw a parallel between the situation identified by the Auditor General and the fact that the government is ramping up its estimates-based management approach, making it extremely difficult for committees to study departments' estimates and make a final determination on budget-related issues?

● (1055)

Mr. Jean-Denis Fréchette: I think we've already mentioned that we have the same problem in terms of estimates oversight. A parliamentary budget officer position exists. In our quarterly reports, we monitor the government's budgetary expenditures.

I'm going to repeat what I said earlier. We, too, have trouble obtaining the necessary data to accurately assess all of the government's measures. We indicate that every three months when we review direct program spending in the absence of all the necessary data. Those issues date back to 2012. Nevertheless, committees do take their jobs seriously, and I hope they are using our data.

I hope that the Auditor General at least mentioned in his report that the parliamentary budget officer is also making those efforts to help parliamentarians, albeit without ideal results, so they can do their jobs as lawmakers and overseers of public money.

Mr. Guy Caron: I hate to disappoint you, but so far, I haven't seen any mention of the parliamentary budget officer's work in the report.

In response to the Auditor General's report, one of the things the government intends to do is extend its fiscal spending forecasts by two years. Do you think that is sufficient?

Mr. Jean-Denis Fréchette: Having not seen the Auditor General's report, I can't comment on that.

I'm not sure whether Mostafa would like to add anything.

Mr. Mostafa Askari: I'm not really in a position to comment. But I can say that medium-term or five-year forecasts are usually more useful for everyone.

Mr. Guy Caron: Did you say five years? So that's your recommendation.

I'd like to come back to your assessment of income splitting. I'm going to switch to English because this is how CTV News summed up your comments:

[*English*]

that income-splitting will have a “near-zero” impact on families in the bottom 20% of income, and that about 7,000 full-time jobs and $90 million in income will be shed by the Canadian labour force due to the policy.

[*Translation*]

To what do you attribute the loss of jobs and income?

[*English*]

Mr. Mostafa Askari: Normally when you have this kind of change in the marginal tax rate for individuals in a family, there could be an impact on the behaviour of the individual in terms of how much labour they supply.

In our estimate in our report, we showed that, if there is a family that benefits from this, normally the higher-income person in the family will actually effectively have a lower marginal effective wage rate because of the lower taxes, and the person with the lower income will have a higher marginal effective tax rate. There are negative impacts on the lower-income individual in the family and a positive impact...and the net impact is a small negative.

[*Translation*]

Mr. Guy Caron: In a nutshell, then, what you just said ties into what I was saying earlier. At the end of the day, those who leave the labour force will be the ones who can choose to do so. When one spouse makes $80,000, $90,000 or $100,000 a year, the other spouse has the flexibility of choice. If both people in the couple make $30,000 each or if one earns $40,000 and the other earns $30,000, they won't necessarily have any choice, especially if they have a family and mouths to feed.

Mr. Mostafa Askari: That's absolutely true.

Mr. Guy Caron: I have one last question for you.

Where are you right now in your cost assessment of Canada's involvement in Syria and Iraq? Are you still looking into that? Are you following up on those costs?

● (1100)

Mr. Jean-Denis Fréchette: We are in the process of doing that follow-up. Without letting the cat out of the bag, I will say that that will probably be the focus of our first discussions with the committee.

Our relationship with the Department of National Defence seems to be improving gradually. You may know that we produced our last report with virtually no information provided by the department. We received more information from the United States Air Force and the United Nations than we did from the department.

This time around, we've contacted the new minister and new deputy minister, and both appeared to be very open. We are following up on the subject, given that we did receive a request to that end in connection with the report.

I'd just like to come back to your other point, the net reduction of 7,000 jobs resulting from the family tax cut. It's equivalent to 0.04% of the total hours of labour supplied, so it's still fairly marginal.

The Chair: Thank you, Mr. Caron.

[*English*]

Mr. Cannan, please, it is your turn.

Hon. Ron Cannan: Thank you, Mr. Chair.

Thanks to our witnesses for being here today.

I just want to clarify one question. With regard to the Parliamentary Budget Office, you said you use your own estimates, or do you...? The finance minister uses the average of 12 private sector economists when forecasting GDP. Do you use those private sector forecasts or just your own?

Mr. Chris Matier: We use our own macro-econometric model to do these projections. The model is similar to that used by the Department of Finance and some at the Bank of Canada, but it's an independent projection. This is our view of where we think the economy will go.

Hon. Ron Cannan: It's just an independent view, then.

Mr. Chris Matier: Yes.

Hon. Ron Cannan: Thanks for that clarification.

I asked the governor, Mr. Poloz, about estimating, predicting, forecasting out into the future. I think the joke is that meteorologists were created to help make economists look good. Trying to predict the future is very difficult, even two, three, or five years out. But in some of your reports you're going out 50 or 60 years, whether it's the TFSA or health care.

How do you base those kinds of projections with any sort of reliability, and why do you go out that far?

Mr. Mostafa Askari: When we actually go that far, we don't really call it a forecast; it's actually a scenario. This is very standard practice in many international organizations and other organizations like ours in other countries. You do this kind of long-term analysis to provide a kind of picture of where things are going if everything else remains constant, if the policies don't change.

That's why in our fiscal sustainability report, for example, we make certain assumptions, which are mostly reasonable assumptions, and we see what happens over a very long period of time in terms of government fiscal structure and debt.

It's the same thing as, for example, the chief actuaries do for the CPP or other programs that have long-term impacts. One does look at the long-term performance of those programs to get a sense of where things are, whether certain adjustments are needed or not. We don't call them forecasts, in that sense. These are projections based on the current assumptions.

Hon. Ron Cannan: Okay. Thank you very much.

Looking at demographics, my background was marketing. I enjoyed microeconomics and macroeconomics, and demographics was a big aspect. With regard to the demographic shifts happening within the Canadian population and with business owners, what's your prediction of long-term economic prosperity for Canada?

Mr. Mostafa Askari: Over a very long period of time, we think the potential growth in Canada will be around 1.5%. That is mainly because of the impact of the demographics on the Canadian economy. In our last fiscal sustainability report, what we had was the potential growth, over a very long term, at about 1.5%. Now, that's consistent with the changes in Canadian demographics.

Hon. Ron Cannan: Thank you for that.

As far as looking at the 1.5% and 2% goes, I think that percentage is what we're looking at with inflation as well with the Bank of Canada's prediction as far as inflation is concerned. Is that correct? Is that what you're anticipating?

Mr. Mostafa Askari: With inflation, normally the assumption is that we'll stay with the target inflation, which is 2%—that's right—in the long term.

Hon. Ron Cannan: One of the other committees that I've been on for just over nine years is the international trade committee. When we started in 2006, we had five free trade agreements. We've added 38 additional, so 43 in additional trade agreements. From the PBO's perspective, do these agreements help diversify our trade balance and support our manufacturing sector?

● (1105)

Mr. Mostafa Askari: In general, sir, economists believe that freer trade is better than not freer trade. Certainly in principle those free trade agreements should help to increase the productive capacity of the economy, in general. How big they are...and that depends on their marginal impact. We already have free trade with the United States, which is our main trading partner.

Hon. Ron Cannan: One of the other areas we're trying to expand is the small and medium-sized enterprises. The majority of them have been trading with our number one trading partner, the U.S., but we're trying to open new markets. One of the ways we're also helping our small businesses is by reducing the tax from 11% to 9%.

I'm wondering if you could elaborate on what your perspective is on the reduction of the small business tax rates. How will that lead to small business owners reinvesting in their companies, in their employees, in the future?

Mr. Mostafa Askari: My understanding is that—

Hon. Ron Cannan: And what will be the effect on the GDP overall?

Mr. Mostafa Askari: Yes. My understanding is that the total impact of the 2% decline in that tax rate over the five years would be about $1.2 billion. Right now, that is about 1/20th of a percent of GDP. In an overall context, that amount is not very large in terms of the impact on the Canadian activity.

Certainly, individual companies and enterprises that benefit from that could have some more activities and increase their production and their operation, but overall the impact on the economy, for such a small dollar amount, is not very large. We haven't done the specific, individual impact of those measures. We've done a very overall impact of the budget measures, which we have shown in our projection: that in the very short run, the positive impact is small—

The Chair: One minute.

Hon. Ron Cannan: Even in those small businesses, the economic engine that drives our economy, you haven't really done an analysis to date yet. Is that something you're looking at doing?

Mr. Mostafa Askari: We can certainly look at that specific measure and provide an estimate to the committee, if you wish.

Hon. Ron Cannan: That would be interesting.

I have one last question in my last 30 seconds. Do you feel a balanced budget, or a surplus in this case, has an impact on Canada's economic growth?

Mr. Jean-Denis Fréchette: I will ask Scott to answer that question.

Mr. Scott Cameron (Economic Advisor, Analyst, Economic and Fiscal Analysis, Office of the Parliamentary Budget Officer, Library of Parliament): In 15 seconds?

Mr. Jean-Denis Fréchette: In 15 seconds.

Voices: Oh, oh!

Mr. Scott Cameron: I think our point usually with balanced budget legislation is that it's a very complex law with many unintended consequences. If you're going to restrict the fundamental prerogative of the executive, there needs to be a very good reason for that.

Right now, we see that the fiscal outlet for the federal government is terrific. The outlook looks good. But certainly, if it were to successfully restrain, there are some benefits that could come in terms of increasing the national savings rate and being able to apply the money we're spending now on public debt charges to other programs.

The Chair: Thank you, Mr. Cannan.

I would just caution, colleagues, that these are very good questions, but we need to leave enough time for the witnesses. We're all going over time. I would ask you to please stay within your time.

Mr. Fréchette, briefly.

Mr. Jean-Denis Fréchette: Thank you, Mr. Chair.

I just want to mention something on balanced budget. One of the principles is that compliance with legislation should be measured and monitored by an independent authority.

[*Translation*]

I don't mean to speak for my own bailiwick.

[*English*]

As legislators, though, you should consider PBO as being that organization to monitor the legislation.

The Chair: Thank you.

[*Translation*]

Mr. Dionne Labelle, you may go ahead.

Mr. Pierre Dionne Labelle: Good morning. Thank you for joining us today.

To govern is to make choices. I won't tell you how to do your job; instead, I'm going to come back to the TFSA.

Earlier, you brought up a new point, at least one I hadn't thought of. Ever since the TFSA program was introduced, we haven't really seen a meaningful increase in the amount of money Canadians are saving. In fact, the focus has shifted to non-taxable savings. The program will apparently cost us billions upon billions of dollars, when all is said and done. The fact of the matter is that it isn't making Canadians save more money, but it is costing us in tax revenue.

Is that a correct assessment of the situation? Could you give us more details on that?

Mr. Jean-Denis Fréchette: Your assessment is right. When we discussed it with another member of the committee, we pointed out that it was a new program. It's only been around for a few years. Indeed, we are seeing a savings shift. In the long term, we'll have to see—and that's what we measured—who will be able to benefit from the current $10,000 contribution limit. No doubt, it will be wealthier individuals, those with higher incomes.

That said, it's important to take into account people's behaviour. Earlier, we were discussing people's previous economic habits. We'll have to wait and see what happens with a program like this over time. Will people use it on an as-needed basis, for example, a student who starts a TFSA in order to save money for a house? If so, people would be able to regularly withdraw that amount. We'll have to wait and see whether the savings are lasting or not. Those are exactly the kinds of factors that will need to be analyzed in the longer term.

● (1110)

Mr. Pierre Dionne Labelle: So this is a measure that, in your view, favours the rich.

Now I'd like to move on to another measure, income splitting.

I've done a bit of math. A couple in which one person earns $100,000 a year and the other earns $20,000 would see their tax bill drop by $1,800. But a family with a total income of $50,000 a year wouldn't benefit at all. In fact, according to a study, 86% of people wouldn't benefit.

I see that the income splitting measure will cost just about as much as a measure that would have brought seniors out of poverty.

Do you have any figures related to seniors and how much it would take to raise their income above the poverty line?

Mr. Jean-Denis Fréchette: We don't have specific data on that. But in terms of the family tax cut, more commonly known as income splitting, the difference in the couple's incomes would have to be significant in order for them to benefit.

Mr. Pierre Dionne Labelle: I also paid close attention to your comments on EI reform. I found them very interesting. One of my constituents has cancer. Under the EI program, the most she could get, in other words, 55% of her income, was $440 a month. After 15 weeks of EI, she had to turn to last resort assistance.

You said that, given the surplus in the EI fund, the government could have increased the EI wage replacement rate from 55% to 68%, or raised the number of weeks available for that individual with cancer. That would've allowed her to access EI benefits a lot longer.

The government is balancing the budget on the backs of those that very money is intended for, people without jobs. And the price of that balanced budget is people's misery, people who are either sick or jobless.

Could the government have done more?

Mr. Jean-Denis Fréchette: I can't really answer that because it's a political question. All I can say is that the EI fund currently has a surplus that is being used. It's the government's prerogative. It's up to the government to decide how it wants to use that money.

Mr. Pierre Dionne Labelle: My assessment is that, in the case of unemployment, the government chose to put that money towards income splitting and a TFSA cap increase, measures that benefit the rich, instead of using the money to help those who really need it.

I have one last question for you. Can you tell us about the next study you will be undertaking?

Mr. Jean-Denis Fréchette: A number of studies are in progress. As I said, we are currently doing a follow-up review on Canada's mission in Iraq, which was expanded. We are also working on a few studies on international trade. And as for the others, I'm going to keep those under my hat for now.

[*English*]

The Chair: Thank you, Mr. Dionne Labelle.

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

● (1115)

Mr. Dave Van Kesteren: Thank you, Chair.

Thank you for being here, and thank you for the work you do. I know it's a difficult job to on the one hand—I'm starting to sound like an economist here—keep the government in check, and on the other hand to give a fair and informed analysis of where the economy is going. I appreciate your challenge there as well.

The issue that I take, however...and it's not a criticism, it's something that I find somewhat perplexing. When you create your analysis—Mr. Cameron, maybe you can delve into this in a minute as well—you seem to do what Harry Truman wished his economists would do, which was not give them the one hand and the other hand: you give them one hand.

I would suggest that the biggest part of the analysis comes from how you see the futures in oil. You have to admit that there are a number of issues and outside forces, geopolitical and just a range of different things, that would completely alter what your analysis would be.

As a matter of fact, we had a great chart from our governor this morning, and we saw the rapid rise of oil prices. I don't know if anybody...well, maybe there were. A lot of people were thinking “peak oil” back then. That's not a term we hear too much about anymore. I'm in that camp that feels there will be a change in oil prices. If all things were equal, absolutely, we would probably see this gradual rise.

I'm asking the question in all sincerity. Wouldn't it be prudent to maybe in this case be one of those economists who says on the one hand, the government's projections are such and we feel this, but on the other hand, they might be pleasantly surprised because we may see something that changes that whole scenario?

Mr. Mostafa Askari: You are absolutely right; surprises can always happen. Some of us who have been in the forecasting business for a long time learn very early on that you never try to forecast oil prices. It's extremely difficult, for some of the reasons that you mentioned. There are geopolitical impacts and other impacts that make it extremely hard to project. In fact, when we were doing our forecast one option was to keep, as the Bank of Canada does, the current oil prices fixed throughout our projection period, which would be a very simple assumption, and not try to project them.

But then we decided that financial markets have a view of where the oil prices are going, so we said that maybe the simplest and the safest way would be to take what the futures markets have for their oil prices. Certainly, there are bands around that. It could be much higher; it could be much lower. Both sides of that will go. There are upside risks and downside risks to that. If it turns out to be higher than what we are assuming, certainly it will have an impact on the nominal GDP and will have an impact on the bottom line for the government. But if it is lower, it will be the other way around.

So we are taking a very simple approach to the projection of oil prices—essentially what the financial markets have.

Mr. Chris Matier: I would quickly add that when you look at our projection, it sits almost coincidentally in the middle between the Bank of Canada's assumption of $50 for WTI and the private sector forecast of $78. We're at $66. We're almost in the middle. For us, we would think that's relatively balanced, but of course there are upside and downside risks.

Mr. Dave Van Kesteren: I think that, and I'm glad you point that out too. There certainly is...and I would argue that, all things being equal, if one were to look at history especially in the last 10 years, we can almost expect a surprise. Let's just say that: we can almost expect a surprise.

There's another thing I want to challenge you on. I don't think you've done that, but it seems to imply that, oh, this saving stuff, nothing is going to change the way people are going to think and it's not going to have a great impact. But isn't that an attitude we should be projecting to or encouraging the populace on? If I look at societies like Japan, prior to what's happened in the last maybe seven years, they were a strong saving nation, and as a result they reaped huge benefits.

So wouldn't you agree that the policy the government has enacted with the savings account would lend to that and subsequently would create a stronger economy and environment for a Canadian populace?

● (1120)

Mr. Mostafa Askari: If it leads to higher savings. Higher savings typically in principle are good for the economy in terms of the long-term productive capacity of the economy. But as I mentioned earlier, we had to go with some of the studies that have been done and the literature. Our conclusion from reading and reviewing those studies was that there isn't really strong evidence to suggest that.

So we made an assumption at that point, based on the literature, that we are not going to assume that the savings rates will increase. We're going to do our study based on the current savings rates. But if the savings rates happen to increase over time, certainly that will be a benefit to the economy.

The Chair: You have 30 seconds, Mr. Van Kesteren. Be very brief.

Mr. Dave Van Kesteren: I want to wrap up by saying that there is, and you agree that there is, definitely a.... The result of this could be good, positive things, because saving is a good, positive thing. You'd agree with that analysis.

Mr. Mostafa Askari: Savings in general will help increase the productive capacity of the economy, yes.

The Chair: Thank you.

We'll go to Mr. Adler, please.

Mr. Mark Adler: Thank you, Chair.

Thank you all for being here today.

Earlier you were discussing future studies. How do you determine what to study? Would you take, for example, recommendations from MPs, suggestions from MPs, on what to study?

Mr. Jean-Denis Fréchette: The legislative mandate is very clear. We can provide our own analysis based on your fiscal policies. What we did, for example, is something that we do as part of the regular publications we have. Any standing committee, including this one, and any parliamentarian can ask for specific studies, and we have many.

How do we choose? It's a team of 15 people, and although we did almost 40 reports in the last 12 months, we have to select some of the projects. Sometimes we have to turn down some projects because in terms of materiality or fiscal impact it's not high enough—$50 million, for example. But for anything that will be quite substantial, anything that will bring a good debate for parliamentarians, we will do these kinds of studies.

So yes, and that's why I asked the member if she wanted to have a specific study.

Mr. Mark Adler: I see. Thank you for clarifying that. I was curious.

There was a lot of discussion about TFSAs and income splitting. Now, on the money that people earn, it's.... They earn that money. There's an underlying implication, particularly coming from the other side, that there is this cost to the government of money that's forsaken by way of lost tax revenue.

Is this not money that belongs to the people who earn it, and it's really a misnomer to say this is costing the government money that's not really theirs in the first place?

Mr. Mostafa Askari: According to the current tax law, if you invest money in a savings account, in equities, or in bonds, the interest and the dividends you get from them are taxable. If you provide another instrument such as the TFSA, which will allow you to transfer the money you had in a regular savings account or equities into it, the revenue you get from that investment is exempt from taxes. So there's a change in the way you're allocating your savings. You can take advantage of that, the new instrument, to reduce the amount of your taxes. But according to the current tax law, any investment income, dividends, or capital gains are taxable. It's true you are making that investment from the income you earned, but the current tax law is that if you invest it and you earn income, you are going to pay more taxes on that.

● (1125)

Mr. Mark Adler: Right. But the government doesn't own the money you make. If the government provides a tax break for you, then you get to keep more of your hard-earned money. It's not something the government owns and is lending to you, right?

Mr. Mostafa Askari: No, it's absolutely not. But the counter-factual argument is that if it weren't for the TFSA, those savings would have been in instruments that were taxable, and those taxes would have gone to the government. Because the TFSA protects those investments from taxes, that forgone revenue is the cost of the program.

Mr. Mark Adler: Perhaps TFSAs are a bad example for this. What about the family tax cut, the income splitting? When you shift income, you're just keeping more of your money, right?

Mr. Mostafa Askari: That's correct, but again, that's compared with what the current tax law is. The cost to the treasury is relative to what the current tax law is. The current tax law is that you pay the taxes according to your income, but under the family tax cut, you can have that exemption or the tax savings by making that allocation. Whatever you do would be a cost to treasury relative to the amount of money the treasury would have gained from that income.

Mr. Mark Adler: Okay. Thank you.

Now, when we introduced the transfer payment to parents with children, there was some discussion about whether this was good public policy. We believe, on this side, that mom and dad are the best arbiters of how to spend that money and how to raise their kids. We are unlike the Liberals, who said at the time that this money would just be spent on beer and popcorn.

Can you clarify for the committee that when dollars remain with the people who earn them, the taxpayers, the money is spent on worthwhile endeavours, with particular regard to the universal child care benefit?

Mr. Mostafa Askari: I have to be very careful how I answer that question, sir. I could get into all kinds of trouble.

In the study we did on the universal child care benefit, we looked at which groups of families would receive the benefits from that, and that was the result. The way the program is structured, certainly a large part of the new money added to that program will go to families who typically don't have any paid child care expenses. Now, the money could be used for other things related to children, but in terms of the paid child care expenses, a very large portion of the new program, actually, will benefit families who do not have paid child care expenses.

Mr. Mark Adler: I have a study here that was just put out by the Rotman School of Management at the University of Toronto, hardly a right-wing bastion. I have a quote from it. This is on the universal child care benefit:

> Over all, we're starting to get a full picture of the effects of Canada's National Child Benefit. It improves the lives of children, an effect that we can actually measure in terms of better school performance and improved health. It is being spent wisely by parents on both necessities for living and direct investments in education.

Do you want to comment on that?

The Chair: We're over time again, but you can make a brief comment if you want to, Mr. Askari.

Mr. Mostafa Askari: Again, sir, in these studies that we do, we don't really judge the validity of the policy. We just provide the consequences of these policies. I'm not going to comment on whether it's a good policy or a bad policy.

The Chair: Thank you.

Colleagues, we have time for four short rounds.

I'll go to Mr. Cullen first, please.

Mr. Nathan Cullen: Thank you, Chair.

The Prime Minister famously said at the UN once that if you don't measure, you can't manage. That was a fair comment, and hopefully true. Yet we have the Auditor General's report here that says not only is the government not measuring the impact of their tax expenditures, but they are not providing information to parliamentarians to actually understand what the impact has been. Let's look at some of these right now...so flying blind and playing politics.

The TD Bank pointed out that the investment per $1 in early childhood education, child care, earns back to the Canadian economy anywhere between $1.50 and $2.78. By any economist's or banker's definition, that's a good investment and a good return on money.

You cited in the government's changes to childhood benefits to Canadians that there would be negligible impact on the creation of child care spaces and early childhood education. Is that true?

● (1130)

Mr. Mostafa Askari: I'm sorry, I don't—

Mr. Nathan Cullen: You said that you considered whether the UCCB and the CCED increases would increase the usage of child care services, and you found a negligible impact.

Mr. Mostafa Askari: Yes.

Mr. Nathan Cullen: Mr. Fréchette?

Mr. Jean-Denis Fréchette: Yes.

Mr. Nathan Cullen: Okay: so we're not getting return back if we're not creating those child care choices for Canadian parents.

I want to go to Mr. Cameron or to Mr. Matier for a moment on oil prices.

Back in November, the finance department released a report and did estimates out into the future. It assumed what price for a barrel of oil for Canada going out one, two, and three years in the future?

Mr. Chris Matier: I believe that was $81 for WTI.

Mr. Nathan Cullen: Back in November.

Mr. Chris Matier: Yes.

Mr. Nathan Cullen: Now, getting that wrong has an impact on what the health of the books will look like. Is that true? If oil were to stay at the level it is now between $50 and $60, what kind of negative impact would that overly optimistic assumption have on Canada's revenues?

Mr. Chris Matier: If you look at the current assumption for oil prices in the budget, it goes back to $78 per barrel. That's pretty close to the $81 the government had assumed in November.

You can compare that with the difference between our budget balances or our nominal GDP. That would be probably about $20 billion for the level of nominal GDP. As Mostafa mentioned, that would translate into probably about between $3 billion and $4 billion on federal revenues.

Mr. Nathan Cullen: So that's a $3 billion or $4 billion hole in the government's plan if oil prices don't elevate to the $80 they're hoping for.

Mr. Chris Matier: Yes, approximately. It's just a rough calculation.

Mr. Nathan Cullen: With no rainy day fund in place and $2 billion taken out of the contingency fund, let's hope there are no natural disasters within the next couple of years.

Mr. Chris Matier: That estimate actually takes into account, so they would have to...that level of nominal GDP accounts for the risk adjustment.

Mr. Nathan Cullen: Okay.

[*Translation*]

The last 30 seconds go to Mr. Caron.

The Chair: Mr. Caron, you have 30 seconds.

Mr. Guy Caron: I'll be quick.

The government seems to be confused about what constitutes a tax-based expenditure. There are two ways to give money to a specific group. The first is through a direct subsidy, which comes out of government coffers, and the second is through a tax credit, which constitutes a tax-based expenditure. Could you comment on the benefits and drawbacks of using each of those measures to basically fund certain groups?

Mr. Mostafa Askari: We haven't done any research on that. It is not for me to comment on that.

Mr. Guy Caron: Let's talk, then, about the definition of a tax-based expenditure. What constitutes a tax expenditure, and how does it differ from the other method used by the government, in other words, providing grants?

Mr. Mostafa Askari: I'm not quite sure what you're referring to. Your question is about—

[*English*]

the definition of the tax expenditures....

Mr. Guy Caron: I just want you to define “tax expenditure”. What constitutes a tax expenditure as defined by accountants throughout the world?

The Chair: We're over time. Can we get this sent to the committee after? We are over time for this round.

We can provide that to the committee. We'll provide the extra numbers.

Thank you.

Mr. Mostafa Askari: Sure.

The Chair: Oil prices were mentioned, and I wanted to follow up on Mr. Van Kesteren's line of questioning. It seems to me that is the main difference between your office and the budget projections.

What were your projections for oil back in 2014, the price of crude oil WTI?

Mr. Chris Matier: I don't know that off the top of my head, but I can get back to you.

Mr. Mostafa Askari: They were certainly very consistent with the futures prices at the time when we did our last projection, which were certainly much higher than what we have right now. Futures prices were much higher at that time, given that the oil prices had not declined yet.

● (1135)

The Chair: Okay.

I'm just looking at your economic fiscal outlook of October 2013, and it seems to me for 2014 you were predicting $100, and this is WTI; 2015, $90; 2016, $85; and 2017, over $80.

On July 2014, it was over $100; October 2014, $85; January 2015, $50; and April 2015, $57.

I think we're almost putting too much.... It's almost like asking who's going to the Stanley Cup. The closer you get, of course, the better you can predict it, but I don't know if we should put too much into any oil price figure going out more than two days, frankly. It's very challenging.

I think perhaps what a number of you were saying was let's not be too critical of the budget numbers and let's not be too critical of your numbers. There are two sets of numbers; take them for what they are. They're two data points and let's use that as information. But for us to say, yes, in 2017 oil prices are going to be this, I didn't hear anybody predict the oil price drop from $100 per barrel to $50. I didn't hear anyone predict it. I mean, everybody now is saying they predicted it, but....

Mr. Mostafa Askari: You are absolutely right, sir.

Mr. Jean-Denis Fréchette: Not only are you right, but I'm also happy that the economists on my team or in Ottawa did not predict the oil prices exactly right at that time, because all these economists would be playing golf in the Bahamas right now. It's a very valid point, but we still have to use some projections to—as we said before —do our calculations and have some scenarios.

The Chair: This is why, Mr. Askari, I appreciate that in response to Mr. Cannan you said in terms of going out to 2080—because I had the same question when we go out to 2075, how can you possibly tell—that it’s more of a model than a prediction. I appreciate that clarification.

I have just about a minute left. My final question is on tax-free savings accounts. I'm a huge supporter, obviously. I don't want to ask you about the policy. You know, I have a tax-free savings account and I put money in investments. Obviously the companies that are invested in benefit from those investments that I and another 11 million Canadians are making in those companies.

Have you as an office done an analysis of the benefits of those investments that those 11 million Canadians are making in companies in Canada? Have you or anyone done an analysis of the resulting economic benefits?

Mr. Mostafa Askari: No; I guess what you're saying would be correct if there are extra savings as a result of the policy, because that money has already been invested in other instruments, and again, the companies continue to benefit from those investments already—

The Chair: Sorry, I probably didn't make it clear.

I may invest in stocks and bonds, but if the vehicle comes up of a tax-free savings account I may decide that instead of doing this with the money, I will invest in a tax-free savings account that goes to company X, which has a resulting economic benefit as a result of me being induced to invest in that way by the tax-free savings account.

Has your office done an analysis of any resulting economic benefits as a result of the moneys that Canadians have put in their tax-free savings accounts and the companies that have been invested in?

Mr. Mostafa Askari: Again, I guess my understanding of your question is that if you move your money from, let's say, another savings account or another equity into a TFSA, you haven't really changed the amount of savings and investment you have had. So the benefits to companies will still be exactly the same benefits. They will have benefits, but because of the—

The Chair: Yes, that's not.... Sorry, I'm out of time here. I'll have to take that up with you later on.

Mr. Brison, please.

Hon. Scott Brison: Thank you, Mr. Chair.

I was just going back to your updated fiscal outlook, including budget 2015 measures where it shows zero...just a balance but no surplus in 2016-17; deficits of $2.6 billion in 2017-18; $2.7 billion in 2018-19; and $2.5 billion in 2019-20.

Would the biggest difference between your numbers and the government's numbers be projected oil prices?

Mr. Chris Matier: That's one of the differences. A rough estimation is that it probably accounts for maybe half of the discrepancy between our budget balance projection and the government's.

There would be other underlying assumptions, of tax bases and effective rates, that we don't have to make a comparison.

● (1140)

Hon. Scott Brison: Sure.

The chair said, quite rightly, that nobody predicted a 50% decrease in oil prices. But the government is projecting a 50% increase and at the same time cutting the contingency reserve. During uncertain times, where so much is riding on the price of oil and the uncertainty inherent in that, isn't there an argument to be made that we ought to, from a sound budgeting principle perspective, actually be increasing the contingency reserve, during a time like this?

Mr. Mostafa Askari: Typically, you're right. Typically, if there is more uncertainty, you try to have more contingency for the uncertainty.

Hon. Scott Brison: What would be an argument for the government, during more uncertain times, to cut the contingency reserve?

Mr. Mostafa Askari: I wouldn't know that, sir.

Hon. Scott Brison: I think I might.

You've done quite a bit of work in the past on the demographic shifts and the future trajectory of health care costs, as an example, for provincial governments but also the federal funding component. You've said in answers to questions from Mr. Saxton and others that the impact of TFSAs is not on the current fiscal framework but is on the future fiscal frameworks of both provincial and federal governments.

With these measures, the quantum is debatable, but is it not absolutely undeniable that there will be a reduction in future governments' capacity, federal and provincial, to invest in health care, at a time when health care costs we know will rise, as a result of these measures that are back-end loaded in terms of costs to the taxpayer?

The Chair: Just a brief response, please.

Mr. Mostafa Askari: We are actually planning to release a new fiscal sustainability report in the next couple of months, which will take into account the new measures that the government has introduced, certainly. We haven't really done the calculation, but obviously things like the TFSA could reduce the overall fiscal room the federal government has; how much, I can't really say right now.

Hon. Scott Brison: Finally, in terms of tax cuts and the impact on jobs and growth, is it true that tax cuts in, say, the middle-income levels have a greater stimulative impact on growth in terms of the marginal propensity to spend, as an example, than tax cuts in the higher level?

The Chair: Again, just a brief response, please.

Mr. Mostafa Askari: Typically, yes; the marginal propensity to consume is higher in lower-income households, absolutely.

The Chair: Thank you.

Mr. Van Kesteren, this will be a very brief round, please.

Mr. Dave Van Kesteren: Thank you, Chair.

If I have time, I'll hand this over to Mr. Rajotte, but I wanted to finish off my line of questioning. This is not specifically on the legislative part of the balanced budget.

Mr. Fréchette, can you tell us why, or if you believe it's important that, as a government we balance the budget? And what are the benefits to a balanced budget?

Mr. Jean-Denis Fréchette: In our report, we didn't say why or not. We just made the principles. I recommend that you read the report again; I mentioned that there are some conditions. I mean, the past history in Canada has shown that many provinces that had balanced budgets did not respect the legislation all the time, or amended the legislation.

Mr. Dave Van Kesteren: I'm not talking about the legislation. I want to talk about the importance of a balanced budget and the fact that we are one of the first nations to come out as a balanced budget.

Mr. Jean-Denis Fréchette: Our view is that a balanced budget is not an *idée fixe*. It's not something that you should always have in mind. As long as you follow the legislation.... It is the privilege of the government to have this kind of legislation.

In our report, as I said, we mentioned that there are some principles that are really important to follow, including the fact that if you have a natural disaster or any kind of catastrophe, you may have to have a non-balanced budget or have a deficit at that time. Those are important factors to take into consideration.

Mr. Dave Van Kesteren: Do you want to finish up, Chair?

The Chair: Maybe I'll try to state my question again. I am happy to follow up with it after the meeting as well.

My understanding of the TFSA analysis is that your analysis assumes that there are no new savings as a result of this tax-free savings account vehicle. That would be assumption number one.

Assumption number two is that there are no new benefits arriving from the new savings vehicle. In other words, nobody is switching money from their chequing account to a tax-free savings account and thus causing additional investments in a company, which is obviously helping them hire people and create more jobs, etc.

● (1145)

Mr. Mostafa Askari: That is correct. The way that we have done this study is that this is just a reallocation of the savings that you already have in different forms, whether it is in equities, savings accounts, mutual funds, or anything else. We just switched those from the taxable instruments to the TFSA, which will...to benefit from the tax exemption. That's right.

The Chair: I'll have a discussion with you about those assumptions, because I think I would challenge you. But I do appreciate that clarification very much.

I want to thank all of you for being with us here this morning for a very good session of discussion with our colleagues. Thank you so much.

The meeting is adjourned.