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Chair

Mr. Brian Pallister

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● (0940)

[*English*]

The Chair (Mr. Brian Pallister (Portage—Lisgar, CPC)): Thank you for being here. I apologize for the lateness of my arrival and that of a couple of my colleagues. There was some confusion, I think, about the location of the meeting this morning.

Pursuant to Standing Order 108(2), we have our study with independent fiscal forecasters. Welcome.

You've been asked to confine your initial presentations to five minutes. I'll give you an indication when you have a minute remaining, and then I'll cut you off so that we can have an exchange with members.

We'll begin with Ms. Ellen Russell, from the Canadian Centre for Policy Alternatives.

Ms. Ellen Russell (Senior Research Economist, Canadian Centre for Policy Alternatives): Hello.

I want to consider only one question with my five minutes: does the federal government have enough money for further tax cuts?

Mr. Massimo Pacetti (Saint-Léonard—Saint-Michel, Lib.): Excuse me, Mr. Chairman—

The Chair: We have a point of order.

Mr. Massimo Pacetti: Are there some briefs available?

The Chair: I'm told the briefs are not in both languages. Unless there's unanimous consent to distribute them—

Mr. Massimo Pacetti: Can we ask? I haven't seen the briefs, but they probably have a lot of numbers on them, so I'm not sure if it's really necessary to have them translated.

The Chair: Is there unanimous consent to distribute?

[*Translation*]

Mr. Pierre Paquette (Joliette, BQ): As an exception.

[*English*]

The Chair: On this occasion only, then, they will be distributed.

Madam Russell, we'll begin your time again now.

Mr. Massimo Pacetti: I have a point of order, Mr. Chairman.

The Chair: There is another point of order, Ellen; excuse me.

Mr. Massimo Pacetti: I don't believe it's the first time some of the witnesses have appeared. You can maybe remind them that we do offer translation services, and perhaps next time they could get their briefs in on time.

The Chair: Okay, yes.

Thank you, Madam Russell. Please proceed.

Ms. Ellen Russell: I want to consider only one question with my five minutes: does the federal government have enough money for further tax cuts?

After many years of large budget surpluses, many Canadians may assume that Ottawa has no problem finding extra cash. In our opinion, the days of large budget surpluses are over. As a result, we believe that if Ottawa embarks on new tax cuts, it will be setting the stage for very large spending cuts down the road.

Last year, of course, the federal government had a surplus of $13.2 billion, but since that time the Conservative government has implemented, by their own calculation, $9.9 billion in tax cuts, as well as further spending for defence and for cash in lieu of child care. As well, they have set aside $3 billion for debt repayment. By their own tally, in the May budget Ottawa would run a surplus of only $600 million.

More recently, we have re-examined Ottawa's finances. I believe our report is being circulated to you now. “Can Ottawa Afford More Conservative Promises?” is the title of the report.

We project that the federal government will have surpluses that are higher than in the May budget. By our projections, the 2006-07 surplus is around $4.2 billion. Remember that in addition there's an extra $3 billion set aside for debt repayment, but there's $4.2 billion available for use. A word of caution: some folks, in describing the surplus, are adding in that additional $3 billion set aside for debt repayment. We leave it out, as did the federal government in the May budget, because we're concerned about how much flexibility there is to fund new tax cuts or, of course, spending measures.

By our projection, the government has about $4.2 billion to work with this year, about $4 billion the following year, and maybe $5.3 billion in the third year. This is factoring in the fact that the forecasts for economic growth are far more pessimistic than they were in May. Of course, if they deteriorate further, then there will be less surplus than we have suggested.

Let's just look. Assuming they have somewhere around $4 billion to $5 billion in surplus to play with for the next three years, is that enough leeway to cut taxes further? Before the government can make new promises, it has to pay for the promises it has already made, promises that were not costed in the 2006 federal budget—nor are they factored into our projections of $4 billion to $5 billion of surplus over the next three years.

What is still on the government's to-do list that it still has to find money to pay for?

Number one, the Conservatives promised to address the fiscal imbalance. While they haven't told us how or when they will do that, this is potentially a very pricey item.

Number two, the Conservatives promised to reduce health care waiting times, yet no additional money was budgeted for that in the last budget.

Number three, the Conservatives promised more defence spending in their election platform than was accounted for in the May budget, so we should expect further defence spending of perhaps $4 billion between now and 2010-11.

Number four, the Conservatives promised to eliminate the capital gains tax on reinvestment. This is potentially very costly. I wouldn't be surprised at $2 billion per year, but we could debate that, depending on the specifics of the actual proposal.

Number five, the Conservatives promised to cut the GST rate by a further percentage point. Again, this is very costly; it is more than $5 billion per year, depending on when it's implemented.

We don't precisely know when the Conservative government plans to implement these measures. They don't have to do them all in the next budget, but the fact is that they could not afford to do all their promises in the next budget even if they wanted to. By our calculations, the GST cut alone would put them in deficit if they did it right now.

Under these circumstances, we don't think it's responsible for the federal government to make further tax cuts. If they make further tax cuts, they're going to have to find more money. There are two possibilities we would like to highlight for you: they could privatize assets, or they could cut spending more dramatically than they have so far.

In the last election platform they promised $22.5 billion in spending cuts over five years. Our concern is that a further tax cut now will set the stage for deep spending cuts in the future and will generate a straitjacket for any future government, of whatever party, which will be forced to radically downsize government to pay for these tax cuts as they hemorrhage money out of the treasury for years to come.

● (0945)

[*Translation*]

The Chair: Thank you very much.

Our second witness will be Mr. Mario Fortin, from the University of Sherbrooke. You have five minutes.

Mr. Mario Fortin (Professor of Economics, University of Sherbrooke): Good morning. May I make my presentation in French?

The Chair: It is up to you.

Mr. Mario Fortin: This morning, I would like to give you a rather brief outline on the state of the American economy for 2007.

According to current forecasts the predicted growth would be between 2.3% and 2.5%, but the American economy is sending out mixed signals. On the one hand, there is a very healthy corporate sector, but on the other hand, the real estate market is in a free fall. The great concern now is whether or not the recession in that market will affect consumer spending.

In my opinion, there is every likelihood that consumer spending will be seriously affected, a trend that has not been properly accounted for in economic forecasts.

I have with me a series of figures representing various US real estate market indicators; they are from an American publication, and I have been granted permission to use them. What these figures show is that, over the past five years, there has been an unprecedented increase in wealth. What is important to note, however, is that American households have used this wealth to spend beyond their means. People have been spending more than they are earning, there is a negative household savings rate, while the rate of spending and consumption is enormous. It is estimated that as much as $300 billion has been spent by consumers against the rising value of their properties.

A falling real estate market will put an end to this source of consumer funding and will no doubt force American household to return to saving. The effects of a slowdown in the real estate market are two-fold. There is the investment side, with residential housing construction in a normal year representing about 4.5% of the GDP in the United States. The rate for the past two years was 6%, meaning that a return to traditional construction rates would cut economic growth by 1.5%. That is a direct effect.

Then we have the indirect effect on consumption. If sustained consumption represents $300 billion, then 2.5% of the US GDP could be affected if people begin to spend less.

American forecasters are currently watching the trend in retail sales. They want to know if household spending is cooling off. The October sales figures were rather disappointing, but current opinion is divided. There is a great deal of uncertainty as to the US economic performance for 2007. In my opinion, a forecast of 2.5% is rather optimistic. Americans have been overspending for years now, and any slowdown in the rate of consumption will have a greater effect on GDP growth than current forecasts seem to predict. Therefore, a 2% forecasted increase for 2007 would appear to be closer to the upper range than what we might reasonably expect in terms of growth for that year. That being the case, there is a great deal of risk in the American economy at this time. And there is another risk — I don't cover it in this document but the Bank of Canada is well aware of it — namely, the effect on the US current account.

That is all I have to say. I will be happy to answer any questions you may have. I believe that I have stated the main point. Thank you.

● (0950)

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

[*English*]

To continue now, we have TD Bank Financial Group, Don Drummond, senior vice-president and chief economist.

Welcome, Mr. Drummond. Over to you.

Mr. Don Drummond (Senior Vice-President and Chief Economist, TD Bank Financial Group): Thank you very much.

I'm not certain what particular areas of the economic and fiscal outlook most interests members of the committee, so with your permission, I will pass on the five-minute introductory remarks—perhaps that would make better use of my time—and target it to the areas you're most interested in.

I look forward to questions.

The Chair: The soul of wit, sir.

We continue with Mr. Dale Orr, Global Insight Inc.

Dr. Dale Orr (Managing Director, Canadian Macroeconomic Services, Global Insight Inc.): Thank you for inviting me. *Bonjour.*

What I'm going to do is identify some of the specific tax changes that I think you'll be hearing about this afternoon and why I think they may be included in the package and what their impact on the economy might be.

I think you're going to see several specific tax changes—in fact, tax changes in most areas. As for personal income tax changes, I would say you can take these to the bank. The Conservatives will probably re-establish the levels for the lowest marginal rate that the Liberals left us with in the first part of the year, as well as for the basic personal amount. There is no way the Conservatives are going to want to go into an election with those two rates higher than where the Liberals left them.

On corporate income tax, the Conservatives have already said what they'd do. I think what they will say is that they will give a very high priority to getting down from the 21% to the 19% as soon as possible, fiscal conditions permitting.

On the GST, they'll remind us of the political commitment to that, and other than that, it's just too expensive to do anything very much very soon.

As for the marginal effective tax rate on investment, we'll probably hear quite a bit about that because that is what really affects productivity. Accelerated writeoffs for manufacturing equipment, possibly.

On capital gains, again they've had quite a few months to give a more precise, thorough think to those initial plans and may make a commitment to come out with a package that's affordable and manageable in budget 2007.

As for income trusts, I don't think they're going to address that specifically.

Tax policy issues. First is harmonization of taxes with the provinces. Here it's really the four western provinces and maybe Prince Edward Island that are at issue, but the main gains come from harmonizing with B.C. and Ontario. This is really a triple whammy win for the Conservatives and this is why they will put such a high priority on tax harmonization. Number one, if they do that, it does aid productivity. It can also address the fiscal balance question, because it gives some room to the provinces, if they wish to take it in a harmonized rate. As well, of course, it fulfills a political commitment they had.

On the fiscal balance and equalization issue, I think what we will see and should watch for is that they will make every effort to try to claim they've addressed that issue without spending very much incremental money on it, and we can talk about possible ways of doing that later.

On the issue of income splitting that you've heard quite a bit about lately, I wouldn't be surprised if they say they will undertake a study paper to be released later. I think that's a fundamentally sound policy, but it is expensive.

I think we're going to hear a lot about a productivity/economic growth agenda. That will probably be the theme of it, and I'll make just a couple of points on that.

Economists will tell you how important that is, that it's really the only route to sustained increases in our standard of living. Sometimes productivity/economic growth is thought of as the same thing as tax cuts, and whenever I address this I try to make the point that this is not the case. A lot of really important things on the program side can be done for productivity. Training and education infrastructure are important, and there are many important things on the regulatory side as well. So that's important.

Productivity/economic growth is always a matter of degree. Virtually any tax cut will have some impact on productivity. Often it's secondary. Sometimes it can even be negative. Even though he is probably going to talk long and emphatically about a productivity/economic growth agenda, it's always a question of balance between that and other issues that are done for equity programs.

I want to emphasize for people who are interested in a productivity/economic growth agenda that the key thing is, what does this tax change do for the incentive structure?

● (0955)

What we really need in this country are a lot more tax cuts that increase the incentive to work, increase the incentive to join the labour force, and increase the incentive to save, innovate, invent, and invest.

Those are really the questions you should be asking about what it does for that incentive structure.

The Chair: Thank you, Mr. Orr. I have to cut you off there.

Dr. Dale Orr: That's fine.

The Chair: We'll move to questions now. We'll begin with Mr. McCallum.

Seven minutes, Mr. McCallum.

Hon. John McCallum (Markham—Unionville, Lib.): Thank you.

Don Drummond hasn't said anything yet. I think it's the first time I've ever heard a witness not use his time to any extent. So perhaps I could begin with Mr. Drummond.

Can you tell me what your surplus projections are for the next three years or so?

Mr. Don Drummond: Yes, sure. Rather than giving you the numbers cold, maybe, as a benchmark, I'll use the May 2006 budget. I think that would be the appropriate context for the update later this afternoon.

Just to step back a bit, obviously you need an economic forecast. Actually, for a long time our economic forecast at the TD Bank hasn't changed very much. In fact, it's virtually identical to the forecast we had last spring. So on the surface—

Hon. John McCallum: Actually, I don't want to interrupt, but I have very little time and quite a few questions. Can you just give me the numbers?

Mr. Don Drummond: Sure. Relative to the budget numbers, our forecast would be that the surplus will be up $1 billion to $2 billion in the current fiscal year, and about $1 billion in 2007-08. If indeed it goes further, it will trend back to the longer-term horizon after that.

In a nutshell, that is basically what has changed. The economic forecast hasn't changed, but the revenues, particularly the personal income tax revenues, continue to come in extraordinarily strong.

Hon. John McCallum: Okay, thank you.

With respect to income splitting, Dale Orr spoke about the need to provide incentives to work. If you're concerned about labour shortages and incentives to work, I would have thought that moving to income splitting would take you in the wrong direction. Would you agree, in the sense that at the margin you'd encourage more people to stay at home?

● (1000)

Mr. Don Drummond: It's a different way.... Is the glass half full or half empty? The current system is a disincentive to do that. This removes some of the disincentive. I wouldn't really look at it as providing an incentive.

There are different aspects to it. Do you look at the family unit as being individuals, or do you look at it as a couple? You can look at it in different ways.

Hon. John McCallum: Okay.

On the productivity agenda in general, we can think about tax measures that foster productivity. We can think about spending measures, whether for research or innovation or training and things of this nature. Maybe this is difficult to answer, but would you think the most effective program to foster productivity would be a mix of these, or would you have a strong focus on either the tax side or the spending side?

Mr. Don Drummond: I think it absolutely has to be a blend of the two. On the tax side, you have to get down the marginal effect of rates on tax, on capital, and also on individuals. They're extraordinarily high in Canada. But having low taxes isn't going to take you very far, unless you have that government infrastructure in education, and hard assets in the country.

Hon. John McCallum: So what would you give top priority to in terms of spending or, as you used to call it in the Department of Finance, investments? Would it be in innovation or in research? Where would you get the most bang for the buck?

Mr. Don Drummond: Certainly it would be on the education and skills training. But you also have to recognize that the federal government has done a lot in those areas in the last years. I'm not really suggesting that at this point you need to do more. Since 1997, there has been quite a substantial reinvestment in post-secondary education. I'm not sure at the moment that this is the area calling out for additional funds. Certainly on the infrastructure side, it is. But again, I think we need to be imaginative. It doesn't need to be a direct hit on the fiscal target. We need to make much more use of private sector funds and public-private partnerships. We need more of it, but it doesn't have to be a federal government-financed initiative.

Hon. John McCallum: Thank you.

This question relates perhaps more to your previous job as associate deputy minister. We're clearly short of money to do a lot of things, as various people have pointed out.

Concerning this idea of privatizing assets, let's say they sell AECL or whatever and get $5 billion or $2 billion or some sum of money at one time. What are the rules in terms of using that money? Remember, you cannot use that for permanent tax cuts if it's a one-time piece of money. How does it work, accounting-wise?

Mr. Don Drummond: Well, if you realize a gain on it, you obviously get some interest relief on $5 billion. At a 4% effective interest rate, you can get a small trickle of ongoing savings. But absolutely, you can't really pair it up with anything other than a one-time expenditure.

In my 23 years in government, I never encountered a one-time expenditure. And on the so-called sunsetting programs, I've never seen the sun set. So that doesn't work out very well.

Hon. John McCallum: But would it be within the accounting rules or the Auditor General's rules to use one-time money for ongoing tax reductions?

Mr. Don Drummond: No. You'd then have to get the asset proceeds coming over a space of time, but even if you managed to do that physically on an accrual basis of accounting, that wouldn't fly. You have to record the transaction when it occurs.

The Chair: You have a minute and a half.

Hon. John McCallum: My apologies to the others, but it's because Don Drummond didn't tell us anything initially.

Dale Orr, do you agree with Don, or do you have other comments on the spending/tax mix or the degree of blending that you would think most useful for a productivity agenda? Within the spending side, which areas would you give particular emphasis to?

Dr. Dale Orr: Yes, thank you.

I pretty much am in agreement with Don. It does have to be a blend. On the tax side, the key thing is that marginal effective tax rate on investment. Trying to line up depreciation rates with useful life is really critical. The reductions in the corporate income tax would be right on target.

On the spending side, I did mention training, education, and infrastructure.

Hon. John McCallum: What about a two-year writeoff for manufacturing investment and processing? That's one thing the manufacturing sector is asking for. If you and Don could, give us a thirty-second answer.

Dr. Dale Orr: I would be really leery about tax reductions for specific sectors. I'd have to think more before I would jump with enthusiasm on that one.

● (1005)

Mr. Don Drummond: Can I answer that?

Hon. John McCallum: Yes.

Mr. Don Drummond: I have a very strong conviction on depreciation for tax purposes. I think it should just match up with the economic life. The tax depreciation should be exactly in match with the economic life of the asset. If the tax depreciation is accelerated, it's a subsidy and we should just recognize it as a subsidy.

In the tax provisions right now, there are actually a host of tax depreciation rates that are slower than the economic life. They just haven't been brought up to time as technology changes and the world changes. In fact, a lot of them are specific to the manufacturing sector, not so much on the machinery and equipment side as on the building side. They're way longer on the tax side than on the economic life side.

[*Translation*]

The Chair: You have seven minutes, Mr. Paquette.

Mr. Pierre Paquette: Thank you, Mr. Chairman.

As you know, there will be an economic statement this afternoon. We will be watching to see whether or not the minister of Finance will be giving us an accurate outline of the federal government's financial situation. In order to do that, we must have some idea of the growth expectations for 2007.

I would like to throw out this question to anyone who might wish to respond. What do you expect the real and nominal growth values to be for 2007? I realize that it is an order of magnitude. In real terms, will it be 1.5% or 3%? What will the inflation rate be? I would like to hear some indications from you.

Mr. Don Drummond: I might be able to answer that question. We have the advantage of using the private sector forecasts which have already been published, most of them in September. I believe that the average for the entire private sector is about 2.5% in GDP growth for 2007. The TD Bank forecasts are somewhat lower, at 2.25%, but that does not make too much of a difference.

Mr. Pierre Paquette: And in terms of inflation?

Mr. Don Drummond: The average consumer inflation rate is about 2%. That is the forecast average. Everyone concedes that the price of oil is more or less stable but similar to the current level, which leaves us with the rate that is forecast by the Bank of Canada. The growth rate is slightly higher for 2008, about 2.75%, and maybe 3%. Ours is somewhat lower, but that does not make much of a difference.

Mr. Pierre Paquette: Mr. Fortin.

Mr. Mario Fortin: Mr. Drummond will no doubt be happy. From the various forecasts that I have read, the ones published by TD are my favourite because they are slightly lower than the others. I explained why earlier. I believe that economic growth in the US might be even slower than what is currently forecast. The effects would be felt mostly in Ontario and Quebec, the two provinces that will no doubt be the hardest hit next year.

I also believe that Canada's economic growth will be about 2% with, of course, an advantage going to the western provinces.

As to inflation, as Mr. Drummond said, it should not be any higher than 2%. I am rather optimistic when it comes to the price of oil and slightly more pessimistic with respect to world economic growth. A slower growth in the US GDP will mean a slower increase in the demand for oil. In 2007, capacity should grow more quickly than demand. There should be a downward pressure on oil prices so that they would finish off the year near the $50 US mark. That price would still be high enough to maintain investment interest in the oil sands.

Mr. Pierre Paquette: Would the other two witnesses care to respond?

Mr. Dufour.

Mr. Mathieu Dufour (Research Associate, Canadian Centre for Policy Alternatives): I would simply like to add that our figures are essentially the same. You can find them in our brief. They are based on a slower growth in the US economy for 2007. We expect it to recover relatively quickly and begin a growth trend towards the end of 2007, to get back on track in 2008.

There is no guarantee. There is a great deal of uncertainty in the US, so the figure may be somewhat high. It is the upper limit of what might be expected. This would mean a relatively short downturn in the United States, which could easily be prolonged and would, therefore, lead to a weaker medium-term growth than expected.

Mr. Pierre Paquette: Mr. Orr.

[*English*]

Dr. Dale Orr: Just about two days ago, I got the forecast from the group called Consensus Economics. It's probably the highest-profile, most widely read group. They surveyed 17 different forecasters in early November and the results came out about two days ago. For 2006 they're forecasting 2.8% growth, and for 2007 it's 2.6%. That's absolutely right up to date in a wide consensus. The Department of Finance forecast for the economy will be based on their survey of Canadian forecasters for September, so it's a bit dated.

I should just say that we're talking about real growth here. Yes, it's the main driver of the fiscal tax base, but GDP inflation is also important, the pace of employment is also important, and interest rates are also important.

● (1010)

[*Translation*]

Mr. Pierre Paquette: What do you think the inflation rate will be?

[*English*]

Dr. Dale Orr: Inflation? The forecast for this year is 2.1%, and for next year it's 1.8%. That's consumer price inflation.

[*Translation*]

Mr. Pierre Paquette: The second item of great importance to us is fiscal imbalance. Of course, when it comes to the surplus, we are not expecting it to be as high as what as been experienced over the past 10 years, even though it will be appreciable, since the first six months saw it at $5.3 billion. We must not, however, forget the expenditure side of the equation.

We did a little study. From 1997-1998 to 2005-2006, federal government spending increased by $235 billion. The surplus was $67 billion, for a total of $302 billion. This flexibility was either used for expenditures or remained in the surplus.

Expenditures increased by 58% during the same eight-year period. Thirty-nine per cent went to transfers, 62% for department operating expenses and the increase for the population and inflation was 24% while the GDP increased by 33%.

Do you not think that the government expenditures might allow enough flexibility to settle the fiscal imbalance? Not by cutting funding to literacy and women's groups, as they did in September, but by reducing spending on the government operations themselves, which appear to be increasing at a faster rate than the economy, the population and the consumer price index.

I would like to hear your opinion on this.

[*English*]

Mr. Don Drummond: If I could start again, there is what we in the fiscal business call a natural wedge that is formed. That's because the interest on the public debt is tending to be flat to trending down. In fact, even if interest rates don't go down further, you will see flatter declining interest on the public debt because bonds were being issued at 10% ten years ago and they're being reissued at 4% as they come up for renewal. That gives you the fiscal dividend that you referred to, and it allows you to run your program spending up to some degree. But that has already been done to a considerable degree.

As you noted, program spending has been rising at a considerable trend in the May budget. While in future it is not to rise at quite the pace it had in previous years, it's still rising at a fair clip. We still have to go off the base of the surpluses that were projected at that time, and, as I said, I think they could be $1 billion to $2 billion higher than that. If a government wishes to keep to its commitment of paying down $3 billion of debt, that doesn't give an awful lot of room for additional initiatives, and there are a number being floated around in addition to the fiscal imbalance.

I should just say something in reference to your question about fiscal imbalance. You were asking about the growth on a national basis. There has never been a time in Canada that a national number has been less relevant for anybody in the country. There's no part of the country and no sector of the country growing remotely close to that average. For example—

[*Translation*]

Mr. Pierre Paquette: Except the federal government—

The Chair: Thank you very much, Sir.

[*English*]

We continue now with Madam Ablonczy, for seven minutes.

Ms. Diane Ablonczy (Calgary—Nose Hill, CPC): Thank you, Mr. Chairman.

We thank all of you for being here. Whether we're members of the government or the opposition, we appreciate reality checks on the finances of the nation. I think they're very helpful to all of us.

As you will know, we've been focusing, as a committee, on productivity and international competitiveness. I found very helpful an article that one of you did. Don Drummond did an article in the fall issue of the *International Productivity Monitor*, but he actually referred to work that all of you have done on productivity. He said that economists in Canada "believe weak productivity is compromising the Canadian standard of living and threatens many aspects of the quality of life that Canadians cherish." So this is a very important issue. The article identifies quite a number of areas where Mr. Drummond feels there is a consensus among economists on measures that need to be taken to increase productivity to make sure that Canada's standard of living and quality of life is maintained and enhanced.

I would like to give each of you an opportunity to emphasize to the committee the two or three areas where you feel it is most important for the government to take action to ensure productivity, which of course really is Canadians' standard of living and quality of life. For which areas would you say, if you don't do anything else, do this to maintain Canada's productivity?

Maybe we can start with you, Mr. Orr, and just go around.

● (1015)

Dr. Dale Orr: I believe I already answered that question when I answered Mr. McCallum. The only thing I would want to add to that would be to emphasize what Ellen Russell said. We're very much on the same wavelength on this one, since sometimes we're not exactly on the same wavelength. It's all very nice to talk about what we should do for productivity, but I warn you to watch the fiscal forecast and to watch very carefully how much money is left in there for the tax cuts that I talked about and recommended and the program changes that I talked about and recommended.

In doing that, there's another thing that I highly recommend to you. You're talking about what the surplus is going to be. That's meaningless unless and until you know exactly what the government has included in their revenue forecast and in their program spending forecast. I'm saying that, whichever way they slice it, there'll be a lot of talk about productivity, but there won't be very much money left to do very much of that over the next couple of years.

[*Translation*]

Mr. Mario Fortin: Since I have been given the opportunity, I would like to make a suggestion. Productivity and innovation depend on brain power. Canada could invest more in post-secondary education particularly in the region which is familiar to me, namely Quebec, where funding is much lower than it is elsewhere. I know that is an area of shared jurisdiction, but it is also an area where innovation could be worthwhile and greater funding in post-secondary education would encourage researchers to remain here.

[*English*]

The Chair: Madam Russell, you can continue.

Ms. Ellen Russell: On the tax cut versus program spending question, there has been a program of corporate tax cuts for many years now. It would be useful to examine whether that program has remedied the productivity issues that are being identified or whether it has remedied the competitiveness issues.

We have a report here quoting Jim Stanford, who did a paper outlining the fact that despite these corporate tax cuts, there weren't the advertised benefits in terms of competitiveness and productivity. Plus, by cutting the taxes, you deprive the federal government of the revenue it could use for doing things—infrastructure, education, or whatever you may consider to be a priority—in terms of spending money to invest in productivity.

Mr. Don Drummond: I have more than four reasons, but I won't go through all of them. I'll pick out four, as you requested.

I think our number one problem on the tax side is the high marginal effective tax rates. They kick in for people up to about $50,000 in income. I know we instinctively think of marginal tax rates as being bad for high-income people, but they're much higher when you take away the social benefits at low incomes, usually higher than 60%. So there's very little incentive to upgrade your education, take second shifts, and look for a better job and what not.

I would say that the employment insurance system would be number one. There's been no study that I'm aware of, or none with any credibility, that hasn't said that this is a disincentive. It subsidizes people to stay where the jobs aren't, and discourages them from going to where the jobs are.

My third one would be immigration. We're within a few years of having 100% of our population growth being determined by immigration, so the economic welfare of immigrants will largely determine the economic welfare of the nation. That's a very sad story, and it has been for the last 20 years. The problems go through the whole thing—the design of the system, the administration of the system, the integration of immigrants.

My final one is a remaining problem, not in the federal jurisdiction but largely in the provincial area. We talk about the high rates of taxation on capital, and largely they're provincial. We still have provincial internal barriers to trade. We have overlapping jurisdictions. One aspect that I particularly appreciated in the spring budget was Mr. Flaherty's use of some fairly harsh, bold language to say that if we want to get our productivity up, we need some improvements on the provincial side, not just federal.

Ms. Diane Ablonczy: Okay, I appreciate that.

Thank you very much to all of you.

The Chair: Thank you.

Madam Wasylycia-Leis, seven minutes.

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

Thanks to everyone for coming today. I trust that you will be giving serious consideration to an ongoing relationship with our committee, since we are interested in, and passed a motion to ensure that we have, some independent forecasting advice until such time as the mechanism in Bill C-2 kicks in. We hope this is the start of a regular appearance before the committee.

The main reason we need you here today is that the minister gives his economic update this afternoon, and we're in the middle of finalizing our report based on pre-budget consultations. We're trying to get a lay of the land that's as accurate as possible, starting with the surplus dollars available.

I'd like just a quick go-round on that again. Ellen has given us an indication not to expect more than $4.2 billion surplus for this year, and for next year a forecast of $5.3 billion. That is way lower than any of us expected. That's been a real eye-opener for me and I'm sure for others.

If I go back to the reports that you gave us all last October, I know that we're all in the neighbourhood. Global, for example, was thinking more in the line of $8 billion or $9 billion flexibility. I think that was the same for everybody across the board. So things have changed.

Since Ellen is the only one who has given us a specific number, does everyone here concur with that number, in a ballpark way? Are we looking at roughly $4 billion in surplus for this year?

Dale.

● (1020)

Dr. Dale Orr: It's really hard to answer that. As I say, it depends on exactly what fiscal actions you include and exclude. Obviously the surpluses have been eroded because of what was in budget 2006.

Previously we did a fairly thorough piece for the finance committee to answer exactly that question. It took quite a bit of time. I can't answer this right off the top of my head. You have to be so careful about what you're including and excluding before you come up with these kinds of numbers.

Ms. Judy Wasylycia-Leis: You said earlier that you were roughly in favour, or that you were eye to eye with Ellen in terms of the overall forecasting. Are you urging us to be cautious in terms of looking at the numbers?

Dr. Dale Orr: Yes. I'm saying that if you only include what was included in budget 2006, look at what the surplus is in 2010. If it's not more than $10 billion, then he doesn't have much money left for anything incremental. Between now and 2010 he has to reserve money for a GST cut of over $5 billion; an increase in the basic personal amount from about $9,000 to $10,000, which is going to cost over $2 billion; and the fiscal balance question, which is a very ill-defined concept, but if he doesn't come up with $2 billion to $3 billion incremental money on that issue, there are going to be some disappointed premiers. We've mentioned defence spending, and I think the forestry sector is expecting him to give money.

None of those things you do because of productivity and economic growth. All of those things are motivated by something other than trying to make the economy stronger.

Ms. Judy Wasylycia-Leis: All right, Ellen, do you want to add anything in terms of your numbers?

Ms. Ellen Russell: I will only say we put out this forecast, but the finance minister does not take me into his confidence. I don't really know what goes on inside the finance ministry, and there may be reasons to think that any number of expenditures could be higher than I put them here. In some ways, you could be looking at less fiscal room than I portrayed.

Ms. Judy Wasylycia-Leis: Okay, but you're giving us a ballpark figure, so we have to take that into account when we assess both our pre-budget presentations and whatever Mr. Flaherty is going to talk about this afternoon. There is limited room. If you consider the fact that another drop in the GST is about $6 billion, even on that basis, just on that term, we don't have enough money, never mind income splitting, which is $5 billion or $6 billion, never mind taking into account all the other things Ellen and others mentioned. We have to be very careful about what we push for and what will actually produce productivity.

There is a real debate about whether or not another drop in corporate income tax will do that. That's an expensive proposition. The question for us is, does that produce competitiveness and productivity?

Don Drummond had some comments in the paper not too long ago questioning whether or not the business sector has done its job of translating tax breaks into real investment in this country that leads to more jobs, higher productivity, and so on.

My questions are as follows. For anyone who wants to answer, does a drop in the corporate income tax from 21% to 19% produce much in terms of productivity? Does the capital gains really do what you're talking about? Does the marginal effective tax on investments do it, or do we need to look at some other things? For example, could you say that the cancellation of the national day care program produces competitiveness? Would it not make sense to look at that in terms of increasing productivity? On some of the other stuff the government has done, does an increase in defence spending increase productivity? Does the 1% drop in GST produce competitiveness?

Ellen, maybe you could start, and then Don and then Dale. Could you give me a response?

● (1025)

The Chair: There is a short 40 seconds to respond to that speech.

Ms. Ellen Russell: If you are applying productivity criteria, a lot of the stuff in the last budget wouldn't meet it. Often these measures are politically motivated.

Second, if you're going to bet the farm on corporate income tax cuts, that's the only thing you're going to be able to do, if you can even do that, because there is just not the fiscal room to do everything. So you're going to have to bet on corporate income tax cuts doing everything you want to do, because you won't have the money for infrastructure, education, the environment, aboriginal peoples. There won't be any money to spend for those other things.

The Chair: Thank you very much.

We'll continue with Mr. McKay now, for five minutes.

Hon. John McKay (Scarborough—Guildwood, Lib.): Thank you to these witnesses. Certainly it's much more pleasant listening to you on this side of the table than on the other side of the table.

I want to go with the projections of surplus for the next couple of years, even though it looks as if a lot of commitments made in the 2006 budget go forward four or five years, which probably to you folks means a lot more than it does to the average folks.

Ms. Russell's projection is that it's going to be in the range of $4 billion. Mr. Drummond's is $1.8 billion to $2.8 billion, and I assume Mr. Orr is somewhere in there, but certainly not disagreeing greatly with that. I want to go through what's left.

If he goes with personal income tax changes—in other words, he takes the November 2005 update, photocopies it, and puts pretty blue paper on it—what is that going to cost him, and where will that leave him? He's bumping up the first basic personal exemption and presumably bringing the marginal rate back down to where it was at 15%. What is that going to cost?

That is for Mr. Drummond, or any of the three.

Mr. Don Drummond: Let me clarify. I did give a range on the fiscal numbers, and that was the budget numbers plus $1 billion or $2 billion this year or next year, so that would put us into the $4.5 billion to $5.5 billion range, and that is assuming all the measures on the table right now are passed. If I understand your question, you're asking if we went beyond that and knocked another half a point off the first tax group. Is that your question?

Hon. John McKay: No, it's with regard to the specific tax changes that Mr. Orr was referring to. The two personal income tax changes will certainly lower the marginal rate and up the base personal exemption. What are those changes going to run?

Mr. Don Drummond: I'm sorry for the confusion, but we've already incorporated, in the numbers I've given, the increase in the basic—

Hon. John McKay: Okay, so you've left those numbers out. I understand.

Mr. Don Drummond: Yes. If you're asking whether we go further, just as a rule of thumb, one point off each one of the four tax brackets.... So taking the top one from 29% to 28% and the bottom one from 15.5% to 14.5% is $6 billion.

Hon. John McKay: That really doesn't leave you too much room.

In terms of the GST, it's basically the consensus that this is a $4 billion or $5 billion item?

Mr. Don Drummond: It's $6 billion if they don't adjust the GST low-income credits to offset it.

● (1030)

Hon. John McKay: All right.

Mr. Orr, you talked about probably monitoring income trusts to ensure that the playing field is level. I'm not quite sure I know what you mean by that. His commitment is pretty firm that income trusts are going to be taxed in four years.

Dr. Dale Orr: Yes, that's right, but has the October 31 change eliminated any artificial drifting from the corporate form into the income trust form for tax purposes? That's what he wants. Has that been enough?

Hon. John McKay: Oh, I see, that's what you mean. All right.

The Conservative platform is to eliminate capital gains tax. They seem to have abandoned this business of cycling the capital gain forever and ever. What would you propose to him in order to be able to accommodate that somewhat ill and rash promise?

Mr. Don Drummond: Just to clarify, you said that the Conservative platform is to eliminate capital gains. As I understand it, it's to eliminate the capital gains on the rollover on investments, not to eliminate all capital gains.

Hon. John McKay: Yes, I know, but once you're dead you'll probably get taxed.

Mr. Don Drummond: But you can certainly understand a rationale for that. There's quite a penalty right now for trade in stocks. You want to hold off because you don't want to incur the tax. The original election campaign document put the cost at $100 million, and by my reckoning, that's off by at least a factor of ten. It depends as well on whether you allow it just for individuals. Everybody forgets that corporations have capital gains as well. In fact it's about the same amount of revenue as for individuals, so that ten factor could even be higher.

You could certainly do it. You might remember that in 1985 there was the ISIP program, which was an account that you were allowed to establish over a lifetime. It only taxed capital gains on the real portion. My suggestion is that if you wanted to go ahead with this, set it up as a lifetime account. The trading has to take place within an account. If you want to limit the costs and limit the regressivity of the measure, put on whatever lifetime cap you want—$100,000, $200,000, $500,000.

So it is doable. I just don't think one would want to allocate that much revenue to do it in an unrestricted fashion.

Hon. John McKay: At this point we're at $13 billion of costs and we have $4 billion worth to play with. Is that fair?

All right, thank you.

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

I'll throw in a couple of questions now.

Opponents of the concept of income splitting are using the argument that it may have the perverse effect of reducing labour force participation by couples who are emboldened by the fact that they're able to keep more of their money, and who may decide to stay out of the workforce and raise their own children.

I'm curious about your perspective on this issue. Certainly in the pre-budget process we heard from numerous people expressing concerns around labour force demographics in the future. I'm just curious to know if you hold any credence to the argument that somehow our productivity as a country will be negatively impacted by income splitting.

Mr. Don Drummond: That's of course the classic argument—the glass half full or the glass half empty. If you want to make the argument as you put it, you have to step back and say that the existing system is arguing for an incentive for additional participation, and if this argues for an incentive for less participation, it's just offsetting the bias that's already there.

That's not an argument that I would put a lot of weight on.

The Chair: I'm glad to hear you say that, because if you buy that thesis, you buy the thesis that to increase labour force participation we should simply raise income tax, it would seem to me.

Mr. Don Drummond: Exactly. I don't think it's an argument that goes very far.

The Chair: Thank you.

Mr. Orr, do you want to chip in here?

Dr. Dale Orr: I'll make two comments.

First, I agree with Don, and I think the overwhelming issue here is the concept that the family—the household—is the spending unit, and the taxes should be based on that. That's why I and a lot of other economists are in favour of income splitting.

This notion that there could be some side impact on labour force participation makes me very frustrated. It leads me to believe that some people here might not favour income splitting because of this side effect. But as far as I can see, no party here is going to tackle the employment insurance system.

If you want to do something, if you're really concerned about labour force participation, then there are 300,000 people in Quebec and eastward, under the age of 45, who are unemployed today. By our forecast and most other people's forecasts, there will be 300,000 people in Quebec and eastward unemployed in 2010. Many of those people will be the same people. Most of those people could get jobs in Alberta and B.C., and the federal government does not really focus on this question of moving people to where the jobs are. They're spending a lot of money on unemployment insurance, but there is not a high priority on moving people from one province to the other to go where the jobs are.

As a matter of fact, as you know, the unemployment insurance system now is perverse, in that sense. Qualifying for unemployment is easier if you're sitting in an area of relatively high unemployment. It should be the reverse. There you go. If you're worried about incentives for labour force participation, it's sitting out there for you to take action on.

● (1035)

The Chair: Thank you, sir.

Ms. Russell, you made a rather impassioned plea, it seems, for keeping government revenues higher. It's kind of ironic, in a way. The reason you're here, I think, is in large part because the previous government's tendency was to use fiscal prudence excessively and to therefore create excessively large surpluses, which deprived Canadians of debate on the use of said surpluses, because their forecast didn't match what Canadians ended up producing in terms of surpluses. And now all of you are chiming in on the need for us to be fiscally prudent and to actually be very conservative in our projections, I think.

Madam Russell, you made the impassioned plea that we should make sure we have more revenue in the hands of government so we can do good things with it. I wonder if you extend that thesis to the idea that we've overtaxed Canadian workers—some estimates say by over $40 billion—certainly in the EI fund alone, over the last decade. Surely you don't carry that thesis to the idea of keeping the EI premiums excessively high, because that would really be a tax on Canadian workers and small business largely, wouldn't it?

Ms. Ellen Russell: There was a lot packed in there.

The Chair: You were saying to keep revenue higher so we can do good things with it. We all know we'd like to do good things with the money Canadians send us.

Ms. Ellen Russell: My interest here is that if the fiscal position of the government is obvious to all Canadians, then we can have a legitimate public debate. I didn't like it when they were low-balling surpluses, and I won't like it either if we pass a bunch of tax cuts that we can't really pay for and it only becomes clear down the road what the consequences are.

The Chair: I'm clear on that. I just want to be sure you're not including in your thesis of employment insurance premiums being too high and continuing to be too high and that you want to have extra revenue coming to the government from that source. I just want to be sure you're not including employment insurance in your thesis, that's all.

Ms. Ellen Russell: I set aside the employment insurance.

The Chair: It's not in your thesis, right? You're not saying to keep employment insurance high. I want to be clear on this.

Ms. Ellen Russell: I have lots that might be done about employment insurance, but this is not the forum where I can really give a whole discourse on that.

The Chair: Fair enough.

Mr. Mathieu Dufour: I just have a note on that, if I may. In our forecast, we calculated the numbers in a way that employment insurance balances out. That is, only enough revenue is taken in to pay out the premiums. No extra money, if you will, goes to the government from that fund.

The Chair: Thank you very much, monsieur.

We continue with Monsieur St-Cyr, *pour cinq minutes*.

[*Translation*]

Mr. Thierry St-Cyr (Jeanne-Le Ber, BQ): Thank you, Mr. Chairman.

I would like to come back to family income splitting and what you see in terms of an impact.

Those who support this type of measure often say that it would favour the middle class, that it is a measure intended for the middle class. I am not a forecaster, which is why I would like to hear your opinion. To my way of thinking, middle class means a family with a small house, two working parents whose income is about the same, who send their children to school, etc. I would like to know how a family, with each partner earning about the same amount, would benefit by transferring part of one income to the other partner, when both incomes are essentially the same. It seems to me that this type of measure would be more advantages for a couple where one earns a very high income while the other stays at home or earns much less than the partner.

Am I mistaken in my assessment of the average middle income earner and am I out in left field when it comes to assessing the impact that will have on the middle class? Who would like to be the first one to respond?

[*English*]

Mr. Don Drummond: Income splitting can only be billed as a middle-class item. It's exactly the same as virtually any tax cut. The vast bulk of people are in the middle class, so that's the vast bulk of people it affects.

But just by definition, it affects people who have unequal distribution of incomes. As you pointed out, if both members of a couple have $30,000 of income, there's nothing in it for them. The greatest benefit is in the less equal incomes. In the extreme, if one person has a million dollars, and one has zero, they're going to have a phenomenal savings. It could affect low-income people as well. If one had $45,000 and one had $15,000, there would be a considerable savings. Obviously the split between the two incomes is where you really benefit. It's just the same as with the pension splitting that was announced on October 31.

● (1040)

[*Translation*]

Mr. Thierry St-Cyr: It is true that the highest percentage of taxpayers are middle income earners, which means that they would be affected by any tax cut. Would I be wrong in saying though, all things considered, those with the highest income would stand to gain the most, and this would also have a greater impact on the way in which they plan their families.

Mr. Mathieu Dufour: I think you would be correct in saying that. Moreover, to use Don's argument, there are probably more variables with higher income earners. Statistically, it would be easier to see a difference of $20,000 or $30,000 if one of them earns about $100,000 and the other $70,000, even if both are working. So I would say that it is indeed the case. Your assessment is quite accurate.

Mr. Thierry St-Cyr: Let's go back to the transfer payments. There was some discussion about tax cuts as opposed to transfer payments to the provinces. Now that the bulk of the work to eliminate the deficit during the 1990s has been completed, rather than continue with tax cuts, should we not consider returning social transfer payments to the provinces to the 1994-1995 levels before reducing taxes?

Perhaps Ms. Russell would like to answer that one.

[*English*]

Ms. Ellen Russell: Obviously cutting taxes is really, really away down on my priority list. To support the kind of social transfers that we could, we should choose as a society to use what resources we have here to invest in our people. I think that would be a great idea.

[*Translation*]

The Chair: Thank you very much, Mr. St-Cyr.

[*English*]

We continue now with Mr. Del Mastro, for four minutes.

Mr. Dean Del Mastro (Peterborough, CPC): Thank you, Mr. Chair.

I'm going to have to go very quickly, because I have so much I want to say.

I guess I'd start by indicating that the three elements that of course go into a fiscal forecast are revenue, interest payments on debt, and program spending. It doesn't seem that we're really considering all facets of some of this in some of the presentations. Certainly, Ms. Russell, you may have delivered, if not the most partisan, certainly one of the top 10 of presentations that we've actually received.

In considering tax cuts, you're doing a very straight-line approach to your calculation. Have you given any consideration to economic expansion from a tax cut?

Ms. Ellen Russell: We go with the forecasts we have at our disposal, which are mostly from all the banks.

Mr. Dean Del Mastro: But you'll agree it's too simplistic to just do a straight line. We had $210 billion this year, we take off $5 billion, that means we'll only have $205 next year. It's not that simple.

Mr. Mathieu Dufour: Maybe I can provide the quick answers to that. This is very true, except that according to the Bank of Canada, we're already close to potential GDP. Domestic demand, personal consumption, if you will, is not low by any account; it's very high, it's sustained, so we don't see tax cuts at the personal level as helping much as far as economic expansion goes.

Regarding corporate tax cuts, we've had record productivity for years. This is probably likely to go down, but as we were saying, this has not brought in the investment you could have expected.

Mr. Dean Del Mastro: Okay. I only have four minutes.

Mr. Drummond, don't you think you could make the case that Canada is on the inverse side of the tax curve, that taxes are at a point where by reducing them we could see some kind of expansion in overall tax revenues, in economic growth?

Mr. Don Drummond: I wondered if that was where you were going to go with your previous questions, and I'm glad you asked that. No, I don't.

Mr. Dean Del Mastro: Thanks. Okay.

Mr. Don Drummond: It's a simple mathematical proposition. The federal government taxes 15¢ of every dollar of economic activity, so you take the inverse of that. To get a dollar back, you have to create $6 of economic activity from every dollar of tax cut, and there's no way a tax cut can do that. You'll get a portion of it back, but you never get all of it back.

Mr. Dean Del Mastro: I'd agree with you, you'll get a portion of that back. That's exactly what I'm saying.

● (1045)

Mr. Don Drummond: If you cut it, yes, sure, and soon you'll notice—

Mr. Dean Del Mastro: The huge surpluses are a symptom of excess taxation. My point is that you simply cannot take off the cost of a tax cut and say this has eliminated this much revenue from the government, because some revenue is created.

Mr. Don Drummond: A protocol has been established in the budgets for a long time to include just the direct costs. Obviously that's not quite accurate. There is some amount of recapture for the economic effect, but on the flip side as you lower the surplus, you would have higher than otherwise public debt charges as well. That's why they tended to be rounded off. The recapture is probably 20% at best. It's certainly not close to fully recovering it.

Mr. Dean Del Mastro: Thank you. That's fine. That was all my point was.

Mr. Orr, you've indicated inflation. You think it will be somewhere in the neighborhood of 1.8% for 2007. Do you think that might allow for a slight relaxation of interest rates overall in Canada, which would reduce some of the cost of carrying the debt?

Dr. Dale Orr: Our forecast for interest rates is that in terms of the bank's policy rate, the bank will keep on hold that 4.25%, where they are, for well into next year. There's a little bit of debate. Will their next move be up or down? I would say it's probably more likely to be down than up, but it's also probably at least six months away.

Mr. Dean Del Mastro: Consistency at the very least?

Dr. Dale Orr: Yes.

Can I just piggyback on what Don said?

Mr. Dean Del Mastro: Certainly.

Dr. Dale Orr: We've done a lot of work on the impact of various tax cuts. As for personal income tax, yes, the federal government might get about 20% of its money back over time, because of the expansion. For corporate income tax, yes, there have been a lot of studies; it really does stimulate investment. In fact, regarding the impact of the harmonization itself with the three eastern provinces, a recent study showed it was very effective in increasing business investment in those provinces.

Some people think, why doesn't the government cut taxes, because it can get its money back? Let's not go that far. We're talking about 20%.

Mr. Dean Del Mastro: No. I would agree with that.

Dr. Dale Orr: There are some unusual situations for corporate income tax where corporations may, if you're right on the margin with the U.S., start reporting more profit in Canada versus the U.S. There is really no shift in real economic activity. In that corner solution, they can virtually get their money back from a corporate income tax cut because of changes in accounting procedures, but generally they might get one-third of their money back. Cuts in corporate income tax, when we are head-to-head competing with the U.S., not only in Canada but in the U.S., and in most of those export markets that head to the U.S., it's very important to have a good tax-cutting agenda on the corporate side.

The Chair: Thank you, Mr. Orr.

We move to Mr. Pacetti now for four minutes.

Mr. Massimo Pacetti: Thank you, Mr. Chair.

My thanks to the presenters. It's been interesting, as always. I want to continue the line of thought Mr. Del Mastro was using, and I think Judy was as well.

I like numbers. It's nice to talk about 3% of the GDP, but let's talk about numbers. As an accountant, I like to see what the numbers are. If we look at what the projections were from the last independent forecasters, pretty well everybody was almost within $5 billion in terms of program expenditures. It's the revenue. Everybody was predicting around $210 billion, but the revenues came in at $222 billion. I know there were some accounting adjustments, but we're still predicting $227 billion this year, or maybe in the $230 billions. Isn't the growth going to come from the revenues?

Mr. Orr, if we look at what *The Fiscal Monitor* is saying, it's $5 billion. Shouldn't we double that and say we're still expecting $12 billion to $13 billion? That's easy mathematics. The revenues should be going up. Finance always seems to be undercutting. I think you guys underestimated revenues. Shouldn't we be looking at $13 billion to $14 billion?

Really, what happened in the last budget—I'll get to you as well, Ellen—was that the government decided to cut the GST, but they increased income taxes. It was almost an offset.

Mr. Orr, perhaps you can answer that, and I'll give Ms. Russell a chance as well.

Dr. Dale Orr: The last forecast on revenues that we did for the finance committee was for 2005-06. The revenues were pretty much bang-on in that forecast.

Of course, in between, we've had budget 2006. We had a lot of changes on the tax side in budget 2006, and a lot of them took effect July 1. So I caution you about looking at *The Fiscal Monitor*, because we only have a couple of months, through September, reported after those tax changes of July. We're seeing quite a different pace of year-over-year changes in the recent months from what we were seeing in the earlier part of the year.

I don't know what more I can say than that.

● (1050)

Mr. Massimo Pacetti: Ms. Russell.

Ms. Ellen Russell: I would just echo what Dale Orr just said in terms of why *The Fiscal Monitor* is not a reliable predictor of what we're going to have surplus-wise at the end of the year.

Mr. Massimo Pacetti: Do you want to answer that, Mr. Drummond?

Mr. Don Drummond: Well, if you look at the fiscal results today, there are two very striking features to them. One is that departments have been underspending their budgets, as they did in the last fiscal year. You have to assume that at some point they'll catch up, because they're underspending what they're allocated to spend.

The second feature is that personal income tax revenues are extraordinarily strong. They've been running at plus 11% year over year, and I suspect a good part of that is the capital gains. The stock market has been very strong, and housing prices have gone up. While we don't pay capital gains on principal residences? We do on investment properties and second—

Mr. Massimo Pacetti: I'm sorry, but it wouldn't be capital gains, because you only report capital gains at the end of the year. So I think it's just—

Mr. Don Drummond: No, most high-income people would be paying instalment payments, plus they would have been paying—

Mr. Massimo Pacetti: The instalments are based on the previous year, so if you're having a good year in capital gains, you're only going to—

Mr. Don Drummond: That's right, but people would have been paying when they filed their tax report, in April, of the acquisition this year.

Mr. Massimo Pacetti: Oh, based on the year before. That's fine. I can agree with that concept.

Mr. Don Drummond: That would have been paid in May and June.

The Chair: Thank you, Mr. Pacetti.

Mr. Orr, I just have a quick question. What impact, if any, on debt service costs does the declining Canadian dollar have?

Dr. Dale Orr: Not very much, because we don't have a lot of debt in foreign currencies. As a matter of fact, the impact of a fall in the interest rate on the debt charges is not that great. The rollover is about a third of that, so a lot of the debt is not impacted by a change in interest rates.

The Chair: So those two variables aren't significant in your overall determination of your numbers.

Dr. Dale Orr: No, they're not, and the forecast of the debt over the next four or five years by all forecasters is $34 billion to $35 billion.

The Chair: Thank you.

Mr. Wallace.

Mr. Mike Wallace (Burlington, CPC): Thank you, Mr. Chairman. I'm going to share my time with Mr. Dykstra so that we make sure we each get a question in there.

The Chair: You both will.

Mr. Mike Wallace: From *The Globe and Mail* of September 27, I quote that “critics charge the choice of spending cuts was ‘political.’ This is utter silliness.”

A voice: That's true.

Mr. Mike Wallace: It has to be true.

Can you explain that comment a little bit?

And there's another thing that I haven't heard from anybody, other than maybe employment insurance. You talk a lot about revenue, but should we be cutting more spending or not?

Mr. Don Drummond: I'm going to give the rationale on why I said that.

It's been a source of frustration to me all the time I worked in government, because everybody would always say that with all that spending, there have to be billions and billions of dollars that somehow just disappear, so you can cut and no one feels it. Obviously, by definition, every single dollar the government spends goes to something or to somebody, and there are always implications to it.

You have to make choices, and Parliament makes choices. You're politicians, so you therefore have to make political choices. But there isn't some little mysterious bag out there that you can cut and no one's going to feel the effect of it.

So yes, the cherished programs get touched, as does the money that goes to people, whether they're civil servants or people on some type of assistance. That's the harsh reality of the world. Unfortunately, you have to face those choices when you cut spending.

Mr. Mike Wallace: That's my question. I know we were talking about revenue and whether we're getting it or not. Do you not think we have a responsibility to look at whether programs are working or not, and those that are not, we should be cutting?

Mr. Don Drummond: We really started a process with the program review in the mid-1990s, and I've always argued that it has to be an ongoing process. Every time you create a new program, by definition, all of the previous programs have slipped down one degree of priority and they all have to be looked at. The new program should ultimately mean the elimination of an existing one. When a new program comes in, it has to be evaluated after two or three years to see if it's working. If it's not working, then get out of it.

Mr. Mike Wallace: Thank you. Those are my questions.

The Chair: We'll go to Mr. Savage now and conclude with Mr. Dykstra.

Mr. Michael Savage (Dartmouth—Cole Harbour, Lib.): Thank you, Chair.

Mr. Drummond, you mentioned that budgets are about making choices. I wonder if any of you think that spending $5.5 billion to $6 billion to reduce the GST further, from 6% to 5%, is a good choice.

Mr. Don Drummond: As it was noted, I tried to do a paper on the consensus of what economists think of what's needed to impact the growth rate, and you won't find an awful lot of economists supporting the cut of the GST. It's extraordinarily effective in reducing the tax burden on people. It gets money into their pockets, but it doesn't give the incentives to increase savings or investments, and therefore it doesn't have an impact on growth. So clearly, almost any economist will give an answer of no. They'd rather work on the tax rate on income and capital rather than on consumption.

Mr. Michael Savage: I want to come back to that. I think everybody can see it's a dumb choice, but one of the arguments that were made by our colleagues opposite, including the one who will rebut me, is that it's an effective way to help those low-income Canadians who aren't necessarily helped by a lower marginal rate but who don't pay tax.

I asked the Library of Parliament for some information on this, and what I had back was the estimated savings from a 1% reduction in GST, from 6% to 5% . For the average single person making $20,000, it would be a savings of $52, and for the average Canadian making $100,000 or more, it would be $647. That's startling to anybody who figures out that the more you spend, the more you save. I would argue that not only is it a dumb move, it's also a mean move.

I wonder, Ms. Russell, if you have a comment on that.

● (1055)

Ms. Ellen Russell: Yes. If you were setting up to design a tax cut that was directed towards low-income people, you'd sweeten the GST credit.

Mr. Michael Savage: That makes sense.

Ms. Ellen Russell: You're basically spraying money on everybody, hoping that some drops fall on the low-income people, by cutting the GST.

Mr. Michael Savage: Or the low-income supplement of the child tax benefit, or many other ways that we could assist. Thank you for that.

I want to ask about education. Mr. Drummond, I had the pleasure of being at a conference you spoke at maybe a year and half ago in Halifax—the AAU. You made some very good points about the competition from emerging economies and the fact that Canada has to move up in the value chain. We have to invest in education, in R and D. Tuitions have gone up. The student-to-faculty ratio is a lot worse than it was 15 to 20 years ago. We need more money. What we've seen in research and development and on education from the government has been pretty skimpy.

The focus has been on tax credits that will do nothing to get Canadians into university or community college, upgrading their skills, but it will help those who are already there.

I wonder if any of you would have a comment. How do we educate more Canadians? Should the focus be on low-income grants? Do we need more research or should we continue tinkering with the tax system, which helps people who are already going to university and/or community college?

Mr. Don Drummond: Let me start.

First of all, to the credit of the current government and the previous government and the provinces, Canada has started to reinvest in post-secondary education. We just about killed the beast off in the 1980s and early 1990s, but we have fresh wind with that. We have a couple of weaknesses in graduate programs and the like, but we're fairly strong.

I don't think student tuition fees themselves are the problem, but you absolutely can't allow financing to be a restraint to somebody going. I would urge you to look at a proposal that was kicked around previously in Canada, but we never went with it, and that was income-contingent repayable loans. The student gets the money up front and pays it back according to income. That will get rid of the financial burden at the beginning of it. That does need to be complemented with low-income grants, but the government has moved in that direction, as most of the provinces have as well.

Mr. Michael Savage: The previous government moved a lot; this government hasn't moved. What does this have to do—

Mr. Don Drummond: It's interesting. If you look at the participation in post-secondary education, while it's obviously still much higher for higher income levels, the biggest increase in participation in post-secondary education has been at lower incomes.

Mr. Michael Savage: I don't agree with that.

Mr. Don Drummond: Well, that's the Statistics Canada statistic.

Mr. Michael Savage: That is—

The Chair: Mr. Savage, we have an argument. You two can conclude in the hall later.

We'll continue with Mr. Dykstra now.

Mr. Rick Dykstra (St. Catharines, CPC): It was great. That was actually an interesting debate to watch.

I'm certainly not going to rebut my good friend across the way, other than to say it was interesting to hear him say that the cut in the GST was a mean and dumb move. He represents a party that actually wanted to eliminate it entirely. I guess it would have been seven times as dumb and seven times as mean if you had actually done that.

In any event, since January, approximately 260,000 full-time jobs have been created. Mr. Orr, you made a really good point about the.... I think all of us enjoy travelling across the country and learning a lot about individual provinces, and seeing the bounty, if you will, with respect to Alberta.

On the transfer, I was wondering if you could comment on two things: one, why you think there are an additional 260,000 people working in this country today who weren't working in January of this year; and further, how we would accommodate the transfer of those 300,000 jobs you spoke about, in terms of making sure they have the opportunity to be dispersed throughout the country.

Mr. Don Drummond: I guess the starting point is where the jobs are coming from. They're disproportionately coming from the west. Quebec and Ontario have been particularly weak. We have an important manufacturing sector, and we've seen a tremendous shedding of jobs in that area.

As I noted before, the national statistics right now are completely meaningless, for a whole host of variables. For example, with inflation, we have a bizarre situation. Every single province other than Alberta is below the national average. The real gross domestic product in Alberta increased this year by about 7%; the nominal income growth there is probably more like 14%.

Looking at the impact does somewhat mask the weakness we've had in the manufacturing sectors. That's really a story of some ongoing struggles in adapting to the stronger value of the Canadian dollar and, now, some additional pressures from the weaker demand from the United States.

● (1100)

Mr. Rick Dykstra: Mr. Orr.

The Chair: Fairly quickly, Mr. Orr, please.

Dr. Dale Orr: Sure.

The main reason job creation has been so strong is the strength in the energy sector. A lot of that job creation has been in Alberta—in vast disproportion. Also, there are the interest rates. Even though they were moving up, they're still relatively low by historic standards and they are helping the construction industry.

What can we do to increase interprovincial mobility? I mentioned EI, but I want to emphasize that the perversities in EI are only a part, maybe even a small part, of why interprovincial mobility is as weak as it is.

One thing I would like to see is a program, in HRSDC, for example, specifically focused on interprovincial mobility and looking at the family as a family. It's a big decision to make that move, find the job, help the family move, counselling, and all that. It's a social program, to help that mobility. I think that's something the federal government could do. I harp on EI, because we've been talking about it for 15 years. It's within your grasp to make those changes. But it is only a small part.

At the same time, I should say that what has happened in the province of Saskatchewan is amazing. Job creation has been weaker in Saskatchewan over the last decade than in most of the eastern provinces, yet the unemployment rate is always one of the lowest. People move from Saskatchewan when job prospects are weak; they don't move from the east.

So you can't just blame our EI system. It's a very complex issue as to why there are all those jobs out there and we have 300,000 people in the east who are unemployed.

The Chair: Thank you very much to all our witnesses. It's always stimulating to have you here. We very much appreciate your sharing your time with us. We look forward to seeing you again.

We're adjourned until this afternoon at 3:20.

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