House of Commons
CANADA

Standing Committee on Industry, Science and Technology

INDU • NUMBER 004 • 1st SESSION • 39th PARLIAMENT

EVIDENCE

Tuesday, May 30, 2006

Chair

Mr. James Rajotte

Also available on the Parliament of Canada Web Site at the following address:

http://www.parl.gc.ca

Standing Committee on Industry, Science and Technology

Tuesday, May 30, 2006

● (1105)

[*English*]

The Chair (Mr. James Rajotte (Edmonton—Leduc, CPC)): Welcome, everyone.

Just before I turn to our witnesses, I want to welcome officially, on behalf of the industry, science, and technology committee, an official delegation from Yemen. They're interested in what the committee is doing, especially with respect to our witnesses here today.

I'll just name the official leader, the speaker of the body comparable to our Senate, His Excellency Dr. Abdul Aziz Abdul Ghani. Dr. Ghani, would you like to stand up and be recognized?

Let's all welcome him on behalf of the committee.

Some hon. members: Hear, hear!

The Chair: Thank you very much for coming.

Having met the delegation, I understand six of the group have been bankers in the past, Mr. Dodge, so they're very interested in your presentation.

Mr. Dodge, on behalf of the committee, I welcome you and thank both you and Mr. Jenkins very much for taking the time from your busy schedules. I'm sorry about the delay in starting the meeting; the last committee went a bit over their time.

We are studying the state of manufacturing in Canada. Obviously one of the relevant factors is the depreciation of the Canadian dollar vis-à-vis the U.S. dollar, and its impact on the manufacturing sector. We have a full committee here today, and we are very interested in what you're going to say.

This is the process here today: we have about an hour with you, I believe, and for both you and Mr. Jenkins we'll have a 10-minute to 12-minute opening presentation, and then we'll go to questions to the members after that.

Welcome to the committee. Thank you very much for coming. You can start at any time.

Mr. David Dodge (Governor, Bank of Canada): Thank you very much, Mr. Chairman.

It's a tremendous pleasure for Paul and me to be here this morning and to meet with you. It really is an honour to be invited, and I hope we can be of some help to you in your examination of the challenges facing the Canadian manufacturing sector.

Members of the committee, as far as I am aware, it's the first time a governor or a senior deputy governor of the bank has actually appeared in front of this committee. Certainly it's the first time for a long time, so I thought it would be appropriate to start with a very brief description of the framework within which the bank conducts monetary policy. I'll then talk about the global forces that are posing challenges for our manufacturing sector and what they imply for the economy as a whole. Finally, Mr. Chairman, I thought it might be useful to share with you some of the evidence we've gathered from Canadian manufacturers about how they are adjusting to the challenges.

Let me start with the first part, then. The Bank of Canada Act calls on us to:

> mitigate by its influence fluctuations in the general level of production, trade, prices and employment, so far as may be possible within the scope of monetary action, and generally to promote the economic and financial welfare of Canada.

That has remained our charge since we were formed in the mid-1930s.

Over time it has become clear that the best way for us to fulfil this mandate is to keep inflation low, stable, and predictable. Specifically, we aim to keep the annual rate of consumer price inflation at 2%, which is the midpoint of a 1% to 3% band.

[*Translation*]

To meet these objectives, we try to keep the economy operating at its full capacity. By this, I mean that we aim for balance between total demand and total supply in the economy. Simply speaking, if strong demand for Canadian goods and services were pushing the economy as a whole against the limits of its capacity, and if inflation were poised to rise above the target, the Bank of Canada would raise its key policy interest rate. This, in turn, would push up other interest rates and help to cool off demand, thus keeping supply and demand in balance and inflation on target. On the other hand, if the economy as a whole were operating below its production capacity, and inflation were poised to fall below the target, the bank would lower its key policy rate to help stimulate demand.

By maintaining low and stable inflation, monetary policy helps to keep the economy operating at full capacity and promotes greater stability in economic output. This point is crucial in helping the economy adjust to global economic forces. A key element of our monetary policy framework is the floating exchange rate.

Let me be clear: we do not have a target or preferred exchange rate for the Canadian dollar. But it is an important relative price in our economy. In terms of the bank's monetary policy, exchange rate movements give us information about economic developments that may be having a direct impact on demand in the Canadian economy. And the movements themselves have their own effect on demand, by changing relative prices for Canadian goods and services and by shifting demand between domestic and foreign products.

The challenge for the bank is to evaluate these movements, together with other data, and set a course for monetary policy that works to keep demand and supply in balance and inflation on target.

When the Canadian dollar rises or falls, we try to determine how much of that movement is due to changes in world demand for our goods and services, and how much is due to other unrelated factors.

It is important that we understand the causes of exchange rate movements, because the implications for the economy — and the appropriate monetary policy response — depend on the cause of the change. We set out a fairly detailed explanation of this in our January 2005 Monetary Policy Report Update, which is included in your package.

● (1110)

[*English*]

Mr. Chair, that's a very quick look at our framework.

We can come back to any of this in the discussion, but what I want to do is apply that framework to our current situation, because I'm sure the members of the committee are well aware of the global forces affecting not just Canadian manufacturers but our entire economy and indeed the entire world.

In the past few years, we've had an extraordinarily strong global economic growth. There's also been an unusually high amount of liquidity in the global economy, which central banks are now in the process of removing.

Meanwhile, we've seen a persistent and growing current account deficit in the United States, mirrored by large and growing account surpluses elsewhere, especially Asia. These imbalances reflect the financial flows associated with mismatches of savings and investment on a global scale.

We've also seen the emergence of China and India as economic powerhouses. The strong growth of these countries and other emerging markets has led the sharply higher prices for many of the products Canada produces. At the same time, the intense competition from their manufacturers has led to lower prices for many consumer durable and semi-durable goods.

Now all of this taken together has resulted in improvement in our terms of trade and in higher incomes for Canadians in general, but particularly for producers of commodities, metal products, energy products, building materials, and machinery, to name a few.

We've also seen a rapid rise in the external value of the Canadian dollar. This gain will largely, although not entirely, effect a stronger global demand for Canadian goods and services.

Against this backdrop, Canadian manufacturers have been getting more efficient. Indeed, we've seen a tremendous rebound in manufacturing productivity. Output has increased, even while the number of jobs has been reduced.

Now this has been very difficult for many workers in the manufacturing sector who have lost jobs as a result of these changes, and it's difficult for the sector's entrepreneurs and managers. We all recognize this, but we also have to recognize that in part this reflects the fact that many firms are taking advantage of the strong Canadian dollar to invest in machinery and equipment in order to improve productivity.

These productivity gains bode well for the future. Improved efficiency helps improve our international competitiveness and our ability to withstand shocks.

Indeed, we see businesses across the country working hard to adjust to an increasingly competitive environment. We've been tracking this adjustment through our regular communication with business groups, manufacturers, and exporters, as well as through the bank's business outlook survey. You'll find a copy of our most recent business outlook survey in your package.

Our surveys have highlighted three areas that are posing problems for manufacturers: labour shortages, appreciation of the Canadian dollar, and competition from Asia. Let me say a couple of words of introduction about each.

First, our surveys have shown that the key problem for some manufacturers—such as firms in other sectors, by the way—has been a shortage of skilled labour. Despite the difficulty in attracting skilled labourers, our most recent survey shows that hiring intentions remain strong across most parts of the manufacturing sector and across all regions. Many of the workers who will be hired to alleviate labour shortages in expanding sectors of the economy are those who are going to be released from sectors that are growing less rapidly.

Second, since 2003, when the Canadian dollar began to appreciate, we regularly asked businesses how they've been adjusting to that appreciation. Roughly half of the firms surveyed say they've been adversely affected by the rise in the Canadian dollar, and those firms are largely concentrated in the sectors exposed to international trade, including manufacturing.

Finally, many firms we surveyed also said they felt the effects of increased competition from Asia, in addition to significant increases in their input cost, particularly higher energy and metals costs.

In response to these three challenges, many firms have undertaken a profound restructuring of their businesses. Indeed, some 80% of manufacturers we surveyed reported changing their operations. Many are repositioning themselves to specialize in higher value-added production. Many have abandoned at least some of their more labour-intensive mass production in favour of small lots and customized products. Many are improving the quality of the products they make, and others have transformed labour-intensive production offshore but have kept and developed their highly skilled high value-added operations here in Canada.

● (1115)

Members of the committee, let me make one last and very important point. From our discussions and our analysis of the data, it is clear that manufacturing is not a monolithic sector. There is no single strategy that will work for every manufacturer, because every business is unique. Some manufacturers face sector-specific challenges; others face booming demands and have difficulties meeting the demands. But while each business is unique, most of them are working very hard to find ways to adapt to and thrive in these challenging times.

Mr. Chairman, I hope that's been useful to set the scene. We're now looking forward to your questions.

● (1120)

The Chair: Thank you very much, Mr. Dodge, for the presentation.

We'll go right into questions. The first round is six minutes. That includes questions and answers, so I ask members to be brief in their questions and try to allow the witness at least as much time for the answers to the questions.

We'll start with Mr. Fontana, for six minutes.

Hon. Joe Fontana (London North Centre, Lib.): Thank you, Mr. Chairman.

Welcome, Mr. Dodge and Mr. Jenkins.

We have already heard, and you, Mr. Dodge, have already pointed out, what the stresses and challenges are with regard to the manufacturing sector. Let me, then, touch on or at least ask you to address three particular issues that I think have been raised already by the manufacturing sector, especially the export sector, as they relate...I think you've already talked about them. One is the dollar, the second is interest rates, and third is obviously high energy costs and how those costs have impacted on their costs of operation.

The government has given the Bank of Canada a mandate not only to stabilize prices and control inflation, but also, as we know, so far it has done an admirable job of keeping it under 3%. But I'm not sure the same can be said with regard to the Canadian dollar, which obviously manufacturers and exporters have already indicated has seen a 30% rise in three years—10% per year. It's not so much the value of the dollar as it is the steep incline that has caused them some irreparable problems, including some incredible losses of jobs already, and in fact it may also cause some additional ones.

Let me ask you to address the dollar, which is their number one concern, second, interest rates, and third, those competitive factors or the tax environment that they feel is important. I'll ask you a question as an example. On the GST, as part of the last budget, was that the most useful way of increasing productivity and building a competitive economy? Your views on that would be much appreciated.

With regard to the high dollar and interest rates, how does a rapidly rising Canadian dollar factor into the Bank of Canada's interest rate decision-making process? Would a slower rise in the Canadian dollar, managed by the Bank of Canada, not avoid many of the layoffs and the plant closures in the manufacturing sector and therefore give us an opportunity to adjust to these increases? And what actions has the Bank of Canada taken to date to stem or slow the rise of the Canadian dollar?

Secondly, with regard to interest rates, there is no doubt—

The Chair: You have put six questions and—

Hon. Joe Fontana: So far it's only been a minute and a half, and I have all the confidence in the world that Mr. Dodge will be able to answer my questions in thirty seconds.

Let me start with those: dollar, interest rates, and taxes.

Mr. David Dodge: Let me start with interest rates, because that's what we directly influence.

As you are aware, we have interest rates across the whole spectrum of the yield curve at almost historic lows. Indeed, we haven't seen rates this low since the 1950s. In part, those low rates are facilitating adjustments in the economy. You have to go back to the mid-fifties, to 1956-57, to see rates as low as we have. We have those low rates because we focused—and Canadians are confident that we focused—to hold inflation down so that we don't have an inflation premium. We also have rates that are at historic lows relative to rates in the United States.

So our rates as such, even though we've been raising them recently to take some of the excess liquidity out of the system, are extraordinarily low.

Let me turn now to the dollar. Because we have what we call “negative spreads”, or rates below U.S. rates, what we can do in setting interest rates to influence the dollar...to the extent that we can do that, of course, we are having an influence to hold that down a little bit. As I said, there are historically wide spreads in the negative direction at the moment.

Our analysis would indicate that most of the appreciation since the beginning of 2003 is being driven by changes in the real economy, both globally and domestically. We've had very sharply rising prices for metals and for energy. As you know, with Canada being a significant exporter of metals and energy, we have seen a very significant improvement in our terms of trade. That's good news, because collectively we're richer, but part of the adjustment to that means that the exchange rate appreciates.

That is actually appropriate in the sense that it's doing some of the work to balance demand and supply in our economy, but it is also signalling changes in relative prices. Of course, it's the change in the relative prices that is making it difficult for the manufacturers. Heaped on top of that, of course, is the thing that every OECD economy is experiencing, and that is the hugely increased competition coming largely, but not exclusively, from Asia. So it's not an easy time for manufacturers in making that adjustment.

It's certainly true that it would be easier for all of us if the appreciation of energy prices and the appreciation of metals prices had been rather slower and the appreciation of the Canadian dollar had been rather slower as a consequence.

● (1125)

Hon. Joe Fontana: Or owed new taxes.

Mr. David Dodge: I don't want to tread on the Minister of Finance's territory. The one thing I would point out, however, is that the structure of the GST, being a value-added tax, is actually a good structure as far as the manufacturing sector is concerned. It would actually be very helpful in the province of Ontario if the structure of the Ontario sales tax was the same as the structure of the federal one. It would be very helpful for the manufacturing sector because it would relieve the sector of a number of taxes on its inputs.

Hon. Joe Fontana: Thank you.

The Chair: Thanks very much, Mr. Fontana.

We'll go to Mr. Crête.

[*Translation*]

Mr. Paul Crête (Montmagny—L'Islet—Kamouraska—Rivière-du-Loup, BQ): Thank you, Mr. Chair.

First, I want to tell you that the reports you produce are excellent. I like working with a document like this one.

You said that the dollar rose more quickly than expected. It's more the speed of this rise, rather than the rise itself, which causes problems.

Could you explain why the increase occurred?

Mr. David Dodge: From early 2003 till late 2005, roughly speaking, the key factor was the increase in the price of natural gas, oil and base metals.

Mr. Paul Crête: And gas?

Mr. David Dodge: That's a domestic price. Here, in Canada, we don't have the capacity to produce enough gas to meet the demand. Black gold is the real problem. Prices escalated very quickly because overall demand has been very strong since 2003.

Those are the major factors, but the demand in the United States in the housing and household products sectors was also extremely strong. Global pressure, therefore, pushed up demand for Canadian products. It is important that the dollar adjust accordingly. The problem is that there have been four price adjustments for metals in three years.

● (1130)

Mr. Paul Crête: You referred to 2003 through 2005. Was this acceleration sustained after 2005?

Mr. David Dodge: After 2005, and especially over the past four to six weeks, there has been quite an extraordinary level of volatility in global financial and commodities markets.

Paul.

Mr. Paul Jenkins (Senior Deputy Governor, Bank of Canada): I would simply like to add that the global economy, since 2003, has experienced a period of growth without precedent in the post-World War II era. In the past four years the growth rate of the global economy was above 4 per cent, and it is likely this level will be sustained both this year and the next. The global environment is extraordinary, as is global demand, which is reflected in the increase in commodities prices.

Mr. Paul Crête: Isn't the fact that Canada's economy is two-tiered dangerous? For 2004-2005, in Quebec and Ontario, employment dropped by 10 and 11 per cent. And yet, these two provinces represent 75 p. 100 of Canada's manufacturing output. Isn't there currently a danger that Canada's economy might almost break in two and that we will end up with what I'd call the energy economy which benefits Western Canada more, and the manufacturing sector? You saw the forestry industry's demonstration; they were not crazy about your last hike. Isn't this dangerous? How are you dealing with it?

Mr. David Dodge: It has caused real problems. It is hard to adjust very quickly to fairly brutal changes in relative prices. It is extremely difficult, and it is extraordinarily challenging.

Mr. Paul Crête: So it is basically a two-tiered economy.

Mr. David Dodge: One needs to be careful. In the manufacturing sector, for example, there are some subsectors working at full capacity, which have trouble keeping up with demand. I am referring especially to the processing sectors: steel, all metals, machinery, etc. For producers of consumer goods, especially semi-durable goods, it is a lot harder.

Mr. Paul Crête: In your opinion, is monetary policy an important tool in dealing with this? Should the government use other instruments to meet the demands of the manufacturing sectors as far as increasing their competitiveness is concerned?

Mr. David Dodge: After a fairly difficult period in the 70s and 80s, we've learned that it is important to have an economy that is as flexible as possible. It is important for all governments, both provincial and federal, and for all regulatory boards to promote flexibility and labour mobility so that workers can hold different positions and to ensure that there are infrastructures fostering this flexibility. It is by no means simple, but the key is to have this level of flexibility because one can never foresee everything which may occur in the future.

● (1135)

Mr. Paul Crête: What tools should the government...

The Chair: Mr. Crête, this will be your last question.

Mr. Paul Crête: What tools should a government provide to enhance the economy's flexibility? Right now, we have a train going full steam ahead in the energy sector, while other people have trouble keeping up. This morning's bicycle example was very relevant. What tools would you like to see the government use more of to increase flexibility?

Mr. David Dodge: That is a very tough question.

Mr. Paul Crête: I know you are capable of answering tough questions.

Mr. David Dodge: I will begin with three points. First, we must not prevent the economy from adapting. It is extremely important to avoid preventing adjustments.

Second, there have been problems for a long time with the availability of skilled labour and the mobility of skilled labour between sectors and between Canada's provinces and regions. This is also extremely important because ultimately the key to our success will be our labour's ability to add value to what we are producing.

Third, our financial markets must be efficient in order to foster investment in key sectors, including public infrastructure.

Mr. Paul Crête: To be able to tell the forestry sector...

The Chair: Mr. Crête.

Mr. Paul Crête: ...that you'll stop?

[*English*]

The Chair: You're over nine minutes, Monsieur Crête.

Mr. Paul Crête: Nine?

[*Translation*]

Time goes by quickly with you.

[*English*]

The Chair: I have Mr. Carrie, and then I have Mr. Masse, but I assume that's Mr. Martin after Mr. Carrie.

Mr. Carrie.

Mr. Colin Carrie (Oshawa, CPC): I'd like to ask one quick question, and then I know Mr. Van Kesteren would like to ask a question as well.

The Chair: No. We're not going to split questions any more, Mr. Carrie.

Mr. Colin Carrie: We're not going to do that? All right.

Thank you very much, Mr. Dodge, for coming here today. As the member of Parliament for Oshawa, I'd like to present an example of what the bigger manufacturers are facing now. There's been an unprecedented increase in the Canadian dollar, 30% over the last couple of years. We export cars, and most of that goes to the United States, and along with the higher costs of energy...it just seems that everything's happening so fast.

So here is my question. Is there anything specific that the Bank of Canada can do to slow that rise of the Canadian dollar? I know you can't do everything, but is there something you might be able to do to mitigate those enormous factors that are causing the difficulty for our manufacturing sector?

Mr. David Dodge: Well, as I said before, we have only one tool and that is the setting of the overnight interest rate, and we've been doing that in such a way as to keep Canadian rates right across the curve. It's very important that it's not just the overnight rate, but it's right out to 10 years and even to 30 years.

We've kept reducing our rates relative to the United States over this very difficult period of adjustment, and we really started in 2004 to be very careful in that regard, but that is the only tool we have to operate with.

Mr. Colin Carrie: Do you think it's realistic for Canadian manufacturers to be able to compete and to become more productive? It just seems like the perfect storm for Canadian manufacturers. It troubles me. I realize we can't stop progress, but if there's something else you might be able to suggest by changing policy, that we might be able to help things out or slow down the bumps.... Do you have any ideas?

● (1140)

Mr. David Dodge: Let me say one word and then I'll turn to Paul to talk about....

We have folks out there in the field who are talking to manufacturers and producers all the time.

Let me make what I think is a very important point. Compared to our rigidity and lack of adjustment in the seventies and eighties, as we faced rather similar problems with big changes in relative prices, compared to that, this economy has matured enormously. Canadian producers and Canadian workers today are making adjustments we would have thought absolutely impossible 20 years ago. They are more flexible. They are more energetic. They are making the adjustments, and compared to other countries in the world, we're making adjustments very rapidly, however difficult it is.

So I don't think we should have the impression that somehow everybody just can't do it. I continue to be enormously impressed with the flexibility of Canadian firms and Canadian workers to deal with the situation. We're talking to folks all the time.

Paul, why don't you say a couple of words?

Mr. Paul Jenkins: Yes, very quickly. This is a document that's included in what we've handed out. Our regional offices go out and talk to companies on a regular basis in terms of not only how they see the outlook, but also how they're adapting to the sorts of global pressures you've identified.

Certainly, one area that stands out is a response in terms of increasing their investment in machinery and equipment to increase productivity and regain some of that competitiveness you're talking about, in response to the appreciation of the Canadian dollar.

There are many other factors as well. Increasingly, firms and manufacturers are looking at using financial hedging as an instrument to provide some offset to exchange rate movements.

As well, you're also seeing companies beginning to look to other markets. I think this is an important point: exchange rates don't move in isolation with what is going on in the world. As we noted in response to an earlier question, the global economy has been expanding at an extraordinarily rapid rate over the last four years—quite unprecedented—and that rate of growth is expected to continue. Markets are expanding very rapidly, so what we're also seeing from the manufacturing base in Canada is looking to these markets as a future source for sales.

So it's a very complex and difficult set of issues, as you've identified, for the firms and workers in these areas. We are seeing these individuals, these firms, responding to these global developments.

The Chair: Thank you, Mr. Carrie.

We have Mr. Martin for six minutes.

Mr. Tony Martin (Sault Ste. Marie, NDP): Thank you very much.

I wanted to ask you a question or two about the resource-based economy, which my neck of the woods, northern Ontario, and the north in general, is immersed in. It's experiencing some real challenges at the moment. I think they're trying as best they can to adjust. I know that in terms of the labour market, a number of the unions up our way have actually taken a reduction in wages in order to help the company adapt. There's a paper mill in the Soo where the union agreed to a 20% reduction until the company could get back on its feet.

I've met with a couple of the leaders in the steel industry and they talk about energy prices and the impact this has had, and I heard you mention that, but they also talk about the dollar. Given that they both import, in some instances, raw materials to produce what they make, and at the same time have to sell back into the United States, the dollar is having a pretty negative effect on their ability to be successful. One of the gentlemen suggested that an 80¢ dollar would be ideal. We've seen it go up and down. Is there anything we could do to situate ourselves more competitively on that front?

● (1145)

Mr. David Dodge: No. That's the short answer: no. The dollar is going to move around, and indeed it's sending signals as it moves around. The volatility is hard to deal with, but it is sending signals that are generally appropriate. As we look at what's been going on, the movement in the dollar largely, though not entirely, has reflected changes in demand for Canadian products.

You mentioned the forestry industry, and they face three sets of problems. One, you've got all the new production from the tropical softwood coming on, so the amount of global capacity to produce pulp and paper has been growing quite rapidly, and those trees grow very fast. So there are real pressures, just as in the consumer goods sector there are real competitive pressures coming from places like Brazil and Indonesia, and so on, on the product.

Second, as you pointed out, the mills tend to be in communities where there are not a lot of other things going on, so when a mill closes down there are few, if any, opportunities for the workers in that community, although there may be tremendous opportunities elsewhere. So there's a huge adjustment problem that is not faced, for example, in a place like Oshawa, where people can get on the 401, clogged as it is, and go 30 or 40 kilometres for another job. The adjustment in northern communities is a much more difficult problem, and we clearly recognize that.

Finally, it is also true that generally speaking our mills tend to be old. We have not made as much investment through the seventies and eighties as we really should have, and now there's a huge challenge to try to get up to date. So it is an enormous challenge, because it is—somebody used the words—a perfect storm.

Mr. Tony Martin: I wanted to follow up on the whole issue of productivity. I mentioned that in our area workers are giving up.... We've had two restructurings of Algoma Steel, and in each of those instances the workers and the community gave up significantly in order to save that industry.

The studies we see coming out now are talking about people working more for less. There's now a growing class of working poor in the country. What impact is that going to have on the productivity of our industries and the willingness of our people to come to work and work as hard as they possibly can if they're consistently getting less wages and actually falling below the poverty line in many instances? It's actually in the thousands. There's a study that came out of Toronto this week that indicates that the growing number of the working poor is becoming a huge issue.

Mr. David Dodge: I'm not the most competent person to comment on that.

In aggregate, of course, what we are finally experiencing is an increase in real wages of workers. It's been a long time coming. We went through an extraordinarily difficult adjustment period in the 1990s, but we are now seeing real wage increases, which is good. We have actually been a bit surprised that we haven't had real wages increase a little more from 2003-04 onwards.

I'm not very competent, I'm sorry, to talk about the issue.

● (1150)

Mr. Tony Martin: To be parochial for a minute, in my own town there was a study done over the last couple of years that indicated there are now 12,000 working families living in poverty. It wasn't nearly that five or ten years ago. So it's a growing phenomenon.

The other issue I wanted to raise with you, because I think you spoke to it on another occasion, is our ability to compete. There's nobody who will deny that our health care system is something that gives us an advantage. We're on the cusp of a new national child care program that some of us feel is going to give us a bit of a competitive advantage in terms of allowing more people to get into the workforce and having them feel more comfortable because their kids are being looked after. Child care is always a huge challenge.

The Chair: Mr. Martin, if we could just have a question....

Mr. Tony Martin: Is that something you'd like to expand on? Are those kinds of programs something that should or could be factored into our ability to be competitive?

The Chair: Mr. Dodge.

Mr. David Dodge: I guess all I'd say is that our strength—to take Dofasco's old line—is always going to be our people. Training and development of people is absolutely critical. It's critical, of course, to the individuals, but it's critical to the health of our firms. The importance of training and development comes up absolutely front and centre every time we're out in the field talking to firms.

The Chair: We have Mr. McTeague to start the second round, for five minutes.

Hon. Dan McTeague (Pickering—Scarborough East, Lib.): Governor, thanks for being here today.

It's good to hear the comments you've made. More than anything else, I think my wife and many others in Canada keep wondering how we made adjustments for a 2% increase in interest rates over the past couple of years. It's to that question that I'd like to canvass some thoughts from you, as to the relationship of the U.S. current account deficit, which you alluded to a little earlier, and its impacts, not just on the Canadian dollar, but, more importantly, for manufacturing and for Canadian consumers.

I note comments you have here suggesting that crude oil will be in the area of $70 U.S. I was relieved to read that. It certainly goes against some of the commentary that's been made by speculators in the industry and various brokerage houses over the past couple of days. British thermal units at $10 U.S. per million, of course, is a reflection of the fact that although the level of supply is still there, if you look at a five-year average, demand and supply, with some exceptions, is static. We see European demand is dropping.

We know there is a certain degree of supply available to meet the world...save and except for the issue of speculation. One thing that seems out of the control of parliamentarians, and perhaps the control of Canadians in general, is the issue of the U.S. current account deficit and its impacts on those two bottom lines for manufacturing. I was wondering if you could shed some light on that.

Mr. David Dodge: Paul has done a lot of work on this, so let me ask him.

Hon. Dan McTeague: Thank you.

Mr. Paul Jenkins: Okay, let me start off on that exact point.

The U.S. current account deficit is in the order of 6% to 7% of U. S. GDP. Of course, that's a situation each year. So with each year of deficit, the U.S. is adding to its level of indebtedness to the rest of the world, and that level of indebtedness is now substantially larger than it was 10 years ago.

Fundamentally, what that current account deficit in the United States is telling you is that the U.S. economy is consuming more than they're producing. They're importing a lot of goods and services, and to finance that they're drawing on savings from the rest of the world.

A large part of those savings are coming from Asia. We've talked publicly, and we've certainly talked privately, about this situation. A good part of that surplus in Asia you see in China, but not exclusively in China. This is really a story for most of Asia, in fact. Japan continues to run a large current account surplus as well. More recently, with the increase in energy prices, you're seeing a run-up in current account surpluses of the oil-exporting countries.

This is a complicated story. Fundamentally, to rebalance these imbalances, as we call them, this current account deficit in the United States, in an orderly fashion is going to take two or three things coming together, and we're seeing signs that this is in fact happening.

First of all, you need savings in the United States to rise to help reduce that level of consumption and therefore bring down their current account deficit. But you also need to see, at the same time, demand elsewhere in the world, particularly domestic demand, beginning to pick up. We are seeing clear signs of that in Japan. There's reason to believe some of that is happening in China as well.

The third element that we deem to be important here is this issue of exchange rates and the importance of having more flexibility in those, because movements in exchange rates—we call it relative price movements—help to bring about this change in behaviour that I've just been talking about.

So this is a very important issue for Canada. We are a small, open economy. How these imbalances get resolved will be critical for us, and we've been talking about it quite openly as well in the international forum that we meet in.

● (1155)

Hon. Dan McTeague: I take it that there will be no interest rate increases for the foreseeable future.

Mr. Paul Jenkins: That was certainly no comment on the monetary policy going forward.

Hon. Dan McTeague: I understand.

Finally, if I could just change gears a little bit, Mr. Dodge, you appeared before Humber College last year and you talked about the issue of education, and in particular, as your remarks were entitled, “Canada's Competitiveness: The Importance of Investing in Skills”.

You said:

> We need a system of incentives for continuous learning and upgrading of skills, and an infrastructure that delivers the training. This has always been important. But, as I mentioned earlier, it will be particularly important in the next two decades, as labour force growth in Canada slows.

Clearly, the budget offering $80 for textbooks doesn't seem to meet the mark. What do you believe we ought to be doing in that regard, in terms of encouraging substantive change in the way we're looking at that?

In the same speech you talked about early childhood development, the need to build an excellent infrastructure, feeding it into a school system that effectively teaches basic skills.

The current scenario of the government does not in fact go down that road. It removes us from that very important precept. How are you going to be able to square your comments with the direction of this current Conservative government, which seems to be moving in a 180-degree different direction?

Mr. David Dodge: First, let's be very clear. Most of the specific tools that governments have are tools that are in the provincial domain. We have a few federally, but most of it is in the provincial domain in terms of government.

In terms of employers, and this is really quite important, we have collectively in Canada, and I think it's true virtually in every province, not put as much emphasis on continuing upgrading and provision of skills to the labour force as we should have. We relied heavily in the past on immigration in a way that we will not be able to rely to the same extent in the future. And certainly in what you might call the skilled trades, whether industrial or construction, we have a labour force that is now relatively old, and I don't think one can ask people engaged in some of that very heavy work to extend their working lives to 70 in the way some of us are privileged to be able to do.

There's an obligation, not only on governments but on employers as well, to work very hard at this. It's something that is an age-old problem, and we recognize it when labour markets get tight. Then we somehow collectively have amnesia when the economy gets a little softer.

So one of the most important questions is, how can we operate through the rather softer periods, which is precisely the time when the real cost to the economy of doing the training is the lowest? That is what we need to sit down and agree on now, at a time when everybody's sensitivity to this issue is heightened, and not wait until we have some slowdown and people say it's all taken care of.

I think there is a responsibility on the industry committee as well as on the social policy committees here, because this is absolutely crucial for the future health of Canadian industry, whether it be the manufacturing sector, the resource sector, or the service sector.

● (1200)

Hon. Dan McTeague: Thank you.

Thank you, Mr. Chair.

The Chair: Thank you, Mr. McTeague, Mr. Dodge.

We have about six minutes. You have until about 12:10 p.m., do you, Mr. Dodge?

Mr. David Dodge: Yes, we need to be out of here by 12:15 p.m., I think, Mr. Chairman.

The Chair: We also have a second witness for the second meeting and we have four members on the list. So we have six or seven minutes between four members. If we could have members go very quickly and have the responses be just as quick, we'll try to get through everyone.

Mr. Van Kesteren.

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

I have a very simple question. I want to go back to our national debt, which stands at about $486 billion, and to service that debt, $31 billion. I would like you to address that. What are the implications, and are we on the right target? The way I understand it, it must be debt to equity ratio, where we want to get to about 25% or something. I think that's the stated government goal. Is that something that's safe, or are we headed toward disaster with that high debt?

Then quickly, if you could, touch on the fact that the American debt is so much more than that, and should they ever come to a situation where.... Are we going to see spiralling inflation?

Mr. David Dodge: Certainly, the Government of Canada and the governments of most provinces have, since the early nineties, been on a track to try to deal with this. Indeed, Canada kind of stands out among the OECD community as having done a pretty good job on the fiscal side. "Having done" doesn't mean we can relax going forward, because as we work that debt service charge down over time, what it does is it allows us to deal with some of the costs of an aging society without having to raise taxes to deal with it.

I think it's fair to say the governments in Canada have done a good job, but we can't relax. We are in a particularly buoyant period at the moment, where national income is growing very rapidly. We've had the great advantage of this improvement in our terms of trade. So this is actually a time when all levels of government ought to be looking toward staying the course, and indeed improving on the course of getting that debt down.

Mr. Dave Van Kesteren: As the second part of that question, what about the Americans? Should we see, as some are predicting, some instability because of their—

Mr. David Dodge: The Americans have a big longer-run problem. They have a short-run problem that I won't really comment on, which they haven't dealt with very well, but they have a huge long-run problem.

First, there's their social security system. We basically dealt with ours in 1996 with the reform of the CPP, and we have a structure of.... The RRSP system is interesting, because of course by providing the deduction up front, we also get the revenues in the 2020s, when we're going to need them. So that side we have dealt with rather well. The Americans have a big problem and have to come to grips with it.

Their problem on the health side is even more severe. They spend roughly the same fraction of GDP publicly on health as we do, but most of it is for the medicare system for the elderly. Of course, the elderly are a very rapidly growing part of the system. While we face a problem in clubs, they face it in no trump on that front.

So they have a long-term structural problem that is very severe, and the longer they wait to deal with it, the more difficult it's going to be. Of course, that poses worries for us, because it could mean a period of rather slow growth in U.S. domestic demand as they come to deal with this in the future.

● (1205)

The Chair: Thank you, Mr. Van Kesteren.

Monsieur Vincent.

[*Translation*]

Mr. Robert Vincent (Shefford, BQ): Mr. Dodge, eight components were excluded from the calculations measuring inflation and the increase in value of the Canadian dollar: fruits and vegetables, gas, fuel-oil, natural gas, mortgage interest and the urban rate, and tobacco. Yet counterfeit products, which are now in Canada, and cheap foreign labour are also factors.

Were those two factors also excluded from calculations dealing with the dollar increase and inflation? How can Canadian manufacturers realistically manage the sharp rise in oil prices, the increase in energy costs and the overall 30 per cent appreciation of the Canadian dollar, in so little time?

Mr. David Dodge: It would be hard to give you a brief answer. This will also require considerable energy.

Mr. Robert Vincent: Take your time.

Mr. David Dodge: I would like to correct you on the connection between our benchmark, the core CPI, and the eight excluded products. The core CPI is simply a guide that tells us what the inflation trend will be, because the total CPI fluctuates according to fluctuations in those eight products and services. The core CPI is useful as an indicator of what the future holds but our benchmark is the total CPI, not the core CPI.

Your second question is very complex and I hand it over to my colleague.

Mr. Paul Jenkins: I'll speak briefly to two points. There are clearly problems but the increase of energy prices is calculated in American dollars. The increase in Canadian dollars is therefore not as high because of the appreciation of the Canadian dollar. That's a rather significant point.

Second, in terms of the ability of the manufacturing sector to react, as I mentioned, it's important to react by investing in machinery and equipment, in order to increase productivity and flexibility.

Mr. Robert Vincent: If businesses are not making a profit, how can they increase productivity and buy new equipment?

Mr. David Dodge: It is true that profits are not very high for some sub-sectors. The situation is a very difficult one, especially in the clothing, textile, furniture and pulp and paper sectors. There are enormous variations in the manufacturing sector. There are businesses that are making enough of a profit, not a huge profit, but enough to invest. Others are having problems.

Mr. Robert Vincent: There must be a connection with the increase in oil prices. Your table indicates that since July 12, 2005, there were seven increases of . 25 of a point, in the months of September, October, December, 2005 and January, March, April, and May, 2006. There must be a connection between these increases and costs.

Mr. David Dodge: That is a problem for businesses everywhere. It's difficult for manufacturing sectors because energy constitutes a major part of their costs, but the situation is the same around the world.

● (1210)

Mr. Robert Vincent: However, salaries are not the same around the world.

Mr. David Dodge: No.

Mr. Robert Vincent: You can't compare us to...

Mr. David Dodge: No, that's true.

[*English*]

The Chair: At this point I'd like to thank the witnesses, Mr. Dodge and Mr. Jenkins, for being with us today. Their information was very insightful. We appreciate that very much.

We are going to formally adjourn the meeting, officially end this meeting, and then we will reconvene for the next witness, Mr. Orr.

Mr. Jenkins and Mr. Dodge, thank you very much for being with us today.

Mr. David Dodge: Thank you, Mr. Chairman.

The Chair: The meeting is adjourned.

Published under the authority of the Speaker of the House of Commons

Publié en conformité de l'autorité du Président de la Chambre des communes

Also available on the Parliament of Canada Web Site at the following address:
Aussi disponible sur le site Web du Parlement du Canada à l'adresse suivante :
http://www.parl.gc.ca
