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Chair

Mr. James Rajotte

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● (1535)

[*English*]

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

Good afternoon, ladies and gentlemen. It's a pleasure to be here today to welcome, pursuant to Standing Order 108(2) and our study on the report of the Bank of Canada on monetary policy, our witnesses today, the Governor of the Bank of Canada, Mr. Mark Carney—welcome, Mr. Carney—and the senior deputy governor, Mr. Tiff Macklem.

Thank you for being with us here, gentlemen. If I could just indulge you for two minutes, we have a couple of housekeeping items to deal with.

We have a motion by Mr. Mai. Also, we should welcome back to our committee Ms. Nash and Mr. Marston, *et bienvenue à M. Caron au Comité permanent des finances.* Welcome to the committee.

Mr. Mai, you have a motion to move very quickly, please.

[*Translation*]

Mr. Hoang Mai (Brossard—La Prairie, NDP): I will quickly read the motion:

That the Standing Committee on Finance resume its study on tax evasion, that the evidence and documentation received by the committee during the third session of the 40th Parliament on the subject be taken into consideration by the committee in this session, that the committee further examine international tax planning in order to ascertain emerging best practices in foreign jurisdictions, and that the committee make recommendations to the Government of Canada to combat tax evasion and the use of tax havens.

Mr. Chair, I believe you will find unanimous consent for this motion.

[*English*]

The Chair: Okay.

Very briefly, I'll recognize Ms. McLeod, please.

Mrs. Cathy McLeod (Kamloops—Thompson—Cariboo, CPC): Thank you. I'll just speak briefly.

Certainly we will be pleased to support the motion. It's always good to finish work. I appreciate the opposition indicating it will not repeat a lot of the work that had been done in the past, and we'll pick up. So again, we're pleased to support this important motion.

The Chair: Thank you.

All in favour?

Mr. Brison, you want to speak to this.

Hon. Scott Brison (Kings—Hants, Lib.): Mr. Chair, we support this motion. We think it actually builds on some of the work the committee has done in the past. It's an important opportunity to evaluate best practices.

I think some of our work internationally in terms of cooperation with other governments makes this a particularly important area of public policy, where we can address this constructively and in a non-partisan way. So I support Mr. Mai's motion as well.

The Chair: Thank you, Mr. Brison.

(Motion agreed to)

The Chair: I see that being unanimous. Thank you very much, colleagues.

Mr. Carney, Mr. Macklem, thank you so much for being with us. As you know, we have this session twice a year with you, and committee members appreciate it very much.

Mr. Carney, I believe you have an opening statement and then you'll have questions from members. Please begin your opening statement.

Mr. Mark Carney (Governor of the Bank of Canada): Thank you very much, Chair.

Good afternoon, members. Tiff and I are very pleased to be with you today to discuss our April monetary policy report, which the bank published last week. In it we note that the profile for global growth has improved since the bank released its January MPR. Europe is expected to emerge slowly from recession in the second half of this year, although the risks around this outlook remain high.

[*Translation*]

The profile for U.S. growth is slightly stronger. This reflects the balance of somewhat improved labour markets, financial conditions and confidence on the one hand, and emerging fiscal consolidation and ongoing household deleveraging on the other. Economic activity in emerging market economies is expected to moderate to a still-robust pace over the projection horizon, supported by an easing of macroeconomic policies.

[*English*]

Commodity prices remain elevated owing to improved global economic prospects, supply disruptions, and geopolitical risk. In particular, the international price of oil has risen further and is now considerably higher than that received by Canadian producers. If sustained, these oil price developments could dampen the improvement in economic momentum.

Overall, economic momentum in Canada is slightly firmer than the bank had anticipated in January. The external headwinds facing Canada have abated somewhat, with the U.S. recovery more resilient and financial conditions more supportive than previously anticipated. As a result, business confidence and household confidence are improving faster than forecast. The bank projects that private domestic demand will account for almost all of Canada's economic growth over the projection horizon.

In particular, household spending is expected to remain high relative to GDP as households add to their debt burden, which remains the single biggest domestic risk. Business investment is projected to remain robust, reflecting solid balance sheets, very favourable credit conditions, continuing strong terms of trade, and heightened competitive pressures.

The contribution of government spending to growth is expected to be quite modest over the projection horizon, in line with recent federal and provincial budgets. The recovery in net exports is likely to remain weak in light of modest external demand and ongoing competitiveness challenges, including the persistent strength of the Canadian dollar.

The bank projects that the economy will grow by 2.4% in both 2012 and 2013 before moderating to 2.2% in 2014. The degree of economic slack has been somewhat smaller than anticipated, and the economy is now expected to return to full capacity in the first half of 2013.

As a result of this reduced slack and higher gasoline prices, the profile for inflation is expected to be somewhat firmer. After moderating this quarter, both total and core inflation are expected to be around 2% over the balance of the projection horizon as the economy reaches its production potential, the growth of labour compensation remains moderate, and inflation expectations stay well anchored.

[*Translation*]

Despite recent improvements to the outlook for the global and Canadian economies, risks remain elevated. The three main upside risks to inflation in Canada relate to the possibility of higher-than-expected oil prices, stronger-than-expected growth in the U.S. economy and stronger momentum in Canadian household spending.

The two main downside risks to inflation in Canada relate to the reintensification of sovereign debt and banking concerns in Europe, and the possibility that growth in Canadian household spending could be weaker than projected.

Overall, the bank judges that the risks to the inflation outlook in Canada are roughly balanced over the projection period.

● (1540)

[*English*]

Reflecting all of these factors, on the April 17 the bank maintained the target for the overnight rate at 1%. In light of the reduced slack in the economy and firmer underlying inflation, some modest withdrawal of the present considerable monetary policy stimulus may become appropriate, consistent with achieving the 2% inflation target over the medium term. The timing and degree of any such withdrawal will be weighed carefully against domestic and global economic developments.

With that, Mr. Chair, Tiff and I will be pleased to take members' questions.

The Chair: Thank you, Mr. Carney, for your presentation.

We'll begin members' questions with Ms. Nash, please.

Ms. Peggy Nash (Parkdale—High Park, NDP): Thank you very much.

Welcome. It's good to see you again.

You say in the report that one of the biggest challenges we're facing in Canada is the level of household debt or personal debt, and these debt levels are unsustainably high, especially with the likelihood of interest rates eventually rising. With these record levels of household debt, and persistent borrowing in spite of the economic conditions, what are the real risks that Canadian households face, and what are the risks to the Canadian economy?

Mr. Mark Carney: Thank you.

Just as one point of clarification, if I may, we didn't say that the levels of household debt are unsustainably high. We were talking about a dynamic in one of the technical boxes of a steady increase in home equity lines of credit. That's an unsustainable dynamic over time that is going to reach a new equilibrium and move from there.

But I think the thrust of your question is on point, which is that this is the biggest single domestic risk to the Canadian economy: the level of household debt and associated developments in the housing market. We have highlighted in the report that this is the major risk to the downside.

I would observe as well that the pace of accumulation of household debt has slowed over the course of the last two years. It has gone from running at a rate of about 9% or 10% per year to present figures, which are around 4% per year.

We think that is in part due to measures that have been taken, not least by the Superintendent of Financial Institutions, to tighten home equity line of credit underwriting standards to increase the capital standards for Canadian banks faster than they are being increased internationally, and in part due to measures that have been taken by the government on three separate occasions to tighten the mortgage insurance rules managed by CMHC, which helps reduce high-ratio mortgages.

But the point, we think, is that Canadians need to continue to be prudent in this environment—interest rates are exceptionally low—when taking on long-term debt, such as for mortgage rates, which are not always going to be this low. Indeed, in our projection we foresee the possibility of some withdrawal of this monetary stimulus over the course of the projection period. So in taking on new debt, Canadians need to think about the carrying cost of that debt over the lifetime of the loan or the mortgage, size it appropriately, and decide between the terms—fixed or variable—appropriately.

I will note as a final point that what we've also seen in recent months is that the proportion of variable rate debt on new debt that's being taken on—new mortgages that have been taken on—has gone down quite substantially and is running in the low teens at present.

Ms. Peggy Nash: So people are locking in.

Mr. Mark Carney: New debt is locking in. The question is whether existing debt is similarly doing the same. Yes.

Ms. Peggy Nash: So there are individual measures that people will take and will try to take. Are there further measures that the government can take? I guess I'm wondering, in the context of an era of government restraint and decreasing public investment, what impact you think that will have on the level of household debt. Are there further measures that the federal government can take to reduce household debt?

Mr. Mark Carney: I assure the member that authorities—the bank, the superintendent, CMHC, and the Government of Canada—are cooperating closely and monitoring the situation. As I referred to in my earlier remarks, a number of measures have been taken, both by the superintendent and by the government. We have a heightened vigilance with the underwriting practices of the banks, so on the supply side there's a variety of measures that have been taken and are resulting in the slowing of the accumulation.

There's always more that could potentially be done, but with these measures there has to be an element of prudence in balancing the pace of the slowing of this phenomenon with the underlying growth of the economy. Now, the housing sector is an important part of the economy; it's not the most important part of the economy. Our focus is on ensuring that this is a sustainable development in the housing sector going forward.

The combination of measures that have been taken, and a clear-eyed perspective of Canadians—which I think they have—that we are in exceptional circumstances in terms of interest rates and we won't always be in those exceptional circumstances, will do much to manage the issue.

● (1545)

The Chair: Thank you.

Thank you, Ms. Nash.

We'll go to Ms. McLeod, please.

Mrs. Cathy McLeod: Thank you, Mr. Chair.

Certainly it is always a pleasure to have you here and to get the updates.

When the budget was recently released I looked at the 2009 budget, and at that time, of course, we were heading into a global recession and were looking at stimulus spending. It was certainly indicated we were going to have short-term stimulus spending. In two years, the 2009 budget was saying, we were going to get back to a balanced budget. I think it was looking at 2014-15.

In essence, when I looked at the most recent budget it looked as if we had been following the plan in a pretty effective manner. Certainly I recognize there have been lots of storms and buffeting along the way and lots of changes in the forecast. So I'm really pleased to see that you're looking at the improvement and also the revision and expectations for real GDP growth in 2012 to 2.4% holding steady.

Certainly there are people who have said we need to continue with deficit spending. So at this point could you talk about the importance of a balanced budget and what the results for Canada and other western countries will be if they don't address their fiscal imbalances and continue to engage in a prolonged period of deficit spending without moving toward balanced budgets?

Could you perhaps look at how Canada is doing and where we're going and also talk briefly about some of the other countries in the G-8, in terms of how effectively they're moving back toward their targets?

Mr. Mark Carney: We meet today in an environment where there is certainly enhanced scrutiny by investors on the fiscal positions of all governments: federal, provincial, advanced economy or emerging markets. A premium is placed on fiscal sustainability. That means credible paths back to a budget balance level that is consistent with a sustainable level of debt. Depending on the starting point that can be a balanced budget, it can be a surplus, or it can be a small deficit. It depends on the initial stock of debt and the underlying strength of the economy.

So there is no question that sovereign risk is bearing heightened scrutiny by investors and that a variety of governments around the world, particularly in the advanced economies and across the G-7, are challenged with getting this right and getting the balance of the path of *l'assainissement budgétaire*, the consolidation of deficits, on the right path. I would note that one of the challenges that face some of the major European economies that are most in the sights of the markets is that there is the challenge of the pace of growth of expansion of nominal GDP, which has a pro-cyclical impact on efforts to reduce deficits and makes it even more challenging for them. One needs to look through to the underlying measures that are taken.

That said, to put Canada in context, Canada is in a leading position within the G-7 in terms of our combined government finances. If you look on a net debt-to-GDP ratio, it's lower than all other G-7 countries. Our deficit path is second to Germany. Given the underlying growth of the economy and measures that have been taken at all levels of government, federal and provincial, there is a strong sense of confidence in markets that is evidenced in our spreads on our bonds to other international bonds, on our spreads on credit default swaps, a strong level of confidence in the credibility of those plans.

● (1550)

The Chair: Thank you, Ms. McLeod.

Mr. Brison, please.

Hon. Scott Brison: I would like to thank the governor and deputy governor for being with us. I want to commend them for their continued important work during difficult times and also to commend the governor for his work globally as chair of the Financial Stability Board.

Governor, back in October you said that you found some elements of the occupy movement protests entirely constructive. You said in an interview that you acknowledged the movement is an understandable product of an increase of inequality, starting with globalization and then made worse by the financial crisis. You said, “You've had a big increase in the ratio of CEO earnings to workers on the shop floor and then on top of that, a financial crisis”.

How important an issue do you believe income inequality is for Canada?

Mr. Mark Carney: Thank you for the question.

First a couple of points of context. Income inequality in Canada has increased, as it has for all OECD countries, over the course of the last two decades. That said, Canada is in sort of the middle tier as measured in the degree of income inequality. There are quite substantial differences between income inequality in Canada before tax-and-transfer and income inequality after tax-and-transfer. It reduces it quite a bit. The Gini coefficient is something like 0.32 for the former, 0.26 for the latter.

That said, as you referenced in your question, there are some big forces that are feeding inequality globally. It starts with trade, which brings tremendous opportunity as well but pushes inequality. Technology and the ability to use technology.... What we're seeing across the OECD, and also very much in Canada, is that the returns to education are much higher.

So is this a big issue? Yes, it's an issue, because it's pointing to differential realizations, if you will, of the opportunities that are being created in the global economy. And if I may, that sort of leads to potentially the approach that can be taken and has been taken in the past here, which is to create greater equality of opportunity in this country.

Hon. Scott Brison: Should Parliament study and address the issue of income inequality?

Mr. Mark Carney: That's obviously a question for the committee to consider.

What I would underscore is that the forces behind this phenomenon affect all major economies. They are longer-term forces, not short-term cyclical forces. Understanding those, and designing policies that address them constructively, is a challenge that all major advanced economies face. So I'd leave it to you to decide.

From the Bank of Canada's perspective, let me say two things, if I have time, Chair. Our single biggest contribution to this issue is to meet our inflation-targeting mandate, because the one thing we know from hard experience is that inflation and inflation volatility hit the worst-off in our society the most. Others can hedge themselves.

The second thing I'll say, which is from an equality or fairness perspective—and you've referenced that quote.... One of the points I was trying to make in my comments, and maybe made poorly, was that one of the issues of fairness is whether the financial sector is special versus every other sector of the economy. In other words, if you have a family farm, crop prices are down, and you have a bad harvest, what things happen? If you have a small business or if you have a big business and you make a series of mistakes, or things move against you, or international competition, you fail. If you have a large financial institution.... What we learned during the financial crisis is that you have to be rescued. And those were legitimate decisions made in economies outside Canada; we didn't have to take these decisions.

But that should change. And a large part—not all of it, but a large part—of the agenda on financial reform, both globally and here in Canada, is to end “too big to fail”, which brings back a true element, in our opinion, of fairness to the system and addresses some of these issues.

● (1555)

The Chair: You have ten seconds.

Hon. Scott Brison: Okay.

TD Bank estimates that the housing market is overvalued by 10% to 15%. Craig Alexander is saying that it could have a significant impact with a correction. Have you done a study on overvaluation? What would be the percentage—

The Chair: I guess that's a yes-or-no answer, Mr. Carney.

Mr. Mark Carney: Not publicly.

Voices: Oh, oh!

The Chair: Okay. Thank you.

Thank you, Mr. Brison.

We'll go to Mr. Hoback, please.

Mr. Randy Hoback (Prince Albert, CPC): Thank you, Chair.

Governor Carney, it's great to have you here today.

Governor Carney, before I get started, I just want to compliment you on how you go about doing your role. The way you go about doing your job actually instills confidence in Canadians and in Canadian businesses. I think the way you and the finance minister have conducted yourselves over this last series of troubling years has been very reassuring. I think Canadian consumers and Canadian businesses thank you for the work you've done there.

One thing I would like to talk to you about is trade. You made a speech in Kitchener last week and you talked about the emerging markets and how important they are to Canadians. Of course this government has been out and about very actively pursuing trade agreements. Whether it's Minister Fast or Minister Ritz or Minister Ablonczy, or even the Prime Minister, it seems like every break week we have in Ottawa they're out and about around the globe, trying to open up new markets for Canadian businesses. Can you explain to this committee just how important these emerging markets are?

I'll just quote what you said in Kitchener, because it kind of sums it up, I think, pretty good:

> Emerging markets represent the greater opportunity for Canadian exporters. Since the recession, these economies have accounted for roughly two-thirds of global economic growth and one-half of the growth in global imports....This is where Canadian businesses must increasingly look for export growth.

How important is getting into these new markets and these emerging markets, and what would be the consequences if we did not get into these markets?

Mr. Mark Carney: First, thank you for reading my speech. It puts you in very select company, I must say. And thank you for the question, because you're absolutely right, in our opinion this is a critical issue and a critical economic challenge for Canada.

To provide a bit more context here, as noted in that speech, 85% of our exports go to slow-growing advanced economies. So it's not just the United States that is having its issues and working through its issues. But the broader set of export markets for Canada tend to be concentrated in slow-growth advanced economies, and only about 8% of our exports currently go to the faster-growing emerging markets. So there's a real opportunity, and that's one of the reasons.

That composition, in our opinion, and as our analysis indicates, is the principal reason why our share of global trade has gone down from 4.5% of global trade to about 2.5% of global trade over the course of the last decade.

Even though the dollar and competitiveness get attention, and it is part of the answer, the real issue is market structure. Where do we have market access, and to what extent are we focused on it?

The opportunities are considerable, in our opinion, and they extend well beyond the primary sector of our economy. In the resource sector, those opportunities are obvious and considerable, but it moves into manufacturing. The way supply chains have been reorganized, there are new opportunities. They move into a broad area that we would call sort of resource productivity: how you build building efficiency, power plant efficiency, clean tech, and others.

Eighty-five percent of these opportunities are in emerging markets. Some of it is Canadian know-how that can be applied. Managing data, managing other aspects, capturing more of the value-added from the resource side, again, are a huge opportunity for Canadian business.

When we look at where the Canadian economy is going, I think we have managed quite well through a very difficult time, as you indicated. But as Ms. Nash's opening question alluded to, one of the risks is that in managing through that process, household debt has gone up, and it's a process that cannot go on forever. We need a rotation of demand. It's not going to come to, I think, Cathy's question. It's not going to come from government. It has to come from business, and it has to come from exports.

Business is picking up now in terms of investment building productivity, but in building those export opportunities, whether it's Colombia or Asian markets, this aggressive trade strategy that is being pursued is consistent, in our opinion, with what needs to be done. We're not going to endorse, obviously, specific initiatives, but the broad thrust of this points to both a challenge and an opportunity for the Canadian economy.

● (1600)

Mr. Randy Hoback: Actually you tied into something about the investment of Canadian businesses that is going on right now. One of the things we've heard in this committee is that we have great research going on here in Canada, but there seems to be a slowness in adapting that research into commercialization. Can you give us some insight into what we should be doing there to create that incentive for businesses to commercialize a lot of this research?

The Chair: Please give a brief response, and then we can return to it later in another round.

Mr. Tiff Macklem (Senior Deputy Governor, Bank of Canada): Sure, I'll give a brief response.

First of all, you've hit on a valid point. We have a fairly high level of public support for R and D. Where we don't do as well is in terms of private R and D and particularly the commercialization.

There is something of a puzzle there. It's not just that the private innovation is low, but translating that into measured productivity and actual increasing output per worker has been disappointing. We are seeing some improvement in productivity, but we have had a decade of weak productivity.

The Chair: Thank you, Mr. Hoback.

We'll go to Mr. Marston, please.

Mr. Wayne Marston (Hamilton East—Stoney Creek, NDP): Thank you, Mr. Chair.

Welcome again.

I'm going to muse over a couple of things before I get into the actual questions. You'll note the difference between ourselves and the government side. We had felt, in the situation we just went through with the interest rates as low as you referred to earlier in your presentation, that there was about $500 billion of capital on the business side kind of waiting, fearful of another bank credit crunch, and that it might have been a good time for the government to do some infrastructure work because of low interest rates.

Regarding your comments about going from 9% to 4% on credit cards, the last time you were before us you cautioned about the household debt. I'm concerned that perhaps to some degree that's card debt actually being maxed out, as opposed to people withdrawing.

I want to pick up on Mr. Brison's question. He was talking about the housing bubble. Are we in a housing bubble? If we are, relative to household debt, where does it fit in the equation? Is there something the government can do to shelter Canadians from this bubble, from the potential harm they face?

Mr. Mark Carney: Thank you for the question.

I wouldn't use that term. With respect to the level of house prices, I would note that there are local markets in housing. I'm going to come back to that.

Overall, the level of house price valuations across Canada is about four and three quarters times income. The historic average is about three and a half times income. That gives you a sense of the extent to which house prices have moved.

What's different now from the historic averages is obviously the overall level of interest rates. It's not just the overnight rate of the Bank of Canada, but it's five-year rates and ten-year rates, which are influenced by us but also influenced by global interest rates. I mean, the ten-year U.S. government rate is less than 2%, and that certainly has implications for the Canadian ten-year rate as well.

As I think we're all aware, mortgage rates are extremely attractive, and that accounts for some of the move up in valuation. The point we've tried to make is that you can't rely on those rates staying there forever, so an individual should size their debt appropriately.

The level of housing activity, particularly the level of condo activity in some metropolitan areas, is quite high. In fact it's reaching in Toronto to levels last seen in the late 1980s, even adjusted for population. We have some concerns over those developments.

The second thing is that even within that national average there are higher levels of valuation, by a variety of metrics. We don't just look at one metric. There are some firmer valuations in some metropolitan areas as well. There are cases where valuations are firm, shall we say, and there's probably more downside risk than upside risk to the future evolution of prices. That's an environment that warrants caution.

I'll go back to my earlier answer—I don't want to use up all of your time—and a variety of steps that have been taken that have slowed the overall pace of not just credit card debt but the overall pace of debt accumulation of households. It's slowed some of the developments in the housing market.

I think what we're reinforcing is that the interest rate environment is exceptional, and exceptions eventually come to an end.

● (1605)

Mr. Wayne Marston: I want to go back for a second to the household debt and my comment a moment ago as to whether or not a fairly large portion of the population have perhaps maxed out their credit cards. I spend quite a bit of time in food courts and Tim Hortons listening to people and talking to them about what's going on in their lives. One of the things they're starting to say is that they feel maxed out.

I thought I'd toss that back to you, as much for information as anything.

Mr. Mark Carney: You're right. We're aware of this challenge. There are different segments of the population. There's a large segment of the population who carry some debt for which it is not a problem, but there is a higher proportion of what we would call vulnerable Canadians than there have been in the past.

The way we measure it is to look at what happens to their ability to service their debt today, but also going forward when interest rates go to more normal levels—and we publish some of these simulations —and one gets to levels of one in twelve Canadians. There are a lot of Canadians in food courts and Tim Hortons and around the country who are prospectively in that situation.

The message is one of prudence and caution, if you are in that situation. We are still in exceptional times.

There are still things that can be done. I would underscore that the Bank of Canada's core mandate is to achieve the 2% inflation target with respect to monetary policy. We have noted that given the state of the economy and the amount of slack from our underlying inflation, it may become appropriate to withdraw some of the considerable monetary policy stimulus. Any such decision would be taken with care and careful consideration of domestic and global risks.

There are a few clear messages there for Canadians.

The Chair: Thank you.

Thank you, Mr. Marston.

We'll go to Mr. Adler, please.

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

Thank you, Mr. Carney and Mr. Macklem, for being here today.

Our government has acted very responsibly to ensure that our social programs are going to be there for our citizens when they need them. So I want to take a look down the demographic tunnel, if you will. That light that we see, which is getting brighter, is not the end of the tunnel but a freight train heading towards us. All level-headed people can't ignore the empirical evidence that our population is aging, and that there are going to be fewer and fewer workers to sustain the people who are going to be 65 years and over, as we move forward.

When the Old Age Security Act was brought in, in 1952, there were roughly nine workers for every one who was in retirement. In the seventies that went to seven to one; today it's four to one; and twenty years from now it will be two to one. Life expectancy has gone up. Our birth rate has gone down. We have taken, I think, a very prudent approach when it comes to the sustainability of our old age security system.

I'll just put my question out and you can take all the necessary time you need to answer. I just want to quote Deputy Governor Boivin, who spoke to the very august Economic Club of Canada just a few weeks ago. He identified three points of pressure resulting from our aging population. He said:

> A smaller fraction of the population will be working and contributing to public revenues, and more people will be depending on their pensions, either public or private, to maintain their standard of living. Further, citizens require increased health care as they grow older, which will also place pressure on the public purse —fewer resources, more demand.

Could you please comment on all of that?

● (1610)

Mr. Mark Carney: Thank you.

That was the august Deputy Governor Boivin at the Economic Club.... No, I'll get the adjective in the right place.

This is a serious issue, as you know, which is why this committee and others have spent time on it. I think you personally have spent time on it.

Without question, this sharp shift in demographics is coming. In fact, even over the tail end of the horizon of our projection we see the impact, in that one of the big contributors to Canadian growth in the decade in the run-up to the crisis was the expansion of labour input, to use the economic term—basically, the proportion of the population that was working, and how much they were working. Part of that was a couple of very positive demographic phenomena. The economy was putting people to work, more Canadians were working, more women were entering the labour force, people were working for a longer time, and also we had the demographics at our backs.

Now that's shifting, and that is one of the reasons why our rate of potential growth in this economy has shifted down from about 3% in the early part of the last decade to about 2%. In fact, right now our estimate of potential growth for the economy in 2012 is 2%, and 2.1% in 2013 because of the lower labour input that's happening, which reflects demographics. As you alluded to in your remarks, and as Jean Boivin referred to, that is going to accelerate over time.

The offset to that can only be an increase in productivity, the productivity of those who are working. I shouldn't say that it can only be. There are some elements of people working longer, ideally by choice and not by circumstance. We do see some evidence of that. We continue to see, in fact in the employment performance since the trough of the recession, that employment of Canadians aged 55 years and up has actually been one of the stronger bits of employment growth that we've seen—again, more people working longer, ideally by choice.

This is a major issue, without question. Slower potential growth of the economy because of demographics will impact all forms of government revenue at all levels of government. This will occasion difficult choices that only you or the collective people in this House are empowered and qualified to make, those judgments about balancing off where the savings need to be with respect to productivity, other fiscal choices, inequality, and other concerns that you have to balance.

So you're absolutely right that it's a major issue. We've provided some simulations. We can do more if that's of use for the committee.

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

Monsieur Caron.

[*Translation*]

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

I want to go back to what Mr. Hoback said. He talked about the importance, for Canadian businesses, of being able to gain a foothold in emerging markets. Based on what I can see, we are facing a parallel problem that is almost as serious, meaning weak productivity. Over the past 10 or 12 years, Canada has been trailing the pack in terms of productivity.

Do you feel that the lagging productivity and weak growth we see not only in the United States, but also in all OECD countries, could be an obstacle that would make us look like non-contenders compared to our economic rivals?

Mr. Mark Carney: That is another good question. You are quite right. Weak productivity in Canada is decreasing our potential growth rate, the wealth of Canadians and both federal and provincial budgetary revenues. The question is knowing how to increase the growth rate for each sector in Canada. One very important aspect is our trade policy, particularly with regard to emerging markets. New markets allow our companies to increase their revenue margins. This constitutes increased productivity. Our companies can achieve economies of scale.

This must be accompanied by other marketing initiatives, ones that have a ripple effect, as well as research and development. The bank believes that R & D initiatives need to be pursued in the primary and university sectors, and by government. Finally, the level of domestic competition has long been an issue in Canada. If we can increase domestic competition, companies will increase their productivity. We feel this is also essential.

● (1615)

Mr. Guy Caron: Your report discusses commodity prices, including oil, naturally. Higher oil prices in particular, combined with more intense Canadian oil extraction, resulted in—

[*English*]

over-reliance or more reliance on the oil and gas sector and slower growth and a decline in some other sectors. I won't say “de-industrialization”.

[*Translation*]

Could this trend be accelerated in the other sectors? If no corrections are brought to bear on the price of oil and natural resources, what sectors, aside from the natural resource sectors, could be helped or hindered by this fluctuating price?

Mr. Mark Carney: You have asked another important question and perhaps we may have more time to discuss it another time.

According to the bank, we are going through a period where commodity prices will remain high for a long time, this being caused primarily by the transformation of emerging countries. There will be some volatility, but commodity prices will remain high for a long time. Given these circumstances, clearly it is better to have natural resources. In addition, we need to adjust the economy. We need to develop products sustainably and derive the most added value that we can from the production of natural resources.

[*English*]

I can give a quick example. For the oil sands, one out of twelve suppliers in the upstream comes from Ontario, and you've actually seen an intra-Canada increase of about 40% in exports from Ontario to Alberta in that example. There's a lot more that can be done, and we should.... If we have a chance and if members want, we can return.

The Chair: Thank you.

If I have time I will return to that question and the question on commercialization. I know you wanted to address that further.

We will go now to Mr. Van Kesteren, please.

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

Thank you for coming, Mr. Carney and Mr. Macklem. I would like to mirror what has been said as well. I think you've been doing a really fine job. I think a lot of the stability we have in this country is a result of the work you've done. The confidence Canadians feel, the public's confidence, is probably as important as anything else.

We talked a little bit about resources. As a nation, we are richly blessed with natural resources, and having those is a significant driver. You've said that too, Mr. Carney, that those have had a profound effect on our economy, especially the oil sands.

One of the issues I hear about and I think all of us hear about in our ridings is the high dollar. There are those who claim—and we know this—that the dollar oftentimes mirrors the rising price of oil. There are those who claim that Canada's currency is nothing but a petrodollar.

Mr. Carney, you did say—I want to quote you—last week in a report:

> It is far too simplistic to talk about [Canada's] dollar as a commodity currency, let alone a currency that moves consistent with one commodity. This is a much more diverse, complex economy than that, and this is one manifestation of it.

I wonder if you could tell the committee what other factors or complexities help determine our exchange rate.

● (1620)

Mr. Mark Carney: Thank you.

It's an important question. That's absolutely right. Let me start by acknowledging that because we are blessed, as you said, with immense natural resources, the prices of our energy exports and our base metals and other agricultural exports are all important factors, but they are only one set of factors that determine over time the fundamental value of the currency. If you look, for example, on the commodity side, if you look at the oil side, the correlation between the level of the Canadian dollar and the oil price has moved quite a bit over the course of the last ten years, from 0.8 or 0.9 to 0.5 if you measure on a WTI basis right now. That's the first point.

The second point I'd like to underscore is on something we highlighted in detail in the report. That is, that what matters a lot is what Canadian exporters actually receive for their oil. And as Brian and you know, we're currently in the situation, in part because of infrastructure challenges, where the price for western Canadian select is actually substantially discounted from the price you normally hear in the morning when you turn on the radio and they say the price of oil has gone up to, let's say, $120 or thereabouts. They're normally quoting the price of oil in the North Sea, because that's the most liquid internationally traded currency. We've reached a level in the last couple of weeks where our producers have been receiving $40 less than that. So even within oil itself there's a big difference. It's not as simplistic as analysts sometimes try to represent it as being. That's the second point.

I think your broader question is about the other drivers of currencies. I think we should all acknowledge that at any given moment, who knows? Currencies are driven by a range of things as the markets move, but in the fullness of time, the sustainability of the fiscal position is a determinant. The strength of the financial system is a determinant. The trade balance—the current account balance and the sustainability of that—is a determinant. Issues around risk—whether they relate to domestic debt, household debt—can be determinants from time to time, and the underlying competitive position of an economy is a determinant as well.

There are other factors, but if you run through that list, we score pretty well on most of them. But we do have issues. We have issues in terms of competitiveness. Our unit labour costs have gone up 65% against the United States, 80% against all our trading partners since 2000, so that's a real issue. Our current account is in a fairly large deficit at the moment. We have issues around household debt, as we've discussed. So our balance sheet is strong, but it's not perfect, and we always have things to work on.

Of course all of this is determined in an environment of relatives. The Canadian dollar moves in part because of what happens here, but also what happens elsewhere. Clearly, as with virtually every currency in the world but even more so for us, what really matters externally is what's happening in the United States and the relative performance there.

The Chair: Unless you have a very brief question....

Mr. Dave Van Kesteren: Okay, I'll pass.

The Chair: Thank you, Mr. Van Kesteren.

Monsieur Mai.

[*Translation*]

Mr. Hoang Mai: Thank you, Mr. Chair.

I would like to use my time to ask Mr. Carney to complete his reply to the question asked by my colleague, Mr. Caron.

Mr. Mark Carney: As regards this situation, to a certain extent, we can sum it all up with the issue of Dutch disease. Several people have already spoken about this issue.

First of all, I think that everyone would agree that natural resources have given Canada some excellent opportunities. Secondly, we must recognize that having a weaker currency does not comprise a plan, it is a hope.

● (1625)

[*English*]

I should be careful, and say this in English. To have a strategy that relies on a weak currency—not that you're advocating it—is not wise. It's not wise for businesses or for public authorities. There are a variety of factors that will determine where the currency is. In an environment where safety, fiscal soundness, resources, and sound financial systems are valued, as they are at present, all those factors will support the currency.

The third thing to say is that there are tremendous opportunities for this economy—some of them are being realized, but more can be realized—to capture more of the value-added from our resource sector.

Fourth, there are tremendous opportunities to export knowledge around resource productivity, as I referenced earlier. We can make our economy much more productive in its use of resources, in its energy efficiency, across a range of areas. That is a tremendous gain for this economy from a productivity perspective, but it's also a tremendous export: productivity.

Fifth, not to simplify, but in our opinion there is a symbiotic relationship that comes from engagement with these major emerging markets that opens up other opportunities across a range of consumer goods—cultural exports, management of digital commerce, mass customization, and other true export opportunities—that would also reverberate back positively on our economy.

[*Translation*]

That being said, to some extent, your colleague's question focused on this idea of an adjustment. Yes, the Canadian economy will go through an adjustment. We have already seen the manufacturing sector proportion of Canadian GDP drop by 20 percentage points. Currently, this percentage is standing at 12.5.

Mr. Hoang Mai: When you were discussing natural resources and sustainable development, you stated that sustainable development was necessary. Could you explain the advantages of sustainable development to the Canadian economy?

Mr. Mark Carney: As I just explained, the advantages would be increased productivity in resource utilization. This is an immediate and direct benefit here, in Canada. This is also an opportunity for the export

[*English*]

of this skill and the products associated with it.

[*Translation*]

Nearly 85% of all resource market opportunities are found in the emerging countries. This is a huge export opportunity.

The Chair: Thank you, Mr. Mai.

[*English*]

We'll go to Mr. Jean, please.

Mr. Brian Jean (Fort McMurray—Athabasca, CPC): Thank you, Mr. Chair.

Thank you for attending today.

I've had to change my questions, because you kept answering them. That's the advantage of being last, I suppose.

You mentioned that there's no real silver bullet in relation to this major threat to the economy. There are a number of things that can be done in relation to household debt. In particular, there is, of course, reducing indebtedness, not taking on new debt, and locking in long-term or short-term loans and mortgages, etc., right now. There is also, of course, as you mentioned, productivity and growing personal income.

I want to talk about two particular things I think would benefit our economy—both personal economy and the economy in general. The first is the impact on the Canadian economy of the natural resources sector, and not just the site-specific impact. Some people say, for instance, that the only people benefiting from the oil sands are northern Albertans. I live in Fort McMurray, but I don't know many people, of the 130,000 people who live there, from northern Alberta.

The second thing, of course, is labour mobility. They are tied together. Of course that's how in our country we can be very quick in a recovery, because we have so many opportunities.

I'm going to use two examples. The first is the Northern Gateway. You mentioned that we're selling our crude right now for $40 less than we could get in the market if we actually had more pipeline capacity. That was the infrastructure you talked about. In that particular case, even though the oil is from the Fort McMurray area, the reality is that the proposal in place is to build and maintain a pipeline that goes into northern British Columbia and to profit-share with the aboriginals whose land it goes through.

There is also the tax base. I think somewhere in the neighbourhood of $5 billion a year currently comes from the oil sands, for instance. I've looked at some of the numbers. Currently governments are receiving somewhere around $5 billion a year. Based on the expected growth, my gross estimate would put it somewhere around $20 billion per year by 2035, based on projections, by the American government, of somewhere in the neighbourhood of 4.3 million barrels a day.

In the speech in Kitchener—Waterloo you said that one out of twelve oil sands manufacturers and suppliers are from Ontario,

> ...and Ontario's exports to Alberta of mining-related services grew 44 per cent in the last year measured. The opportunity to capture more of the value added in commodity production from energy to agriculture remains a tremendous opportunity for all of Canada.

Now, in that statement, which I agree with wholeheartedly, were you speaking in particular of the opportunities for growth in the oil sands, the growth in getting the value added, and the growth from making sure that we get fair market value and don't have just one customer, as we have in the United States?

● (1630)

Mr. Mark Carney: All of the above, and even more, if I may. What I was trying to do in that speech was address some of the broader implications and the broader opportunities Canada has on the export side through the diversification of trade.

Let me go to the core of your question.

If we look at the resource sector as a whole, it's a little more than 5% of employment. In the country, it's about 45% of the exports of the country at present. And it is about 11% of GDP. All those figures have gone up in the course of the last several years, as you would expect.

As members will well appreciate, the resource sector in Canada is much larger than just the energy complex. It includes, importantly, metals and mining. We look to the scale of opportunities that exist across the country, notably in northern Quebec and Labrador, and that are currently being developed. They are resulting in considerable additional investment and should result in considerable investment for some time.

You mentioned labour mobility. About a third of the interprovincial mobility has been into Alberta and Newfoundland, even though the combined population of those two provinces is about an eighth of the Canadian population. You see it in Fort McMurray. One sees it in Newfoundland. It's not just Newfoundland going to Fort McMurray any more. It's people from across the country going in both directions, given the scale. That is the strength of the Canadian economy. These are difficult decisions—to move—for people to make.

Mr. Brian Jean: I have 30 seconds left, and the chair is very strict.

So you see a real correlation, and possible success and an acceleration of Canada's success, through encouraging labour mobility into these areas that have potential needs to exploit the natural resources.

Mr. Mark Carney: It's part of the adjustment. But as you referenced in your initial remarks, other mechanisms spread the returns across the country, including through other revenues of the federal government that come from these resource developments and through upstream suppliers and potentially through infrastructure, which isn't necessarily just export-oriented infrastructure but could be pan-Canadian infrastructure as well.

Mr. Brian Jean: Thank you very much.

The Chair: Thank you, Mr. Jean.

We will now go to Ms. Glover, please.

Mrs. Shelly Glover (Saint Boniface, CPC): Thank you, Mr. Chair.

There's been a shuffle since we left for our break. I want to welcome our new members back to committee. We did have a very good working relationship with both Ms. Nash and Mr. Marston.

[*Translation*]

Mr. Caron, welcome. This will be most pleasant.

[*English*]

Governor Carney and Deputy Governor Macklem, I want to ask you two questions. I'll give you a heads-up as to what they're going to be: I'm going to ask you about the penny and then I'm going to turn to the IMF reforms.

Governor, you and I seem to have this tradition of always talking about our currency when we get together. The reason I want to ask you about the penny is that the penny is made in St. Boniface, which is my riding back home in Winnipeg. As you know, budget 2012 is looking to eliminate the penny. But some have said that they have some concerns that the rounding mechanism may lead to having some kind of inflationary effect. I do know that the bank produced a report in 2005 that demonstrated that the inflationary impact of eliminating the penny would be small or relatively non-existent. So I'd ask you to comment on the study that was made, particularly with respect to the offsetting effects of the rounding.

● (1635)

Mr. Mark Carney: Yes, we share a numismatic obsession, I guess, is the point. It's a pretty small club, but we're there.

The first thing in terms of the study is we can provide that to the committee, if it's of interest. We provided the core conclusions of it to the Senate committee that studied this issue a few years ago. Deputy Governor Duguay presented it.

There is experience, and I will get to that in a second, but the first thing to recognize on the issue of rounding is the penny question should only be a question for cash transactions. That's when you use pennies, leave them, or pick them up.

Of course it matters how many items you get. We all think of the $1.99 price. Are they going to round up to $2 or down to $1.95? It matters how many items you buy at the time you're at the till, and where they round up to at that point. They don't necessarily round up to 0.99.

So first, it's only cash, and second, it's how many you get. Third, it's post-tax, as well—sales tax and GST vary by province. The fact is if you're using electronic payment there's no need to make this rounding decision.

The important point as well is that there is experience here. There's experience in New Zealand and Australia. In the case of New Zealand there's the elimination of the one-cent, two-cent, and the nickel. The experience is that there is no discernible.... There are rounding rules. People round down when it's appropriate and they round up when it's appropriate. The fact is that with competition retailers are held accountable, and they know how to serve their customers. So experience shows that it's not inflationary. This deals with a much smaller subset of transactions than one initially thinks.

And the last point, which is not where we would start on this, is it's a penny: we're talking about a penny move. In terms of the overall level of inflation, it is quite modest.

Even all of that said, the experience has been that you get both up and down as appropriate. It's relatively small in terms of the overall transaction, and there's no discernible effect. That is our perspective on what will happen with the elimination of the penny here.

Mrs. Shelly Glover: I appreciate that. Hopefully it will reassure those who have concerns.

On the IMF reforms, as you heard recently, our finance minister was in Washington for G-20 meetings and talked a great deal about the IMF's response to the European debt crisis. Specifically, our minister questioned the troika system that is being applied by the IMF in Europe, whereby the agency jointly monitors aid to European countries with the European Union and the European Central Bank.

As Minister Flaherty noted—and I'm going to quote him—“That's not the traditional way the IMF operates. Traditionally, the IMF would direct what needed to be done.”

Could you explore more fully the concerns raised by Canada and explain why the IMF should perhaps re-examine its quest to find sustainable solutions in this crisis?

The Chair: About 30 seconds are left in this round, so we may have to return to this as well. If we could have a brief answer, then we'll return to it.

Mr. Mark Carney: Yes, I'll answer very quickly and then maybe we should return.

This is an unusual situation. It grows out of the fact that European authorities are providing, in the program countries—Ireland, Portugal, and Greece—about two thirds of the funds, and one third is coming from the IMF. The minister has raised the issue whether this is appropriate going forward if there were to be other programs. What we succeeded in having underscored is that this is a concern shared by a number of countries. What was clear in the communiqué of the G-20, and understood around the table, is that there should be strict IMF-level conditionality for any new programs, an IMF standard conditionality for any new programs. Now, how exactly that is constructed was not detailed. But it's important to ensure that any potential future IMF lending continues to be done to the high standards of the fund.

● (1640)

The Chair: Okay, thank you.

We'll go to Ms. Nash, please.

Ms. Peggy Nash: Thank you.

I'll continue on the issue of Europe and the sovereign debt crisis for some European countries. Obviously with measures that are being taken, there's going to be reduced spending, and the differential between what banks now have to keep on hand as a security measure versus what they lend will have an impact on economic growth. This will obviously have an impact globally and some impact on Canada.

Given this ongoing debt crisis—and there have been a number of measures taken—what is the potential impact on Canada? What would the impact be if a major country, such as Spain, defaulted on its debt?

Mr. Mark Carney: The situation in Europe remains challenging, without question. We welcome the measures that European authorities have taken to improve economic governance, to put in place a fiscal compact, the major structural reforms that have been taken and are agreed and are beginning to be implemented in Italy and Spain particularly. We welcome also the moneys that Europeans have put into the so-called firewall through various measures, and that firewall potentially augmented, subject to the last discussion, by the resources in the IMF.

All of that, from our perspective, suggests that the situation in Europe, as difficult as it is, remains contained. And over the course of our projection, our expectation or assumption is that the situation will remain contained. Now, unfortunately, if you're European, if you're living in Spain or Italy, containment vis-à-vis Canada isn't going to feel that nice. A severe recession has begun in those countries. We see Europe only weakly coming out of recession later this year. The risks are still there, and there are risks around the eventual resolution of this, because fundamentally this is not just a fiscal challenge, not just a banking challenge. In fact, our view is that those situations are more a manifestation of a fundamental balance-of-payments problem that exists within the European monetary union.

What's the potential impact on Canada? In an environment of containment, where Europe is having a recession—mild growth, but not spillovers, because of potentially the example you used.... I'm not endorsing that example, but one can think of scenarios that would have spillovers across financial markets. We're not expecting that in the course of our projection. If that were to be the case, through both the financial channel—things tighten up in financial markets across a range of financial markets—and through the confidence channel, where businesses and Canadians would adjust because of uncertainty, it would be a material impact on our projection. It would have a potential to adjust, certainly, the outlook for activity growth in Canada and potentially the outlook for inflation, all other things being equal in Canada, which would potentially have an impact on the path of monetary policy in this country.

The last thing I'll say is just to assure the committee that we are engaged with European authorities, with authorities of the IMF, with my fellow central bank colleagues virtually on a daily basis on this issue and are as well informed as anybody about the potential evolution here.

Ms. Peggy Nash: I have one quick supplementary question on the IMF European firewall. Canada has so far declined to provide any money to that firewall. Can you briefly describe the pros and cons of Canada deciding to add to that firewall?

Mr. Mark Carney: This is a decision of the Government of Canada, not the Bank of Canada, as you can appreciate. One of the major issues was highlighted by the previous question, and that is the structure of conditionality—the way money has been dispersed and potentially will be dispersed in future programs. We're concerned about getting the governance right and having the governance of potential future programs be more consistent with previous lending. That's the first point.

The second point is on having a firewall developed out of Europe, where they have immense resources, or developed in conjunction with the IMF or others. The value of this is that the process of adjustment in a number of European economies to solve the underlying balance of payments and fiscal and banking issues will take some time. It will be measured in years, not weeks, weekends, or months. Over the course of that time it is possible that access to markets will not be there, or won't be there on sustainable terms, and there will be a need to draw on these resources. So having sufficient resources to address that possibility is advisable. That's the main argument in favour.

The argument against is partially around governance and resources provided from Europe. Ultimately it's a Government of Canada decision.

The last point is that this all has to be looked at in the context of current resources of the IMF. Are they adequate for potential eventualities? Judgments can be made around that as well.

● (1645)

The Chair: Thank you.

Thank you, Ms. Nash.

I'm going to take the next slot, as the chair. It's challenging, because there are a lot of big questions and a lot of issues we'd like to raise with you.

Governor Carney, perhaps I'll raise a couple of issues. Then there's a third section I want to get your particular response to today.

The first one is on page 29, where you talk about ongoing competitiveness challenges. If you went back ten years and made a list of the things the Government of Canada should do to address productivity or competitiveness, I'd say we have probably fulfilled nine or ten out of the ten—both this government and the past government. In fact many of those changes were made when the two of you were at the Department of Finance, so you're well aware of them. It is a big policy question in terms of how we address the competitiveness issue. So if you have anything further on that, either today or at a later date, I'd certainly appreciate that.

On the second item, in response to Ms. McLeod you talked about the federal government's approach to debt. I wonder if you have any comments about the debt situations of any provinces, particularly the two large provinces of Ontario and Quebec.

The third area is banking sector reforms, and this is the area I'd like you to spend most of your time on. The president of the CBA gave a speech recently in which he said we should perhaps look at pausing on future reforms. I want to get your remarks on the consequences of implementing the Volcker rule, and any comments you may have on the regulation of the shadow banking sector, in your role as governor and also in terms of the Financial Stability Board.

Mr. Mark Carney: Okay, let me—

The Chair: Those are just a few small items for you.

Mr. Mark Carney: Yes, a few small items. I'll do two and three and then pass to Mr. Macklem for the first one, although we may need to come back.

Just as it is for governments in Europe, the United States government, and the Canadian federal government, it's important that all our provinces are on sustainable fiscal paths. We note the efforts of our two largest provinces to accomplish that. The lesson we've all learned over the years has been that it's important to have a path, it's important to have a plan, it's important to over-perform relative to that plan over time, and credibility is built with performance, as opposed to announcements.

There have been tough decisions that have been taken in those jurisdictions, and it's not really appropriate, obviously, for us to comment in detail, aside from the overall. It is important for the continued health of the Canadian economy that these provinces continue to make progress consistent with the fiscal paths they have outlined over the course of the last several years, and we welcome the progress they have made.

With respect to number three, on financial reforms, let me break it into three parts. First, we entirely disagree with the comments of the president of the Canadian Bankers Association. I gave an answer to this shortly after it came out. It was a good thing we didn't press pause when the financial crisis was on, didn't press pause in providing liquidity to the Canadian banks. It's a good thing the government didn't press pause when they were providing extraordinary liquidity, when we were engineering a restructuring of the non-bank asset-backed commercial paper that ended up preserving tens of billions of dollars of value for individuals, for our major pension funds, for governments across this country.

The crisis revealed deep deficiencies in the structure of the global financial system. Some of those deficiencies were shared here in Canada, fewer here than elsewhere. But we're resolute and I think the government is resolute and the Superintendent of Financial Institutions is resolute as well to ensure that we methodically and quickly address those.

● (1650)

The Chair: I've got about one minute left.

Mr. Mark Carney: Now to Volcker and shadow banking.

On Volcker, we have made our concerns known to the Secretary of the Treasury and the chairman of the Federal Reserve. Obviously we respect absolutely the sovereign right of the United States or any country to regulate their financial affairs within their country, but it's the extraterritorial impact of Volcker that concerns us. That happens from time to time. Our basic concern is the structure of the rule—and I won't go into detail—and the distinction between market-making and proprietary trading, which we don't see as a workable definition.

I'd note in passing that there were 17,000 comments on this rule, and that it recently was announced, last week in fact, that implementation would be delayed by two years as they work through these comments. And we do have faith in the U.S. system to address any deficiencies that are found there.

On shadow banking.... Are you out of time?

The Chair: I am out of time, so maybe we'll return to that at a later date.

Mr. Mark Carney: We can come back to it, because there are five main thrusts of what we're doing on shadow banking.

The Chair: Maybe Mr. Brison will ask the same question I had. Thank you.

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

Hon. Scott Brison: Given that you asked two questions I intended to ask, I would be delighted for the governor to continue on that. I have another question further on the Volcker rule, but I would actually ask the governor to continuing in answering the question on shadow banking.

Mr. Mark Carney: Okay. Well, first, for some quick context, most of the focus of regulatory reform has been on the regulated banking sector. The other half, though, of the financial system is the so-called shadow banking system. Our objective here is to turn that from something that exists in the shadows to something that has full daylight, from a pejorative term—shadow banking—to something that has a more neutral term: market-based finance. The way to do that is to address five aspects. Let me unify and comment on them.

What matters for financial system stability, for what happens outside the regulated sector, is the provision of credit where there are maturity transformations. You borrow short and lend long. It's that combination of maturity transformation and credit intermediation where you create risk that could potentially impact the whole system. With regard to the non-bank ABCP in Canada, people borrowed short, they lent long, and that's fundamentally what created the risk.

The first of the five areas we're focused on at the Financial Stability Board is the links to the regulated sector, the links to the banks, whether through back-up liquidity lines or other arrangements.

Second is how money market funds are structured, particularly in the United States. More broadly it's this structure where you have a guaranteed net asset value in a money market fund. It looks like a bank. You put your money in the fund and you have what's perceived as a guaranteed net asset value. It's upon the realization that the guarantee has no safety net, no capital underneath it, that you get a run on the money funds, which is what we saw in the U.S. There will be a report and recommendations coming out on that very shortly.

Third is issues around securitization markets.

Fourth is other shadow banking entities, which can include hedge funds, as an example. There are a variety of measures there.

Finally, and very importantly, there is the structure of what's called the repo market, the repurchase market, which is one of the core funding markets for institutions. Basically, it's asset-based short-term lending. The fact is, the way those markets operated was exposed during the crisis. Bear Stearns and Lehman showed you can have huge impacts across the system.

I would note that in Canada we've made tremendous progress in the launch of a central counter-party for repo, which is going to take out a lot of those risks.

● (1655)

Hon. Scott Brison: There have been concerns raised recently on regulation LIBOR, interbank interest rates. What are the concerns here in Canada, or should we be concerned, and is there a need to evaluate this more thoroughly?

Mr. Mark Carney: Could you just repeat...? The concerns are....

Hon. Scott Brison: LIBOR, interbank interest rates.

Mr. Mark Carney: Oh, LIBOR. Yes. We're not privy to any particular information, but as you're aware, the performance of LIBOR is a key reference rate. During the course of the crisis it did not move as much as underlying tensions in the market would have suggested it could have moved.

Hon. Scott Brison: Do you think the concerns that have been raised could be applicable here in Canada?

Mr. Mark Carney: The Competition Commissioner from the Competition Bureau of Canada is engaged in the investigation. As I said, we're not privy to any information, but it's certainly being handled in the right hands.

Hon. Scott Brison: Do you think the U.S. administration has been receptive to your concerns raised on the Volcker rule? We're coming up on...what is it, 2014 when it is due to be implemented?

Mr. Mark Carney: Yes. The way U.S. officials have to behave, and do behave, is that when they put out a rule they are entirely in receipt mode in terms of comments. Their job is to understand the comments and then decide whether they have merit and make adjustments accordingly. That's their legislative responsibility.

We're in a process where they are entirely neutral, if you will. As I said, they're in receipt mode; they're neutral.

That said, I would observe that quite a range of participants, both in the official sector and the private sector, from across a range of geographies, have pointed out some very common deficiencies in the rule as it was structured, and some major international spillovers. These are quite serious comments.

The Minister of Finance also has written to his counterpart, and so has the Superintendent of Financial Institutions. We would expect that they would take it seriously.

Hon. Scott Brison: Finally, with your concerns on the CBA president's statements, do you fear that if we push the pause button there would be a risk of what you call backsliding?

Mr. Mark Carney: Pause is normally a euphemism for rewind.

Hon. Scott Brison: For rewind. Okay.

The Chair: Thank you.

Thank you, Mr. Brison.

We'll go to Mr. Adler, please.

Mr. Mark Adler: Thank you, Mr. Chair.

I want to turn to another topic. I recently read a rather interesting book by Jim Clifton, the chair of Gallup. He wrote a book called *The Coming Jobs War*. His thesis is that the next major battle is going to be over jobs, and those countries that can create the jobs of the future and attract those workers are going to be the powerhouses of the future; it's not necessarily military power that is going to dictate what countries are going to be economically powerful. I was wondering if you could comment on that.

Also, when I go through my riding, where we have a lot of private small and medium-sized businesses, I always receive a lot of accolades that we've lowered the corporate tax rate—because we all know corporations don't pay taxes—and that we seem to be hitting all the right buttons to create jobs. I was wondering, as a supplementary question, what you're hearing in your circles, among your colleagues in other countries, about how Canada is performing and what they're asking you.

Mr. Mark Carney: I'll look for this book with interest. I think one of the things to recognize, whether you term it a jobs war or the changing nature of work, is that because of trade and technology, a variety of tasks are being transformed and elements of them are becoming tradeable, if you will.

Highly sophisticated skills—don't worry, I won't use finance as an example, because some would be tempted to.... With diagnostic skills, for example, you can break apart the basis of diagnostics and outsource elements of the testing and analysis. We all know that you can outsource large amounts of programming and other elements on IT to other countries and form teams among people who have never met and are never physically in the same place.

The consequence of that is that there is more that's tradeable and that the bit that remains in Canada is the truly high-value-added component, which is good news. That leads to a higher return to that individual. It also puts a premium on our developing those skills, recognizing that there are elements of the other skills that could be outsourced over time because of the development of trade. That is something the appropriate people need to be alive to in the development of training, both retraining and university-level education.

In terms of what we hear from colleagues, I'm not sure that we get a general message. People are very focused. There's a little bit of jealousy, I guess.

● (1700)

Mr. Mark Adler: That's only fair.

Mr. Mark Carney: I think the lessons of the Canadian financial system can be boiled down to three or four lessons: a focus on real capital; a belt-and-suspenders approach with a leverage ratio, so you look at actual assets over actual capital and not just risk-weighted; a proactive supervision model that is practised by OSFI as an important component of that. These are the core lessons that come from Canada that have been followed.

Away from that, I think this is what we're all focused on in the advanced economies. Some are immediately focused on fiscal sustainability—without question—but then more broadly, we're in a global economy that is dominated by this phenomenon of deficient demand in the advanced economies.

Because households in the United States have to repair their balance sheets, because they've lost so much wealth from their houses and to some extent their stock market, because banks and governments in Europe have to repair their balance sheets, there are these big headwinds that exist in the major advanced economies. That puts a real pressure on an economy like Canada's, which needs to rely more than ever on domestic sources of growth, first, which is what we've done. As we've discussed, at the same time we need to build those new markets, so we get growth from investment that is poised and focused toward those new opportunities and ultimately from exports for those opportunities.

It's a difficult transition. It's a big transition of the economy, just to underscore what we've been discussing. This is not just a resource issue. This is how we reorient our manufacturing to where you started. It's in the changing nature of work, which goes to the service sector at its heart.

The Chair: Thank you, Mr. Adler.

[*Translation*]

Mr. Caron, the floor is yours.

Mr. Guy Caron: Thank you very much. I will be brief, because I am sharing my time with Mr. Mai, unless he finds the answer really interesting and allows Mr. Carney to continue speaking.

Please be brief, because I have two questions. Could you please provide an answer in two and a half or three minutes?

The Canadian dollar has appreciated significantly in comparison to the American dollar for the past decade. Its appreciation with respect to the euro has been less dramatic. I would like to know what the current trend is. Where is the Canadian dollar heading with respect to the currency of these emerging countries with whom we will eventually be dealing?

When you talk about the restructuring that will occur in the Canadian economy, what industries are most at risk and which ones could stand to gain, should the dollar follow the current trend, namely that there be neither a dramatic rise or fall?

Mr. Mark Carney: I will answer the first question and Mr. Macklem will answer the second.

Let's discuss the relationship between our currency and emerging countries' currencies. Last week, China increased its currency's flexibility. That is a good thing because it is absolutely essential to increase the Chinese currency's flexibility in order to adjust demand within the global economy. It is difficult to say in the world of currencies, but what is clear or likely is that in the medium term, the major emerging countries currencies will increase in relation to the American dollar and most likely in relation to the Canadian dollar. This is another reason for which our societies must open up markets within the emerging countries because we will see other revenues, that is the appreciation of their currency in relation to ours.

Mr. Guy Caron: Do you have an answer to the second question?

• (1705)

Mr. Tiff Macklem: As you said, a change in the value of the Canadian dollar has various effects on companies, depending on their area of activity. For example, if we are talking about an import company, a stronger dollar means it is less expensive to buy goods or services from other countries. In that case, it would probably be good for that company. It would be a positive thing.

Furthermore, that company may have to make major investments. Most of the machinery and equipment in our country comes from abroad. So it costs less to buy it with a higher-value currency.

On the other hand, if a company mostly exports, that would be a negative thing.

We have conducted surveys. We have regional offices across the country. Companies have done surveys for us across the country to study the various effects on different companies and to have an idea of the aggregate effects because, ultimately, we only have one instrument, one single goal, which is to target inflation at 2%. We must therefore consider the economy as a whole. We can see that overall a higher currency slows growth in Canada, and all things being equal, this will exert a downward pressure on inflation. This is something we keep in mind in doing our daily work.

The Chair: Mr. Mai, you have two minutes.

Mr. Hoang Mai: I find this most refreshing. I find it very interesting that the Governor of the Bank of Canada speaks of sustainable development when we talk about natural resources. In your opinion, when we speak of sustainable development, should we also internalize environmental costs?

Mr. Mark Carney: That question should be put to the federal government and provinces, not the Bank of Canada.

With respect to companies, it is always a good idea to think in the medium term. On a global scale, companies—and that includes companies that work in the commodity sector for example—have included a virtual price for greenhouse gases. That is quite normal for large corporations. That would be an input for an investment decision because in the context of a long-term project, a project that is staggered over 30 years, at some point, there probably will be a cost for that.

[*English*]

That is the best practice.

[*Translation*]

So it is a good idea, but it is up to the private company. I do not comment on government decisions.

The Chair: All right, thank you.

Thank you, Mr. Mai.

[*English*]

We'll finish our rounds with Mr. Van Kesteren, please.

Mr. Dave Van Kesteren: Thank you, Chair.

I have a quick question, Governor. Once I'm done that I'll pass the buck over to Mr. Jean.

I want to finish up talk on the high Canadian dollar that is at least perceived as being a result of natural resources. Some have said it's an artificially inflated dollar. There's also a reference to the hollowing out of the manufacturing sector as a result of that. They refer to that as the Dutch disease. I came from the Netherlands just last week, as a matter of fact.

This is a common refrain in some circles. What's your opinion? Are we seeing a hollowing out of the manufacturing sector? Is that happening as a result of our dollar being tied to it?

• (1710)

Mr. Mark Carney: I'll try to be quick. It's an important question.

To bring it together, Dutch disease means technically that you have a spike in activity because of a spike in the price of a product that then goes down. Our view is that commodity prices are going to stay elevated for some time, so we're not seeing a spike; we're seeing a natural adjustment. That's the first point.

Second, in that environment it's better to have commodities than not. The question is how well you develop them in a sustainable way to capture the most value added.

Third, it's important that we have the adjustments in the economy we talked about earlier. That means partly labour moving and it's also capturing more of the value added, as I said.

Fourth, there are tremendous opportunities for Canadian manufacturing. Some of those opportunities are easier to take advantage of because of where the currency is. As Mr. Macklem said a moment ago, there's the advantage of importing machinery and equipment to build productivity and build up new markets. We've detailed in other speeches some of the opportunities that exist for our firms from digital commerce, big data, the changing nature of work, resource productivity, and other aspects. Those opportunities are there.

What's important is that our economy continues to adjust to the broader forces in the global economy. In our view, those broader forces are commodity prices being elevated for some time; the transformation in terms of the relative importance of emerging markets; and a United States that is not as strong as it used to be. I choose all those words advisedly. It's not that the United States is terminally wounded or anything like that, but it is going through a multi-year process of rebuilding and adjusting to the aftermath of the crisis. That means a U.S. economy that grows more like 2% to 2.5% each year instead of the 3% to 3.5% we became used to.

All of those are broader forces. Domestic demographics is the final one we need our economy to adjust to in order to continue to build prosperity. The contribution of the Bank of Canada will be price stability, as defined by the inflation control agreement with the Government of Canada.

The Chair: You've got about two minutes maximum, Mr. Jean.

Mr. Mark Carney: Shouldn't we end on that rousing...?

The Chair: I could, but it's up to Mr. Jean.

Mr. Brian Jean: I want to end on a note of positive work mobility. I'd like to talk a little about and hear from you from your expertise and have you describe some of the ways we can make Canada's labour more mobile. As you know, the Canadian Chamber of Commerce recently cited this as the top barrier for business, and the Association of Canadian Community Colleges called the labour market imbalance the largest threat to our economy.

We have 1.7 million passengers per year flying into the Fort McMurray airspace. So 141,000 passengers per month are flying in there, and we still do not have enough people—not enough skilled people, not enough unskilled people. For some odd reason, with the highest household income in Canada, $185,000, we can't seem to attract them.

I've looked at some of the impediments to work mobility, and one of them is the issue of housing to accommodate the labour demand.

I know you're not going to be able to give an answer, but if you could provide the committee with an answer in writing I'd greatly appreciate it. How can we use the Canadian market more effectively as far as labour mobility?

The Chair: The members of this committee love me so much that they ask these great questions and then leave you ten seconds to answer.

You have about 30 seconds.

Mr. Mark Carney: As the member knows, everything that can be done to enhance the portability of trades across the country—and much has been done.... Anything more that can be implemented to ensure that always bears monitoring: how well things have worked in practice as well as in theory.

Of course, as you also well know, when you think about the dynamics at Northern Alberta Institute of Technology and Southern Alberta Institute of Technology, there's the need to continue to grow the number of people who are qualified in the trades. Part of that is getting the sustainability of this demand across the country, that this demand is going to be here for a while. These are good opportunities; they're far-above-average incomes and they're good careers. A real skill is needed. And obviously we would all prefer that we max out the number of Canadians who seek these jobs and get these jobs before we import those skills. Canada is built on immigration, but.... So getting the message across that these opportunities will persist for some time, in our opinion, I think is as important as shorter-term fixes.

● (1715)

Mr. Brian Jean: Thank you.

The Chair: Thank you, Mr. Jean.

Thank you very much, Mr. Carney and Mr. Macklem.

I thought you were going to use yourself as an example of labour mobility from Fort Smith to Edmonton—

Mr. Mark Carney: —to Harvard to Ottawa—

The Chair: —to Oxford to Ottawa and beyond.

I want to thank you so much for being with us and for your responses to our questions. We had an excellent discussion here this afternoon.

If there's anything further you wish the committee to study, please submit it to us, and we will ensure that all members get it.

Thank you so much for being with us.

Colleagues, I have a couple of items I need to deal with, so I'm going to suspend for a couple of minutes. We'll say goodbye to our guests and then resume.

Thank you very much.

● (1715)

(Pause)

● (1715)

The Chair: I call the meeting back to order.

Colleagues, we have two hopefully very short items.

First, I have some very sad news to report. I've received the resignation, unfortunately, of Mr. Mai as the vice-chair. Perhaps Mr. Mai should explain.

Mr. Hoang Mai: It's been a pleasure to be the vice-chair. I'm still on the committee, I'm happy to be here, and I'll nominate Peggy to be the vice-chair.

The Chair: Yes, we can proceed right to the election of the first vice-chair.

Ms. Nash is nominated.

Ms. Glover.

Mrs. Shelly Glover: I want to take a moment to thank Mr. Mai for his work as our vice-chair. He did an excellent job, and it was much appreciated by this side. It will be sad to see you leave.

Ms. Nash is back, and we have just as good a working relationship with her, so we're prepared to vote in favour of that motion.

● (1720)

The Chair: I think we echo all those comments on Monsieur Mai and thank him for his work.

All those in favour of Ms. Nash for first vice-chair?

(Motion agreed to)

The Chair: It's unanimous.

Ms. Nash, congratulations on your election.

Ms. Peggy Nash: Thank you for that ringing endorsement.

The Chair: Mr. Brison, you're still okay being second vice-chair?

Hon. Scott Brison: Yes, no problem at all.

The Chair: The second and final item is dealing with our proposed travel to Washington and New York. If this passes, I will take it to the Liaison Committee, obviously dealing with pre-budget consultations. I'll just read the motion in English. It states:

> That in relation to the study of pre-budget consultations 2012, the proposed budget in the amount of $45,556.50, for the Committee's travel to Washington and New York be adopted and that the Chair present the said budget to the Subcommittee on Committee Budgets of the Liaison Committee.

Is there any discussion?

Ms. Nash.

Ms. Peggy Nash: Yes. I know there has obviously been some discussion on this. I just want to raise the issue of witnesses or meetings in Washington and New York. I understand there have been a number of things proposed already. I haven't seen this document with some potential meetings, but we have some names that we would like to propose. We can get them in fairly quickly. I just want to raise that because I don't know if this is locked in and final and everything is booked. There are some folks we would like to meet with when we are there.

The Chair: I think I can speak to who is scheduled right now. In terms of Washington, we have the IMF. We are looking for congressional visits in the afternoon. We do have one visit scheduled with Representative Barney Frank, specifically talking about Dodd-Frank, obviously. We have a meeting at the U.S. Treasury. We have a lunch with at least one member of the House Committee on Financial Services, Republican Congressman Huizenga. In terms of New York, confirmed we have Mr. Paul Volcker, which frankly is an outstanding meeting for us to get. Also, we have Mr. William Dudley, president of the Federal Reserve Bank of New York. Those are two excellent meetings already.

I encourage members if they have suggestions to get them in today, because we are filling this agenda up. It's been out for some time in terms of who we are proposing. The embassy in Washington and the consulate in New York are working very hard to fill the agenda with what has been agreed on in the past. If you have any suggestions—Mr. Brison had another one today—we need those in today in order to pass them on to the embassy and the consulate. It looks to be a very fruitful two-day visit, frankly.

Mr. Mark Adler: What are the dates of that?

The Chair: The dates are May 10 and 11.

What we are looking at logistically is we would travel down on Wednesday. The embassy is having a reception on Wednesday night, which we would be invited to if we are able to get down on Wednesday night. Then on Thursday we would have all-day meetings in Washington. Just to save some time, we would actually take the train from Washington to New York on Thursday night. We would eat on the train. Then, Friday would be our day in New York.

Mr. Wayne Marston: Returning on....

The Chair: We would return home on Friday night. If members want to stay there, it's their own cost if they wish to stay in New York. That would be the plan, to return home Friday night.

Mr. Jean.

Mr. Brian Jean: Did the proposed dates go out to our offices?

The Chair: We have sent this information out multiple times.

Mr. Brian Jean: I'm just asking.

The Chair: Okay. All in favour of the motion?

Some hon. members: Agreed.

The Chair: Thank you all. We will see you on Thursday.

The meeting is adjourned.

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