



**Opening Statement of Kevin Page, Parliamentary Budget Officer
to the House of Commons Standing Committee on Finance
February 15, 2011**

Good morning Mr. Chair, Vice-chairs, and members of the Committee. Thank you for inviting me and my colleagues to speak to you about Canada's economic and fiscal outlook.

I will make some brief remarks about the Parliamentary Budget Office's (PBO) updated fiscal projections and highlight issues for consideration in the context of the upcoming 2011 Budget. A handout with charts and tables is provided to accompany my remarks.

The Outlook

PBO's updated fiscal projections are based on the economic outlook from Finance Canada's December 2010 survey of private sector forecasters. On a status-quo basis the fiscal outlook is essentially unchanged from the projections provided to this Committee last fall.

The federal deficit is projected to fall from \$56 billion (3.6% of GDP) in 2009-10 to \$10 billion (0.5% of GDP) in 2015-16.

The federal debt is projected to rise from \$519 billion (34.0% of GDP) in 2009-10 to \$652 billion (31.9 % of GDP) in 2015-16.

Before continuing I would like to clarify some issues regarding the forecasting processes used by Finance Canada and PBO. First, both organizations construct their fiscal projections using the average of the private sector economic forecasts compiled by Finance Canada. From this stage of the process onward, both PBO and Finance Canada use their own assumptions to translate the private sector economic forecasts into fiscal projections. I want to be clear – the private sector economists with whom the Minister of Finance consults do not prepare the fiscal projections presented in the Government's budgets or updates. Both organizations produce their own budgetary projections and should be willing to provide, and defend, the assumptions used.

Based on Finance Canada's recent survey, forecasters expect the Canadian economy to grow faster than PBO's estimate of its potential growth, allowing the output gap to close by the end of 2016. The unemployment rate is projected to decline to 6.6% by 2015, inflation is projected to remain stable, and short- and long-term interest rates are projected to rise only gradually over the medium term but remain low by historical standards. PBO views this medium-term economic outlook as relatively favourable given the elevated level of economic uncertainty.

PBO has identified four key downside risks to the private sector economic outlook. First, global growth, particularly in the U.S., could be slower than anticipated. Second, the recent appreciation of the Canadian dollar could restrain the recovery in exports. Third, sovereign debt concerns could restrain the recovery in Europe and put upward pressure on global interest rates and finally, domestically, the high level of household debt represents a further risk to domestic demand.

Thus, on a status-quo basis, and given the risks and uncertainty surrounding the private sector economic outlook, PBO estimates that the likelihood that the budget will be in a balance or surplus position over the period 2010-11 to 2013-14 is effectively nil; and, there is only a 16 per cent chance that the budget will be in surplus in 2015-16. These estimates reflect the historical forecasting performance of private sector economists and Finance Canada's fiscal sensitivities.

PBO projects that the reduction in the budgetary deficit over the medium term largely reflects a cyclical improvement, with the economy reaching its potential by the end of 2016. That said, a budgetary deficit remains. This means that a structural deficit exists, which PBO estimates to be \$10B (0.5 per cent of GDP) in 2015-16. As a consequence, policy actions would be required to achieve a balanced budget.

While PBO's estimate of the Government's structural deficit is small on a historical basis and likely significantly lower than other central governments, any structural deficit is a potential concern given the demographic transition that is underway.

Issues for Consideration

I would now like to highlight two key issues for your consideration in the context of the upcoming 2011 Budget deliberations.

1) Canada's major fiscal challenge is long term, not short term.

Canada's serious fiscal challenge is underscored by ageing demographics and weak productivity growth.

Our population is getting older. In 1971 there were 7.8 people at working age for every person over 65; which fell to 5.1 in 2008 and is projected to be 3.8 in 2019 and 2.5 in 2033. Growth in labour supply will fall dramatically due to slower population growth and the retirement of the baby boom generation.

Productivity growth is trending down: 2.6% average growth from 1962 to 1976; 1.2% since 1976; about 0.8% since 2000.

The bottom line is that Canada does not have a fiscally sustainable structure. There is a fiscal gap. This means that sustained fiscal actions are required to avoid excessive debt-to-GDP accumulation. Based on PBO's 2010 report, assuming that the Canada Health Transfer grows in line with projected provincial-territorial health spending beyond 2013-14 – which is projected to be approximately 4.2% per year on average – the fiscal gap is about 1% of GDP, or \$20 billion in 2016. Alternatively, if the Canada Health Transfer continues to grow at 6% per year as currently assumed by Finance Canada, the fiscal gap increases to 1.9% of GDP, or about \$40 billion in 2016. Moreover, a significant delay in taking fiscal action substantially increases the required amount of corrective measures.

Budget 2011 should include a fiscal sustainability analysis.

In 2007 the Government committed to producing long-term sustainability analysis – it should deliver on this promise. Furthermore, in its 2010 Article IV Staff Report the IMF called on the Government to increase transparency and communication surrounding the fiscal challenges related to the impact of population ageing. Parliamentarians may wish to consider reforming the budget process to ensure a more forward looking assessment and management of the nation's finances. In my opinion, the current process and political climate give too little weight to the fiscal impacts of current policies on future generations.

The PBO is committed to expanding its work on fiscal sustainability this spring to include all levels of government.

2) Parliament needs more fiscal transparency and analysis, not less.

There is genuine concern that Parliament is losing control of its fiduciary responsibilities of approving financial authorities of public monies as afforded in the Constitution. In the recent past, Parliament was asked to approve changes to crime legislation without financial information or knowledge of monies set aside in the fiscal framework. Parliament was asked to approve authorities related to operational restraint without access to a government plan.

PBO believes that the Government should provide the strategy to achieve estimated operating savings in the 2011 budget and departments and agencies should outline their plans to achieve their respective three-year savings contributions in their 2011-12 Reports on Plans and Priorities.

It is our view that this would be similar to the approach the Government took in its Economic Action Plan where the two-year stimulus strategy was outlined in the 2009 budget including additional planned resources for government programs before Parliament was asked to provide financial authorities. The degree of transparency demanded by parliamentarians for stimulus spending should parallel those required for spending restraint measures.

The PBO also wishes to note this Government provided Parliament details on spending restraint by department and agency in 2006 prior to parliamentary approval of financial authorities as did the previous government in 2005 on its expenditure review exercise. This raises the question as to why the application of Cabinet confidence with respect to restraint measures appears to have changed in such a short period of time.

Further, the application of Cabinet confidence has been used to withhold information regarding the assumptions used to translate the private sector economic forecasts into Finance Canada's fiscal projections.

New policy measures (e.g., Afghan mission extension) and existing measures (e.g., corporate income tax reductions) must be debated in an open and transparent manner with the information required for parliamentarians to assess their financial costs and risks.

Budget 2011 should provide a frank picture of the short- and medium-term planning environment and budgetary constraints. Parliamentarians could benefit from having access to the Government's estimates of the output gap, structural budget balances, and the quantification of risk and uncertainty.

Thank you for this opportunity to serve this Committee. We would be honored to address your questions.