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Lundi 27 janvier 2003

Standing committee on finance and economic affairs

Pre-budget consultations

Comité permanent des finances et des affaires économiques

Consultations prébudgétaires

Chair: Joseph Spina
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ASSEMBLÉE LÉGISLATIVE DE L'ONTARIO

STANDING COMMITTEE ON FINANCE AND ECONOMIC AFFAIRS

COMITÉ PERMANENT DES FINANCES ET DES AFFAIRES ÉCONOMIQUES

Monday 27 January 2003

Lundi 27 janvier 2003

The committee met at 0903 in room 151.

PRE-BUDGET CONSULTATIONS

MINISTRY OF FINANCE

The Chair (Mr Joseph Spina): Good morning, ladies and gentlemen. This is the beginning of the pre-budget consultations for the committee on finance and economic affairs. Welcome to everyone, and a happy new year to those we haven't seen so far.

We begin our agenda today with comments from the Minister of Finance, the Honourable Janet Ecker, followed by questions and answers from committee members. That will be split equally in the remaining time until the hour is up.

Are there any items the committee wants to bring forward before we begin?

Mr Gerry Phillips (Scarborough-Agincourt): Just a quick one. I submitted questions to the minister and I gather the answers are available, but we don't yet have them. I find them useful in listening to the minister's remarks. I suspect they're coming shortly.

The Chair: Yes. They're being photocopied right now, as I've been informed by the clerk, and they will be distributed and given to the minister, of course.

Mr Phillips: Thank you.

The Chair: There being nothing else, we'll turn the chair over to the Honourable Janet Ecker, Minister of Finance.

Hon Janet Ecker (Minister of Finance): Thank you very much, Mr Chair. Good morning to all the committee members. I'd like to thank you all for this opportunity to address you as part of our pre-budget consultations.

I'm going to be presenting an overview of the government's fiscal and economic plan, beginning with where Ontario stood in 1995, the steps we've taken to put the province on the road to recovery and a report on our progress to date.

I'm then going to identify some of the key issues we must address going forward, as we continue to support job creation, productivity and competitiveness in Ontario's economy.

The Ontario that our government inherited in 1995 had quite simply lost its way. Our economy had virtually flatlined. Real per capita GDP had actually declined between 1990 and 1995. Unemployment was high, and that was simply unacceptable. We were losing jobs to other provinces and to the United States. Public spending and the provincial debt were out of control. We were facing a potential deficit of $11.3 billion and the provincial debt was growing by $1 million every hour. Taxes had been rising steadily during the previous decade, driving investment and job creation to lower tax jurisdictions. We were quite simply becoming uncompetitive with our trading partners. Excessive government regulation and red tape were also contributing to stifling investment and innovation.

Since 1995, we've been pursuing a very deliberate plan to place Ontario on the path of growth and prosperity and to keep it there. We've introduced a new set of fundamentals to the fiscal and economic management of the province. We took control of our finances through balanced budgets and reduced debt. We introduced disciplined management of public spending to focus on key priorities and to make sure that the most efficient and effective delivery was there for government programs and services. We cut taxes to raise personal incomes, to make us more competitive with our trading partners and to support investment and job creation. We cleared away unnecessary regulations that were weakening investor and employer confidence and that were crippling investment and initiative. And we made key investments in priority areas to meet the needs of our growing population, to improve the quality of life of our citizens, to build opportunity and to support economic growth.

Our tight discipline in the management of taxpayer resources has played a key role in our turnaround, and I'd like to take a moment to highlight a number of key initiatives.

Through the past eight years we've focused on the priorities that mean the most to our citizens, while finding savings in non-essential programs and more efficient operations. The result has been that, excluding the priority areas of health care and education, real program spending per person has been reduced by close to 30% since we took office. We are taking several initiatives to support better planning, to make government more transparent and to improve our accounting practices and enhance accountability.

We've committed to a budget before the start of the next fiscal year, including a multi-year fiscal framework that will provide projections of economic developments, revenues and expenditures. Based on experience in other jurisdictions, and as recent events have certainly reminded us, it will be important that the multi-year framework strike a balance between providing increased stability and retaining the appropriate flexibility to respond to changes in economic circumstances and strategic priorities.

We have committed to developing three-year base funding for hospitals, school boards, colleges and universities. Our intent is to provide a more stable and sustainable fiscal framework, while at the same time recognizing that the government and its partners will need to work together to manage the risks, improve the service and enhance our accountability. In the budget this spring we'll take some further steps in this direction.

Effective April 1, legislative spending authority and appropriation control will move to an accrual basis. As the Provincial Auditor has noted, this move will significantly increase the government's accountability to taxpayers.

In addition, we are beginning this year to depreciate assets in the same way that a business does. We are also replacing the many cash-based accounting systems across the government with the integrated financial information system, called IFIS.

All of these measures will lead to increased transparency in government operations and to greater accountability to taxpayers in our stewardship of their tax dollars.

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Another important aspect of good management is ensuring that tax revenues are collected fairly, efficiently and effectively. I am pleased to advise the members that in response to the Provincial Auditor's concerns, the ministry will be bringing forward a plan to ensure that all Ontario corporations are paying the tax they owe to Ontarians. I'm expecting to make an announcement shortly on the action plan which will address the default filings issue.

The government has recognized that a sustained, balanced, long-term, multi-year tax reduction plan was essential to return Ontario to growth and prosperity. Our tax cuts over the past eight years have been dramatic, but then they needed to be. By 1995, a decade of higher taxes and new taxes had made Ontario one of the highest-taxed jurisdictions in North America. We've lowered Ontario personal income tax rates by 30%. As a result, 5.7 million Ontarians have seen their income taxes reduced or eliminated. These tax cuts mean a tax reduction of more than $2,000 for the typical two-earner family of four making $60,000.

We enhanced the Ontario tax reduction program to focus tax savings on lower-income taxpayers. Since 1995, our tax reductions have relieved an additional 500,000 low- and moderate-income earners from paying any provincial income tax. Unfortunately, 745,000 low-income Ontarians, though, continue to pay federal income tax even though they are paying no Ontario income tax.

When combined with tax rate cuts, our reduction in the taxable portion of capital gains has lowered the top marginal rate of Ontario personal income tax on capital gains by close to 50%. We've lowered small business tax rates from 9.5% in 1995, one of the highest in the country, to 5.5% today. The general corporate income tax rate was reduced from 15.5% in 1995 to 12.5% in October 2001, and the manufacturing and processing rate was lowered from 13.5% to 11% in the same period. We have reduced the mining tax rate from 20% in 1995 to 12% today.

Our reductions to business education taxes above the provincial average are this year delivering tax savings totalling over $400 million to Ontario businesses. Residential education taxes have been reduced by $250 million.

And our changes to the employer health tax have relieved 88% of private sector employers from filing payroll tax returns, and have lowered the employer health tax for all other private sector employers.

As the remaining steps in our current multi-year tax reduction plan are implemented, Ontario taxpayers will see additional benefits.

Legislation is in place to complete an additional 20% personal income tax cut by 2004. This means a typical two-earner family of four, earning $60,000, will see total Ontario personal income tax savings rising to more than $2,500 next year.

Small business tax rates will be reduced further, from today's level of 5.5% to 5% in 2004, and to 4% in 2005. By the time our tax reduction plan is fully in place, small business tax rates will have been reduced by a total of 57.9%.

The general corporate income tax rate will be reduced further, from today's level of 12.5% to 8% in 2006. The M and P rate will also be further reduced, from 11% to 8% in 2006. Again, by 2006, the general corporate income tax rate will have been lowered by more than 48%, and the M and P rate by over 40%.

In addition, the mining tax rate will be cut by another two percentage points in 2004.

These tax cuts, together with many others, have helped to move our tax system more in line with those of our competitors and trading partners, and that's an important step. But as the recent tax proposals made by US President George Bush remind us, maintaining our tax competitiveness will require ongoing vigilance.

The goal of providing balanced and sustained tax relief remains central to our economic plan. We would certainly welcome advice on the next steps aimed at improving our competitiveness and productivity in the economy. We're going to continue to work toward eliminating the personal income tax surtax and the capital tax, and a new multi-year tax reduction plan, which will be based on the advice we receive, will address these and other issues in the March budget.

A sound regulatory system can do much to promote confidence, efficiency, competitiveness and growth, while at the same time protecting health, safety, the environment and other vital public interests. We've eliminated more than 1,900 unnecessary and outdated regulations. We've introduced balanced and innovative regulatory approaches across the government and we've improved regulatory protections in a number of areas such as clean water and clean air.

Another example: to ensure a modern and effective capital market, last fall we moved to strengthen investor confidence with amendments to the Securities Act and the Commodity Futures Act.

Because of the discipline we have brought to public spending, and because of our tax cuts and the resulting economic growth, provincial tax revenues have increased by $14 billion since 1995. This money has enabled us to reduce debt and invest in priority programs that support our prosperity and quality of life.

Our commitment to health care operating spending in the current fiscal year is $25.5 billion. That's an increase of almost $2 billion over last year, excluding the recent announcement of added support for hospitals. Ontario's total health care spending is $8 billion more than in 1994-95.

In communities across the province, we're seeing the positive impacts of these investments. The number of MRI machines has risen from 12 machines in 1995-96 to 46 this year. That's 34 more MRI machines benefiting communities all over the province. A total of 20,000 new long-term-care beds are coming on stream, and an additional 16,000 beds are being renovated. The number of nurse practitioners is being doubled, focused on northern and under-serviced areas.

We've substantially increased our support for hospitals as well. So far, we have committed $2.4 billion to build three completely new hospitals—in Thunder Bay, North Bay, and West Parry Sound—and we're modernizing and expanding more than 80 existing hospitals across the province.

We've invested to increase access to dialysis services, cardiac care and cancer care.

We are creating a new northern medical school located at two sites, in Thunder Bay and Sudbury, so that we can train more doctors and encourage them to practise in the north.

The financing of health care, though, remains a particular challenge, not only to Ontario but to other provinces across the country. In 1995-96, health care operating spending equalled 38% of our total program spending. In this fiscal year it's expected to grow to 47%. In fact, the annual growth in health care operating expenditures continues to outpace our economic growth.

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We all know the history of health care financing in Canada, but I think it bears repeating. Over time, the federal government has reduced its share, has cut its share of health spending from its original 50%, down to 18% in 1994-95, and down further to today's level of only 14%. So we've gone from 50% down to 14 cents on the dollar. For Ontario, this has created a shortfall of $2.1 billion in federal support for health care in the current year. We've made up this shortfall here in Ontario and also addressed important priorities in other areas: in education, in the environment and in infrastructure.

For example, we continue to invest significant resources in our public education system. Since we took office in 1995, public education funding has increased from $12.9 billion to $14.8 billion this year. Just last month, we responded almost immediately to the recommendations of the Education Equality Task Force. We announced $610 million in funding to support special education, student transportation and the current round of collective bargaining. When added to the almost $400-million improvement announced in the 2002 budget, our additional investments in public education for the 2002-03 school year alone total $1 billion.

Also, by investing in new and more rigorous curricula, by setting higher standards, with province-wide testing to chart our progress, with improvement strategies that respond to those test results, with comprehensive standards for teachers' professional development and performance appraisal—through all of these steps we're starting to raise student achievement. The plan is working, because our students' test scores are moving up in year-over-year provincial comparisons and in national and international rankings.

At the post-secondary level, we're undertaking the largest expansion of Ontario's colleges and universities since the 1960s. As part of our comprehensive plan to accommodate increased enrolment, Ontario and our partners are investing $2.2 billion to create more than 79,000 new student spaces across the province. In the June budget, we announced additional capital funding that will add at least 13,000 more spaces. We asked colleges and universities to provide us with the most cost-effective and creative financing proposals to increase student spaces where they're needed. The deadline for us to receive these proposals is actually today. We will continue to work closely with our post-secondary institutions to ensure that there will be a place for every willing and qualified Ontario student.

As we move toward meeting the challenge of necessary spaces, I also want to acknowledge that we have additional work to do in ensuring that students receive the quality post-secondary education they need for future success. We look forward to working with our post-secondary institutions to do that.

That's one of the reasons why we've been providing significantly increased support for operating costs, state-of-the-art equipment and the special needs of northern colleges. In 2003-04, post-secondary operating grants will be $368 million higher than in 2000-01. We're also investing more than $120 million to modernize the apprenticeship system in Ontario so that we can connect more young people and those trained outside of Canada to good careers in skilled trades.

Another critical area for investment is of course the environment. As we announced in the June budget, we are investing more than half a billion dollars over two years in clean, safe drinking water for Ontario's citizens. This investment is focused on improvements to municipal water and waste water systems and on implementing Mr Justice O'Connor's recommendations and several other additional clean water initiatives. We have, for example, three new pieces of legislation to ensure that we have clean and safe drinking water: the Safe Drinking Water Act, the Sustainable Water and Sewage Systems Act and the Nutrient Management Act. We're doubling the number of inspectors to inspect municipal water systems. We'll also continue to take steps to improve the quality of Ontario's air.

To make Ontario one of North America's top-performing jurisdictions for innovation, we provided an estimated $2 billion between 1997 and 2001 to encourage research excellence, commercialization and partnerships between industry and research institutions. Ontario's $2 billion in support of innovation has generated more than $6 billion in investments in our R&D industry by Ontario businesses, universities, colleges and research institutes. These investments are creating the innovative products and services of the future that will enable Ontario to succeed in the global economy, to build even more jobs and prosperity for our citizens.

Last June, we committed nearly $800 million in additional funds for research and innovation over the next seven years. This investment will help entrepreneurs to access expertise and commercialize inventions from publicly funded institutions. It will help make Ontario a North American leader in biotechnology. Based on past experience, this commitment can be expected to generate a further $2.4 billion in additional public and private sector investment in both research and innovation.

Ontario's prosperity depends on ongoing investments in the infrastructure required to support our economy and our quality of life. We've asked SuperBuild to achieve a target of investing at least $20 billion in infrastructure over five years. By the end of March, approximately $15 billion worth of capital investment will be at work in Ontario's hospitals, highways, transit systems, universities, colleges and local community infrastructure. For example, when I was in Kenora and Thunder Bay last week for pre-budget consultations, I saw numerous SuperBuild investments in those communities—for example, a recreation centre and a water treatment plant in Kenora; the new hospital in Thunder Bay; a new, advanced technology and academic centre under construction at Lakehead University.

In the current year, we've allocated $2.7 billion to SuperBuild for investments across the province, and that includes more than $1.2 billion for highways and transit and an increase of almost 70% for hospitals and other health capital investments.

Recognizing the key role that municipalities play in building our economic growth in their communities, we've also increased funding for the community reinvestment fund by $40 million in the current year. We're also introducing tax incentive zones to enable communities to break down the barriers to growth and to build on local competitive advantages. The 62 expressions of interest that we've already received propose innovative and interesting ways of renewing communities, of attracting and supporting value-added industries and of sustaining long-term growth.

In the current fiscal year, the province is providing substantial support for municipal infrastructure, but we certainly recognize that much more is required. Therefore, we are providing an initial capital infusion of $1 billion to the new Ontario Municipal Economic Infrastructure Financing Authority. This authority will issue opportunity bonds to augment the funds available for subsidized loans to municipalities.

Our government made a promise to restore opportunity and prosperity to Ontario. I am pleased to tell the members of the committee that the government's plan is working. Ontario's economy is growing again, and at a rate that is faster than all of the G7 countries, including the United States. In the past eight years, the economy has created 1,035,000 new jobs. That's more than 45% of the jobs created in Canada since 1995. All parts of Ontario are benefiting from these new jobs. This has helped approximately 613,000 people to leave social assistance since 1995.

Average family incomes in Ontario are also rising dramatically. In 1995, two-parent Ontario families with children had an average after-tax income of $57,000. A growing economy and tax cuts had raised this in real terms by 19% to $68,000 in 2000. Single-parent families saw a 33% increase in their real average after-tax income, from $26,000 in 1995 to $35,000 in 2000.

The days of out-of-control spending and annual deficits are also long gone. Today we're on track for our fourth consecutive balanced budget. Since we ended deficits and balanced the budget in 1999, we've paid down $4.5 billion of net provincial debt. As a result of prudent management, our long-term credit rating has been raised nine times since 1995.

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Regaining Ontario's ability to make important investments in key priorities did not happen by accident. Those investments are possible because the fundamentals of our plan have moved the economic performance of this province from worst to first.

So, how do we move forward? How do we create more jobs? How do we keep building Ontario's competitiveness and productivity to secure future prosperity? How do we generate the revenues we need to meet growing public expectations for world-class public services?

The short answer is by sticking with the plan, by continuing with the initiatives that set the stage for Ontario's turnaround: vigilant fiscal management, lower and more competitive taxes, balanced budgets, reduced debt, and key investments in priority areas.

Our tax and fiscal policies have helped Ontario recover from the 2001 economic downturn more quickly than other jurisdictions. In 2002, the economy demonstrated its strength and resilience and exceeded expectations at the time of the June budget. Despite the weak economic performance of the US economy, job creation in Ontario remained solid throughout 2002.

Today I am releasing the Ontario economic accounts for the third quarter of the calendar year 2002. Those accounts show that Ontario's economy continued to grow strongly. In the third quarter, real GDP rose at an annual rate of 3.9%, significantly higher than the 3.1% rate for Canada.

That being said, we still live in an uncertain world. Oil prices continue to fluctuate due to ongoing tensions in the Middle East. The US economy remains tentative and uncertain, and world stock markets continue to be weak. As a result, private sector forecasters have moderated their growth outlook for 2003.

All of this points to the need for continued caution and prudence in the management of our fiscal plan. Strict controls on spending are in place and discretionary spending has been frozen to ensure that we meet our goals this year. As we always do, we are continuing to make adjustments and to reallocate to accommodate our priorities within our resources. The full results will of course be available in the March budget.

The challenge of meeting our targets is made all the more difficult by the federal government in a number of areas.

On health care, the evidence is clear. The federal government is simply not doing its part, and the provinces are paying the price. For the federal government just to return to its 1994-95 national share of health care costs would require an additional $20 billion in transfers over the next three years, as well as an immediate $5.4 billion in the current year. Such an increase would provide $2 billion more to Ontario, rising to close to $3 billion by 2005-06.

Following last week's Premiers' meeting, Premier Eves noted that the increased support provinces are requesting represents less than half the anticipated federal surplus over the next two years. As the Premier said, "Canadians regard health care as their first priority. Why doesn't the federal government regard health as its first priority? I don't think that's an unrealistic proposal on behalf of the Canadian people."

But health care is not the only concern we have with Ottawa. The federal government continues to short-change Ontario in a number of additional ways: the province, municipal governments and school boards are being forced to make up the shortfall in federal support for the settlement services required by immigrants to Ontario; Ontario continues to be the only province where the federal government has refused to sign a labour market development agreement; both the funding and the time being offered by the federal government to ensure proper implementation of the Youth Criminal Justice Act are inadequate; while services for aboriginal people are a constitutional responsibility of the federal government, it covers only 34% of Ontario's spending on services for our aboriginal communities, and this is clearly not enough.

At a time when the federal Department of Finance recently reported a surplus of more than $8 billion for the first nine months of the fiscal year, this simply does not make sense.

Despite these ongoing challenges as we approach the March budget, Ontarians can be confident that the provincial economy is sound. Growth and prosperity have returned. We will not forget the lessons so painfully learned between 1985 and 1995. We will keep focused on the fundamentals that restored confidence, investment and job creation to Ontario: lower and more competitive taxes, balanced budgets, less debt, sound fiscal management and key investments.

Mr Chair, as you proceed with your deliberations, there are a number of areas where we seek your advice:

What are the best ways to structure multi-year base funding to help our hospitals, school boards, colleges and universities plan and manage their activities while increasing accountability to the people of Ontario?

What is the appropriate balance between improving predictability and yet retaining the flexibility the province needs to adjust to changing economic circumstances and priorities?

What further can we do to help colleges and universities reach their goals?

What should be the key priorities for future innovation and infrastructure investments?

How do we get Ottawa to address the growing fiscal imbalance between the federal government and the provinces?

What should be the next steps in providing sustained, balanced, long-term multi-year tax relief to continue to support growth and prosperity?

I'd like to thank the members of the committee for this opportunity to meet with you today. I certainly look forward to your comments and questions, and to the report you will be providing at the completion of your consultations. Thank you very much.

The Chair: Thank you, Minister. With the time left, we have about seven minutes per caucus, beginning with the official opposition.

Mr Phillips: We certainly appreciate seven minutes a year. We'll try to make it as quick as we can.

Mr Marcel Beaubien (Lambton-Kent-Middlesex): You sound like a broken record, Gerry. Last year it was 12 minutes.

Mr Phillips: Yes, that's right. It's getting worse.

In your budget, for 2003 the real growth was going to be 4.2%; in the economic statement last month it was 3.5%; today it's 3.4%. For 2004, in December you estimated 3.9%; it's down to 3.7%. Does that impact on our revenues and, if so, how?

Hon Mrs Ecker: Certainly economic growth, as it increases or decreases, can impact on our revenues. We've seen that the stronger growth last year actually has increased revenues somewhat. We anticipate that we must be prudent for the next year, given how private forecasters have been reducing their forecasts for next year. We've set out our expenditure and revenue forecasts, as we always do, in our regular accounts. I believe it's covered in the material, and I'm sure the deputy could elaborate further if you wish.

Dr Bob Christie: Just a note that the outlook—

The Chair: Excuse me, Deputy. Would you be kind enough to please state your name for the record, for Hansard.

Dr Christie: Sure. Bob Christie. As part of the general review of the economic situation, the economic outlook for the current year, 2002-03, is basically driven by the performance of the economy last year. That's been revised up from 3.2% to, I believe, 3.5%. We have somewhat stronger growth in the current year, so that gives us a higher base on which we move into future years, which should have some favourable impact on revenue in those outgoing years.

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Mr Phillips: In December you were anticipating asset sales of about $2 billion this year. Is that still the case?

Hon Mrs Ecker: As the Premier announced, we're going to be retaining 100% of Hydro One because he feels that's in the best interests of Ontario consumers to meet the policy objectives that he set out. There may well be some in-year adjustments on revenue figures. That's not unusual. When you put together a budget plan, you make your revenue forecasts and your expenditure forecasts. You build in-year flexibility into the plan because you quite anticipate that some things will change within the year. So we're certainly making adjustments to ensure that we stay on track for a balanced budget.

Mr Phillips: On page 6 of the answers you gave us in response to my questions, it shows that the goal of Ontario is to get corporate taxes to roughly 30%. Corporate taxes of our competitors in the US are somewhere around 40%. Based on the numbers you provided before, in terms of forgone revenue, if the taxes were at 40%, there would be about $4 billion more of corporate tax revenue coming in. What's the rationale for wanting to be 25% below our competitors in the US in terms of corporate income taxes?

Hon Mrs Ecker: The rationale is quite simple: we need to attract and keep investment here. We want businesses and highly skilled individuals to come here and we want investors to invest here. When you look at the total package of benefits, if you will, that are offered sometimes in the United Sates, we have to be very vigilant that what they see when they look at Ontario is a very attractive investment environment.

For example, the United States has a much, much larger market just within its own country than Canada does. That is a benefit for companies that might wish to locate there. So one of the reasons that we think we need to have a very competitive tax rate is to make sure we are attracting and keeping investment here. That's what generates the jobs.

As we've seen with our tax cut plan, and as I've said, a sustained long-term, comprehensive tax reduction plan is what works the best for increasing investment and increasing prosperity and jobs. We need to continue down that road to make sure that the growth is here. The plan is working, because with the tax reductions we've made to date, we've seen increases in tax revenue, and those increases are coming from increased growth, increased investment that is attracted by lower taxes.

Mr Phillips: Well, it's an interesting debate. I just wonder if we need to compete on the basis of 25% lower corporate taxes. I think we've got several other dramatic advantages.

Just in case I run out of time, page 15 of the responses indicates that private spending on health care continues to increase as a percentage of health care in the province. The numbers you've provided, at least for the last two years, show private spending as a percentage of health spending going up. Why would that be? Is that something you see continuing?

Hon Mrs Ecker: We've always had a blended public-private partner participation in health care. We as a government believe that a publicly administered system, as we currently have, is the way to go, but that shouldn't forestall using the private sector for delivery, for example, or management in places where that makes sense.

Mr Phillips: This isn't delivery; this is spending.

Hon Mrs Ecker: Well, to use the private sector in management and delivery in some cases where that makes sense, but to make sure that it continues to be a publicly accessible system. We've always had private sector expenditure in our health care system and that will remain.

Mr Phillips: But it isn't delivery service; this is the spending side of it. Why would the spending side be going up as a percentage?

Hon Mrs Ecker: I think you might want to address that to the Minister of Health.

Mr Phillips: It's good that she's coming. I didn't realize that.

Hon Mrs Ecker: She? Sorry—

Mr Phillips: Whatever; the minister.

Interjections.

Mr Phillips: If the Minister of Health is coming, great. I will address it.

The Chair: We now move to the third party. Mr Christopherson, seven minutes.

Mr David Christopherson (Hamilton West): Thank you very much, Chair, and thank you, Minister, for your presentation today.

I have to say at the outset that the Ontario you describe certainly doesn't reflect the Ontario that most citizens are seeing. You spend pages and pages and pages talking about the importance of tax cuts and the benefits of tax cuts and how tax cuts are going to be the magic silver bullet for everything, and yet nowhere in here have you talked about what you're going to do about child poverty. We've got more children living in poverty than we ever had before, and you don't even talk about it.

What are you going to do about housing? What are you going to do about the fact that there are more people on the streets of our cities than there have ever been before because you slashed all the services that used to be provided to pay for your tax cuts?

Where's your commitment to the Romanow report? You want to go after the feds. You want to play this, "It's not our fault; it's their fault," but where's your absolute commitment today on behalf of the citizens of Ontario that implementing the recommendations of the Romanow report is an absolute priority of this government? Where's that?

Kyoto: we have the disgrace in Ontario of having our government being opposed to Kyoto and having now seen it passed in the national House. Where's your commitment? You talk about clean air and clean water and you say all the right rhetoric, but where's the money? You've got lots of money for tax cuts. What are you going to do to make sure that Kyoto is implemented, because those are the life-and-death issues that are facing people? Not a word. "Disgraceful" is the only way to describe a presentation like this that does nothing but talk about tax cuts and dollars.

Municipalities: we're going through a nightmare in Hamilton, and I'm sure it's the same across the province in all municipalities. We've got water mains that are bursting in my riding because the municipality isn't able to put the money they want to into capital infrastructure because they're so busy trying to cover off the new services that you downloaded years ago, without giving them the money, to pay for your tax cuts.

So I want to say to you very directly, Minister, that all the things that you're bragging about here are coming at the expense of the things that matter to people.

Where's your commitment to public transit? I was at a public meeting not long ago in Hamilton dealing with public transit for our disabled citizens. The service has been cut year after year after year. Why? Because we have mean-spirited councillors? No. They don't have the money, because they've been given all these new services that you didn't give them the money for. So we've got disabled individuals who are literally trapped like prisoners in their homes. They can't get out, because the only service available to them doesn't have enough money because you thought tax cuts were more important.

We've got massive school closures in Hamilton, and that's not even being decided by our elected trustees. That's your appointed supervisor. The long arm of the dictatorship of this government reaches right into the education system and shuts down our schools, unilaterally changes our boundaries, creating all kinds of havoc and fear and concern on the part of parents for their kids' future.

We've got parents who are wondering what's going to happen to their children who are part of the double cohort. Yes, you're trying to deal with that in terms of spaces—and, by the way, we warned you about this years ago and you did nothing. Why? Because, again, you didn't want to upfront the money because you had to pay for your tax cuts. So we've got parents wondering how they're going to pay their property taxes and how they're going to send their children to post-secondary education. In here, Minister, you bragged about one of your tax cuts and you said that the funding had gone from worst to first. Well, in post-secondary education we went from first to worst. How's that supposed to help our future?

Interjection.

Mr Christopherson: I hear you, Chair.

On all the things that matter—and I share the concerns of my colleague Mr Phillips in terms of not having enough time to ask the pointed questions, because this is a fine reflection, perhaps, from your ministerial boardroom, but looking at the community of Ontario and looking at what's happening in our cities and the things that matter to people on a day-to-day basis, the quality of life, let alone the desperation that's out there, you don't even comment on it. It's like it's a different world; it's not the same universe in which you exist.

Minister, my general question to you would be, how can you roll in here and brag about this, knowing the kind of deterioration, desperation and complete lack of hope that exists among millions of Ontarians because of the strategies of your government? How do you justify that?

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Hon Mrs Ecker: Mr Christopherson, I respect your view, but I would point back to the record that shows what happens when you don't pay attention to what creates growth and jobs and investment in your province. Your government raised taxes, raised spending, went into debt; you had fewer jobs, you had loss of growth and you had decreases in family income. Under the plan we have put in place we have more jobs, we have fewer children in poverty and we have an increase in take-home pay. We have over one million new jobs in this province. Family take-home income has gone up. Investment has gone up. If you don't have investment, if you don't have businesses here to create jobs, you end up in the trouble that the NDP gave this province in 1995: $1 million more an hour going into debt, over a million people on welfare—a disgraceful record for this province.

Under our plan more people are working, they're getting to keep more of their money, and investment is up. That is the plan we must continue to follow if we expect this province to grow the way it needs to grow to meet education needs, to meet health care needs, and we do not back away from that.

The Chair: We now move to the government side.

Mr Beaubien: Thank you very much, Minister, for your presentation this morning. That must have been some convention this weekend, Dave, because you were really energized.

Mr Christopherson: I wasn't there.

Mr Beaubien: Oh, you weren't there. OK.

I'd like to put something on the record also, because Mr Phillips and Mr Christopherson mentioned the time allocation. We had unanimous agreement from all three parties that different presenters would be given different periods of time to present. How the presenter uses his or her time is their decision. Whatever time is left is divided amongst the three parties for questioning. That has been the rule for a number of years and it's still the rule today.

Minister, you mentioned that tax cuts are central to the plan, and I would have to agree with that. When we look at our economy compared to the—and I think I'll take your word. You said that our economy is growing faster than all of the G7 countries, including Canada. I think tax cuts are certainly a very important part of the plan.

If we look at some of the incentives that are available in our economy and south of the border, the economy south of the border seems to be sputtering at times. They have low-percentage financing for mortgage rates and they have 0% financing for automobile purchases, and we have that here, yet our economy seems to be performing better.

Mr Phillips mentioned, about the answer on page 6 to the question he asked, that Ohio's combined tax rate is 40.5% and ours is 30.12%, and we want to reduce it. Well, Cleveland and Detroit are probably more central to my universe than Toronto is because they're close to my community. If we look at what's happening in the state of Ohio at this point in time—because they do have 0% financing for car purchases; they do have low interest rates for mortgages—they have two choices, and that's what the Governor of the state says: (1) they can increase spending, which I'm sure you would support because that's what you advocate all the time; and (2) is to lower taxes.

Taxes have worked in the past. We have debated and argued the point that tax cuts have been an integral part of why the economy is performing much better than that of the other G7 nations. Minister, I would like to get your personal point of view and your future commitment to tax cuts. Where do you see this government going in the future? I know you mentioned it in your report, but where do you see tax cuts proceeding in the future, especially with the upcoming budget?

Hon Mrs Ecker: It is a complete plan, if you will, a complete approach that has lower competitive taxes, balanced budgets and an appropriate regulatory environment offering things like an educated workforce, a strong health care system. There is a range of things that help make a jurisdiction attractive to new investment. But key to that is the tax rate, and that's why we have worked as hard as we have to provide $14 billion worth of tax relief for individuals and our business community here.

We need to finish the multi-year plan we laid out that runs to 2005-06 for personal and business tax reductions that are scheduled to come into effect. We are asking for advice during this pre-budget consultation on what other strategic tax reductions or tax changes are needed to keep us competitive. As I mentioned, as other jurisdictions change, we have to be very vigilant about how our tax system stacks up with our competing jurisdictions. We want to take additional steps on the personal surtax and the capital tax because we need to make sure that when businesses look to this province, what they see is an attractive investment climate so they will come here and stay here. As I mentioned, we have over a million new jobs here in Ontario, but we need to keep that record going. As I also mentioned, you can see the pressures we're seeing in health care, social services and education, and the only way we will be able to meet them is with economic growth driven by competitive taxes, balanced budgets, less red tape, key investments in economic infrastructure: roads, bridges, water, sewers etc.

Mr John O'Toole (Durham): Thank you very much, Minister, for a very comprehensive overview of what lies before us: this balanced budget and wise fiscal management. I just want to go back to the key issue that I hear in my riding of Durham which, of course, like for many members, is the health care issue. I was very impressed last week with Minister Clement as well as the Premier, along with all the Premiers of Canada, in looking at the federal commitment, as we look at their budget in February, whether or not the $5.4 billion is a solution—or whatever the solution is. There's a lot of public concern there about the question that Mr Phillips suggested: the increased spending on health care from the private sector.

I've attended a number of forums, and I'm going to ask you the question if I have enough time. The question really came out in the last federal election, when the Prime Minister of this country said that there's no private money in health care. Yet I've paid auto insurance with personal accident insurance all my life; I've paid workplace compensation, which is insurance money; my dental, drug, vision, hearing, all that has been part of my employee plan for years—that's called "insurance." Could you tell me what part of the health care spending—even though I'm looking at Mr Phillips's question—has been, and probably will continue to be, private? By that I mean paid for by some kind of premium plan. I suggest to you that about 40% of the funding in health care is basically private and has been for many years: Blue Cross or whatever you call it, distance travel money, all that insurance money.

The small amount indicated in private sector health spending, in your response to Mr Phillips's question on page 15, indicates an increase from $12.7 billion to $14.8 billion. I think that's only measuring a very, very small amount of that health care funding. I know, as a person who goes to a chiropractor the odd time, that I pay a copayment fee and have for many years. In fact, for many years I had to pay it all. Many provinces don't even have that. Many provinces don't have any support in community care, and some of that today is private, where there's a copayment requirement. Could you give us some indication as to the amount of money that's coming from either individuals or insurance plans like compensation or auto insurance?

Hon Mrs Ecker: We can certainly get from the Ministry of Health a more detailed breakdown of what that share is. But as you quite rightly point out, there has always been a blended approach, if you will, between public and private investment and services. Certain ancillary services have been paid for by employers or individuals. What's important, though, and I think the biggest threat to our public health care system in Ontario today, is not whether or not the private sector is involved; it's whether the federal government will come back to the table with their share of health care funding and also come back to the table to help the provinces make the innovations we need to make to continue to have a publicly accessible, publicly financed health care system here in Ontario.

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While the federal government has cut its share of health care spending from 50% down to 14 cents, this province and other provinces have increased health care spending dollar for dollar as a percentage of what the government spends. We've gone from just over a third to now almost half of what we spend is spent on health care. We have increased health care over $8 billion. We're starting to see those investments pay off in expanded hospitals, new equipment, new diagnostic services. I believe the biggest challenge, the biggest threat, the biggest risk to public health care is Ottawa not living up to its responsibilities to help share funding with the provinces.

The Chair: Thank you, Minister. That concludes this portion of the presentation. We will begin the next portion of the presentation with the officials from the Ministry of Finance, led by Deputy Minister Bob Christie. If we could just take a moment to shuffle the players around the room, we'd appreciate it.

Hon Mrs Ecker: Thank you very much, Mr Chair.

The Chair: I would ask that, as each of you begins to speak, you would please clearly give your name—I think many of you are accustomed to this—so that Hansard has it accurately. We have two hours with this group. I'm going to ask the deputy, will you be going through a presentation together or in blocks?

Dr Christie: Mr Chair, the plan was for me to do a very short introduction and then have the responsible assistant deputy ministers provide a more in-depth briefing for members in the various areas for which they're responsible.

The Chair: And then when that's completed we'll have the rotation of questions. Proceed.

Dr Christie: Thank you very much. My name is Bob Christie. I'm the Deputy Minister in the Ministry of Finance. To my left is Phil Howell, who is the chief economist and assistant deputy minister for the office of economic policy. To my right is Mr Gabriel Sékaly. He's the assistant deputy minister of the fiscal and financial policy division. Gabe will be providing details of the province's fiscal situation and some other related issues, such as controllership, multi-year-based funding and the change to accrual-based appropriations. John Whitehead, next to Phil, is the director of the personal taxation and fiscal arrangements branch in the office of the budget and taxation. John will be talking about taxation matters. Mr Gourley, sitting behind me, is the CEO and vice-chair of the Ontario Financing Authority. He will be providing an update on the borrowing activities and debt management of the province, as well as discussing the new Ontario Municipal Economic Infrastructure Financing Authority.

In her statement, the minister outlined the set of fundamentals that have been applied since 1995 and indicated some of the top-line results: clearly, more than a million jobs created since 1995 and about 613,000 people having left social assistance since 1995. Ontario's growth has also been quite favourable when compared to that of the G7 countries, as was mentioned, and Phil will be providing more detail on that. Taxes, both personal and corporate, have also been reduced significantly, and John will provide more information on that. The budget has been balanced and debt has been paid down, and Gabe will give you some additional information about that.

As of the second quarter finances, a balanced budget is projected. This would be the fourth balanced budget consecutively. Of course, since 1995 the province has also paid down a substantial amount of provincial debt. In investments and key priority areas, significant investments have been made, particularly, as the minister noted, in health care but also in education and the environment. As I said, Gabe will provide more information on that picture.

I will now pass the mike to Phil, who will talk to us about the economic situation.

Mr Phil Howell: I'm pleased to have the opportunity today to address the standing committee. Today the Ministry of Finance is releasing third quarter Ontario economic accounts. The accounts confirm that Ontario's rebound from the slowdown in 2001 continued through 2002 and at a pace somewhat faster than expected at the time of last year's budget. Unfortunately, the resilience of the Ontario economy is not being matched to the same degree by the US economy. As was noted in December's economic outlook and fiscal review, this has triggered downward revisions to 2003 forecasts made last June.

Today I would like to provide you with some perspective on current and forecast performance of the Ontario economy. I hope that this economic backdrop will assist you in your forthcoming hearings at Queen's Park and around the province.

As the minister noted in her presentation, the 2002 Q3 economic accounts reveal annualized real gross domestic product growth of 3.9% during that period. This compares to Canadian growth of 3.1% for the same period. While the fourth quarter economic accounts will not be available for some time yet, available data points to continued growth. For example, Ontario employment rose by 47,000 net new jobs in the quarter. Retail spending over the first two months of the quarter is up 1% from the third quarter and 5.8% from a year earlier. Wholesale trade, which includes sales by the big box stores, is up 3.5% in the same period. Non-residential construction rose 3% during the quarter.

The data for the first three quarters of 2002 show that the growth is being driven by domestic demand; that is, spending by consumers on goods and services and housing and by businesses on machinery, equipment and factories. Sustained high economic growth rates require strong growth in domestic demand. Policies that support personal disposable income growth and encourage business investment and profitability underpin domestic demand.

Of course, trade is also critically important to our economic success. However, as this slide shows, net trade, that is, exports minus imports, actually subtracted from growth over this period. This is not surprising given the softness of the US recovery, but it does underscore that policies that promote domestic spending add resilience to an economy and reduce vulnerability to external shocks.

Prospects for continued growth are reflected in Ontario's consumer confidence index, which is up 7% in quarter four of 2002 from the year before. While this index is volatile, it is near historically high levels. The Conference Board's business confidence index tells a similar story. It is up 16% from a year earlier. More importantly, the dramatic shifts in business confidence over 2001 and the first quarter of last year have stabilized in the last three quarters. Significantly, almost half of respondents to the latest survey indicated that it was a good time to expand plant and equipment.

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Private sector forecasters now believe that real growth for 2002 as a whole will be 3.6%. That could edge up further, once today's new data is incorporated into forecasts. The economy has returned to a trajectory of solid, stable growth after struggling in the 2001 global slowdown. That rebound is reflected in job creation performance, as noted earlier by the minister and the deputy. December-over-December job creation jumped sharply in 2002 compared to the previous year.

This slide also highlights the remarkable job creation record since 1995. Over a million net new jobs have been created, accounting for over 45% of the national job gain over the period. Importantly for underpinning domestic spending, over four fifths of these jobs were full-time positions. Over the period, employment in Ontario has grown 20.2%. This compares to 15% for the rest of Canada and just 7% for the United States.

Another perspective on Ontario's improved economic environment is provided by the growth in Ontario's labour force participation rate as measured by the share of adult Ontarians in the labour market. From a low of 65.2% in mid-1995, lower taxes, improved employment prospects and sustained strong economic growth have pushed the participation rate to 68.3%.

Ontario's improved fundamental economic strength and resilience are demonstrated in the next two slides. The first compares Ontario's job creation record coming out of the 2001 slowdown with that of the United States. Since its peak in March 2001, US employment has declined by 1.3%, or 1.75 million jobs. By contrast, over the same period, Ontario employment increased by 3.6%, or 213,000 new jobs.

This performance is markedly different from that after the last global recession in the early 1990s. Then, the reverse was the case. On a peak-to-trough basis, Ontario employment declined by 6.4%, compared to 1.6% in the US. You will also note from the slide that US employment began growing again much sooner than in Ontario.

The Ontario contrast in the two periods is partly explained by significantly different environments. In the early 1990s, personal taxes were rising, budget deficits were large and growing, the Canadian dollar was overvalued and tight monetary policy was holding interest rates up. As well, the economy was absorbing structural adjustments related to the Canada-US free trade agreement.

Today, the budget is balanced, personal and corporate taxes are significantly lower, the dollar is not overvalued, interest rates are low and Ontario's competitiveness has been enhanced by business rationalization and integration within the North American economy flowing from the North American free trade agreement.

The effect of different policy environments is evident in the next slide, which you also saw in the minister's presentation. Rising productivity is widely acknowledged as the only enduring way to achieve an improving standard of living. The broadest measure of productivity growth is real gross domestic product per capita. Since 1995, Ontario's real GDP per capita has exceeded that of the rest of Canada, the US and the average of industrialized countries. The productivity record, combined with strong job creation over this period, reflects the benefits of pursuing policies that lower taxes and encourage investment.

Further evidence of the boost to domestic economic activity provided by this policy approach is provided in the next slide. Over 80% of real GDP growth in the last five years has come from spending by Ontario consumers and investment by Ontario businesses. The ability of Ontarians to spend and invest reduces the economy's vulnerability to weakening foreign demand and increases the capacity of the economy to sustain economic growth.

I will now turn to the outlook for the next two years. This slide shows the evolution of the private sector forecasters' real GDP growth outlook for Ontario since last June's budget. In a nutshell, real growth is now expected to be stronger in 2002 and weaker in 2003. The former reflects the data already in for 2002, showing stronger growth in business and household spending, alongside robust employment growth and less weakness in corporate profits than expected.

The weaker outlook for 2003 primarily reflects the spotty recovery in the US, combined with uncertainty stemming from the current situation in the Middle East. The consensus remains that growth will pick up again in 2004, posting a solid 3.7% pace.

Notwithstanding last week's remarks by the governor of the Bank of Canada that the risk of inflation is increasing, most private sector forecasters expect inflation to remain moderate.

Continued employment growth should reduce the unemployment rate as the rapid growth in the participation rate moderates to a slower pace of expansion.

The key external assumptions underlying the Ontario forecast are shown on the next slide. You will note that Ontario's real growth will continue to outpace the rest of Canada and the US throughout the forecast period. A key assumption is that oil prices moderate from current levels, reflecting reduced tensions in the Middle East as 2003 proceeds but, more significantly, increased oil production by producers outside of Iraq and a return to more normal production levels in Venezuela.

Interest rates are expected to rise slowly over the period as growth in the US and globally strengthens. In Canada, the Bank of Canada is expected to gradually increase interest rates later this year to ensure core inflation remains within its 1% to 3% target range.

A critical element in sustaining economic growth is consumer spending, which accounts for about 55% of total spending activity in the Ontario economy. Underpinning consumer spending is disposable income or, more specifically, real disposable income. As this slide shows, during the 1993-96 period, real consumer spending growth was constrained by falling real personal disposable incomes. This was the legacy of rising personal tax rates alongside very sluggish employment growth. Since then, tax cuts have contributed to growth in real disposable income, which has translated into significantly higher consumption growth. Over the next two years a further pickup in per capita disposable income will support strengthening consumer spending.

A reason for optimism about the outlook is the interest rate outlook. I mentioned the relatively benign inflation situation earlier. Indeed, one of the significant differences in today's economic environment compared to the early 1990s is the inflationary situation. Not only are rates less than half of what they were then, the level is also very low by the standards of the last 30 years. This has allowed monetary authorities more latitude to stimulate growth through lower interest rates without sparking inflation.

Low interest rates combined with rising personal disposable incomes are also contributing to an improvement in consumers' ability to service their debt. Debt costs as a share of personal disposable income continued to trend downward, which will continue to support consumer spending. Corporate balance sheets are also relatively strong. The slide reveals how business debt-to-equity ratios have declined. Healthy balance sheets will support a pickup in investment spending over the next two years as businesses respond to increasing demand.

This slide shows the quarterly pattern of US real GDP growth over the next two years associated with the annual averages I showed you earlier. This pattern is one of the reasons that forecasters see Ontario growth strengthening in 2004 compared to this year.

Ontario's housing market will remain buoyant over the next two years. Though new starts are expected to retreat somewhat from last year's exceptionally robust performance, strong growth in after-tax personal income and relatively low mortgage rates will continue to ensure historically high levels of housing demand and construction.

Business investment in both machinery and equipment and non-residential construction stalled in 2002, reflecting the global slowdown in economic activity and the after-effects of the September 11 attacks. Private sector forecasters anticipate that machinery and equipment investment will grow 6.7% this year and 7.2% following last year's 1.9% gain. A similar pattern is expected to prevail in non-residential construction: after no growth last year, spending is projected to grow 4.8% this year and 6.7% in 2004.

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Private sector forecasters are clearly confident that Ontario's economy is poised to continue its rebound from the 2001 slowdown. While individual forecasts naturally vary around the average, all expect solid growth over the next two years. While a sluggish US economy and geopolitical uncertainty in several parts of the world make it unlikely Ontario will grow as strongly in 2003 as last year, the resilience demonstrated by the Ontario economy in 2002's performance is evident in the expectation of stronger growth in 2004. That resilience reflects an economy in which economic participants, be they consumers, businesses or government, are equipped through lower taxes and healthy personal, corporate and government balance sheets to take advantage of the opportunities provided by the domestic and international economies.

Thank you, Mr Chair.

The Chair: Is there anything else, then, Mr Deputy?

Dr Christie: Yes. Mr Sékaly is next to talk about the fiscal situation.

Mr Gabriel Sékaly: My name is Gabriel Sékaly. I'm the assistant deputy minister of fiscal and financial policy. It's a pleasure to be here this morning to present an update to the committee. I'd like to spend a few moments reviewing the province's fiscal outlook and then focus on a number of priority areas, including health and education. I will also briefly outline some recent developments, aimed at making government more efficient, effective and accountable, that are a follow-up to the government's commitments.

In November 1995, the government introduced its balanced budget plan, which set out declining annual deficit targets for the province, culminating in a balanced budget in 2000-01. As the slide indicates, the balanced budget targets were overachieved each year and the budget was balanced in 1999-2000, one year ahead of the schedule laid out by the government. This fiscal year will be the fourth consecutive year in which the government has balanced the budget and the eighth consecutive year in which the government has met or exceeded its deficit- and debt-reduction targets. These results, combined with the Balanced Budget Act of 1999, demonstrate the government's commitment to maintaining a balanced budget on an ongoing basis. As of September 30, the second quarter outlook for 2002-03 is a balanced budget, on track with the 2002 budget plan. The 2001-02 public accounts reported the audited surplus for the year at $375 million. Once again, the province has received an unqualified opinion from the Provincial Auditor.

The next slide summarizes the fiscal outlook for the current year. As reported in the second quarter Ontario Finances, revenue in 2002-03 is projected at $66.611

billion. That is $2.725 billion above the level recorded in 2001-02. As at second quarter, total expenditures in 2002-03 are projected at $65.6 billion, up $2.158 billion from the 2001-02 level of $63.4 billion, mainly due to $1.7 billion in higher health care program spending, including additional funding for hospitals, OHIP, long-term care, drug programs and other health programs, and $600 million in increased spending on schools and post-secondary education.

Ontario's 2002 budget plan includes a $1-billion reserve designed to protect the balanced budget against unexpected and adverse changes in the economic and fiscal outlook. The reserve will be available for debt reduction at year-end if not needed. With continued uncertainty in the economic and fiscal outlook and consistent with prudent fiscal planning, the reserve was maintained at second quarter to protect the balanced budget.

As at second quarter, the revenue outlook for 2002-03 of $66.611 billion is up $67 million from the budget plan and $65 million from the first quarter Ontario Finances. In terms of major changes reported that quarter, I'd like to highlight the following:

The tobacco tax revenue has been reduced by $100 million, reflecting a larger-than-expected decline in cigarette consumption. The forecast for land transfer tax revenues has been increased by $40 million, reflecting the robust Ontario housing market. The forecasts for gasoline and fuel tax revenues have been increased by $35 million and $10 million respectively as a result of stronger economic growth.

Other federal payments have increased by $55 million, including a $31-million federal contribution toward provincial payments to Ontario farmers for past years and $24 million in support of provincial primary care health initiatives.

Independent Electricity Market Operator revenues are increased by $21 million, due to recognition of revenues related to ancillary services, rural rate assistance and remote area subsidies consistent with the treatment in 2001-02 public accounts.

Finally, miscellaneous revenue has increased by $4 million from the victims' justice fund to support new initiatives as part of a multi-ministry interim response to the Hadley inquest into domestic violence.

The next slide shows operating expenditures for 2002-03 at $63,519,000,000, up $65 million from the budget plan and $63 million from first quarter Ontario Finances. Major changes in that quarter include an expenditure increase of $73 million to fund Ontario's portion of a federal-provincial transition program for farmers in Ontario, partially offset by $20 million from the contingency fund. Additional forest firefighting costs resulted in an in-year increase of $24 million.

Expenditure increased by $21 million consistent with the treatment in the 2001-02 public accounts to reflect the Independent Electricity Market Operator expenditures related to ancillary services, rural rate assistance and remote area subsidies not included in the 2002 budget.

Increase in legal aid tariff rates effective August 2002 increased expenditure by $4 million. An additional $4 million was also provided to help residents, small businesses, farmers, municipalities and municipal organizations affected by severe flooding in northwestern Ontario earlier this year.

Operating expenditure also increased by $2 million to support the community service improvement grants, domestic violence bail pilot projects, public education and regional conferences as part of a multi-ministry interim response to the Hadley inquest into domestic violence.

Public debt interest costs were down $45 million from the 2002 budget plan projection due to lower-than-expected interest rates and cost-effective debt management.

The next slide highlights in-year changes in terms of capital expenditure. Net capital expenditure is up by $2 million from the budget plan. The major change reported is in the capital component of the multi-ministry interim response to the Hadley inquest into domestic violence: $5 million was provided to enhance safety, security and accessibility of women's shelters and $2 million for the expansion of the domestic violence court program. The expenditures are offset by $5 million from the capital contingency fund and $2 million of revenue from the victims' justice fund.

Since the release of the second quarter Ontario Finances, the government has announced a number of significant investments in priority areas. On November 20, the government announced up to $350 million in funding for hospitals to enhance patient care. Including this announcement, 2002-03 funding for hospitals will total up to $9.8 billion, a 12% increase over 2001-02 actual expenditures.

In early December, following the release of the Rozanski report, the government committed funding to implement the three recommendations Dr Rozanski deemed necessary to implement in the current school year, namely: funding to support the current round of collective bargaining, funding to help school boards put more special education resources and programs in place, and funding for student transportation.

Additional funding has also been provided for child welfare to address caseload and volume pressures and for the Ontario drug benefit program due to increased drug costs.

While these investments are not reflected in second quarter Ontario Finances, we expect to accommodate the costs of these initiatives within the fiscal plan laid out by the government. Every year the government reallocates spending from non-priority areas to priority areas to deal with such situations.

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At this point, I would like to briefly review the province's fiscal performance in recent years.

As this slide demonstrates, the government's commitment to controlling spending has allowed the province to reduce spending as a percentage of provincial GDP while at the same time investing in key sectors such as health care, education and the environment. In 2002-03, total spending as a share of the economy is estimated at 14.1%, down from a peak of 18.9% in 1992-93. That 14.1% total spending, as a share of Ontario's gross domestic product, is at its lowest level since the early 1980s.

With a balanced budget since 1999-2000, the government has begun to reduce Ontario's net provincial debt. As a result of four consecutive deficits of over $10 billion annually, Ontario's debt rose dramatically in the early 1990s. Net provincial debt as a percentage of GDP more than doubled, from 12.7% in 1989-90 to 32.2% in 1996-97. Strong economic growth, sound fiscal management and three consecutive years of budget surpluses have reduced net provincial debt to a projected 23.7% of GDP in 2002-03.

With respect to specific sectors, the government's investment in health care reflects the priority of the people of Ontario. Health care funding has increased every year since 1995. While the government promised three years ago to invest $22.7 billion in health care by 2003-04, that amount was exceeded last year, two full years ahead of schedule. Health care base operating spending will be approximately $25.5 billion in 2002-03, an increase of almost $2 billion over 2001-02 actual spending of $23.7 billion. This represents an increase of almost $8 billion since 1994-95. Health base operating spending represented 38% of total Ontario government spending in 1995-96. In 2002-03, health base operating spending is expected to be 47% of total Ontario government program spending. Over the last three years the average annual rate of increase in terms of health operating spending has been 7.7%.

The government has been encouraging reform and innovation in health care, including Ontario's pioneering telehealth system, which offers quality advice on an around-the-clock basis across the province for an average 3,500 Ontarians every day. Ontario has North America's first free universal influenza vaccination program, administering five million doses annually. Family health networks ensure that services are consistent with the reformed primary care system, and the Ontario Cancer Research Network was created to support research into new cancer treatments.

Turning to the education sector, this graph illustrates that for the 2002-03 school year, funding available to school boards in Ontario in direct provincial transfers and education property taxes will be at a record level of $14.8 billion. This represents an increase of almost $1 billion over the 2001-02 funding level and an increase of $1.7 billion since the introduction of a student-focused funding model in 1998-99.

The creation of the Education Equality Task Force under the leadership of Dr Mordechai Rozanski demonstrates that education is a key priority of the government. The task force mandate was to review the student-focused funding formula and make recommendations on ways to improve fairness, certainty and stability for our schools and our students. Dr Rozanski delivered his final report and recommendations in December 2002. The government accepted the report and recommendations and committed to implementing its immediate recommendations.

In December 2002, the government announced a $610-million package for the 2002-03 school year to support investments in the three priority areas identified by the task force: $340 million to support the current round of collective bargaining; $250 million for special education; and the $20-million enhancement for student transportation announced in the 2002 budget is being allocated to address priorities identified by the task force.

The inclusion of the December announcements brings total school board funding to over $14.8 billion in the 2002-03 school year, which corresponds to an increase of 7% over the 2001-02 school year while enrolment has increased by 0.4% over this period.

The government is committed to addressing the remaining recommendations within the province's multi-year fiscal framework and the planned introduction of multi-year base funding for school boards.

Since 1995, we have focused on building a more open, transparent and accountable government that affirms taxpayers' confidence that their money is being managed effectively and efficiently. As a step in this evolutionary process, the government passed the Taxpayer Protection Act and the Balanced Budget Act in 1999. While we have more to do, we have built a solid foundation for a culture of continuing improvement that works to build public trust in government operations, plan for effective and accessible public services for future generations, advance our accounting and controllership practices, improve accountability to the citizens of Ontario and keep our staff well qualified to meet the challenges of managing in the 21st century.

In keeping with the recommendations of the Ontario Financial Review Commission, we have established a system of annual public reporting of ministries' business plans that communicate their vision, core business activities, performance goals and results. Business plans serve as a tool for public accountability, as they define expectations and report on efficiency, effectiveness and consumer satisfaction. It is important for the public to understand what the public service does and how it is progressing against its publicly stated objectives.

The government is working with its partners in the hospital, school board, college and university sectors to ensure stable and sustainable public services in Ontario.

Everyone has a responsibility to ensure that these essential services are available to people when they need them—today and in the future. To that end, the government has heard and has noted that our partners in the broader public sector need to plan their work more strategically for the current year and years ahead. So this year, the budget will be tabled before the start of the fiscal year.

As many OECD countries have done, the government is taking further steps toward publishing a multi-year fiscal framework that describes revenue expenditures and economic projections. This is a necessary foundation for developing a model of multi-year base funding for hospitals, school boards, colleges and universities. The government's vision is to develop a new longer-term base funding strategy by working collaboratively with its partners.

Such a strategy must not focus on money alone. Successful implementation of multi-year base funding depends on strengthening the partnership between government and organizations in the broader public sector and on co-operatively developing the mechanisms needed to support this initiative, such as tools to assess ongoing performance, mitigate risks and periodically review funding arrangements. Thus, multi-year base funding will evolve over time while respecting the need to balance the budget and ensuring that other important public priorities such as environmental protection, road safety and policing are funded and external risks are taken into account.

To accomplish this, we will work collaboratively with our broader public sector partners. We are confident that through consultation we can ensure sustainable funding, supporting the best possible services for the people of Ontario.

Better accounting and reporting practices support relevant, accurate information-sharing with decision-makers and the public. A new policy on accounting for tangible capital assets will allow the government and the public to understand the condition of our capital assets, the true cost of delivering government services, and improve our ability to better allocate scarce resources toward the most urgent capital needs. This policy will help governments ensure that the appropriate public infrastructure investments are made for future generations.

The Ontario Financial Review Commission recommended in 1995 that the government adopt the accounting recommendations of the Canadian Institute of Chartered Accountants' public sector accounting board and its budget-spending authority and updates to its fiscal situation. In its response to the commission's 1995 recommendations, the government, in the 1996 budget, indicated that they had adopted the accrual basis of accounting for the financial statements in the budget. Further, the government indicated that adopting PSAB—or accrual accounting—standards for legislative spending authority as recommended by the commission would require further investment in financial systems and training and legislative changes. The government would continue to work toward adopting these changes. As a transitional measure, a reconciliation of accrual or PSAB to modified cash expenditures would be provided at a ministry level in the estimates starting in the fiscal year 1996-97. The Ontario Provincial Auditor has also urged the adoption of the accrual accounting basis for legislative authority and appropriation control.

The government introduced amendments to legislation in the spring budget bill, which received royal assent in June 2002, that converted legislative spending authority and appropriation control to the accrual basis of accounting, effective the fiscal year starting April 1, 2003. This change is in line with the government's commitment to improving accounting practices in the context of a more efficient, effective and accountable government. It provides for more effective legislative and management control by enhancing the quality of financial information available, and better reflects the financial obligations of the province.

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On the final slide: the way we manage our day-to-day financial information and how we prepare Ontario public servants to meet the modern challenges of managing public resources will determine the success of our efforts to improve the efficiency and effectiveness of the public sector in Ontario. To that end, we have established IFIS, a single financial management system that will replace the many different systems currently used by the provincial government. It has many benefits, including online access to comprehensive financial data, allowing for greater analysis; producing quarterly financial statements and year-end public accounts more quickly and efficiently; and the ability of the government to purchase goods and services as a single buyer and maximize all possible discounts. Finally, IFIS will form a key part of the infrastructure for e-government initiatives.

Finally, modern controllership is a set of management functions that ensure ethical behaviour, clear lines of accountability and stewardship of resources to achieve organizational objectives and report on results. The implementation of modern controllership across the OPS is fundamental to supporting a results-oriented and customer-focused public service. As a former federal Clerk of the Privy Council once pointed out, people make the difference, not systems. In order to work in different ways, they will require appropriate skill development formally and, most importantly, on-the-job training experience. To meet this challenge, the government has implemented a modern controllership training program which is offered throughout the public service to ensure staff have the necessary skills to deal with modern management principles and state-of-the-art systems that can respond to public demand for continuous improvement in the way the government executes its business.

Mr John Whitehead: I'm John Whitehead. I'm the director of the personal tax and fiscal arrangements branch. I wanted to take just a few moments this morning to review some of the key tax policy changes that have been made since 1995.

In 1995, Ontario's personal income tax rate was set at 58% of basic federal tax. By July 1, 1998, that rate had been reduced to 40.5% of basic federal tax, a reduction of 30.2%. Since then, the government has introduced a number of personal income tax cuts in addition to these basic rate cuts. A 5% across-the-board rate cut was implemented in 1999 toward the government's 20% personal income tax goal, and further reductions to Ontario's first and middle tax rates were made beginning in 2000, when Ontario moved to its new tax-on-income system. As a result of the changes that have been made since 1995, taxpayers are now benefiting by over $11 billion per year.

By next year, the remaining steps of the 20% personal income tax commitment that was made in 1999 are planned to be delivered. The first and middle tax rates will be cut to 5.65% and 8.85% respectively, and the 20% surtax will be eliminated for those taxpayers who pay surtax only in the first tier.

The chart that you have in front of you now shows the effect of these changes over the years. At all income levels, personal income tax is down in Ontario. In the first bracket, for example, our rate has dropped from an effective rate of 9.86% in 1995 to 6.05% today. Of course, it's on its way to 5.65% by January 1, 2004.

In addition to the rate cuts, you'll notice that the tax brackets engage at different points now than they did before. This is a result of indexing the brackets. Ontario's consumer price index is used to increase the income level at which the next tax rate applies. The surtax thresholds are also indexed to ensure that non-surtax-payers whose incomes rise at the rate of inflation will not become surtax payers. As a result of the government's plan to eliminate the surtax, the first tier of the surtax will be raised to the level of the second tier effective January 1, 2004. The remaining surtax will be calculated as 56% of basic Ontario tax in excess of an estimated $4,850.

Because the surtax is based on Ontario tax and not income, there is no single income point at which the surtax engages. For the purpose of this slide, we have used interest income, which is the least advantageous demonstration of where the surtax would begin. Other forms of income would begin higher.

Cutting Ontario tax rates was key to reducing Ontario's personal income tax, but the government took many other important steps as well. In 2000, non-refundable credit amounts were increased by approximately 1.4%.

In 2001, tax support for students and people with disabilities was increased substantially more than the rate of inflation. For example, the underlying amount of the disability tax credit was raised from $4,293 in 2000 to $6,000, an increase of about 40%.

The education amount for full-time post-secondary students was also increased, in this case from $200 a month to $400 a month.

Starting in 2001, all of the key components in the calculation of Ontario personal income tax are now indexed to inflation. This includes the income tax brackets and the non-refundable credit amounts. It also includes the surtax thresholds and the parameters we use to calculate the Ontario tax reduction. The increase to these amounts in 2003 reflects a 1.7% inflation growth in Ontario.

On a cumulative basis, Ontario's personal income tax system has been indexed by more than 8% since 2000.

The next slide shows that the Ontario tax reduction program reduces or eliminates the Ontario personal income tax otherwise payable by individuals with low or moderate incomes. All Ontario tax filers can claim a basic amount in this program—$181 was the basic amount in 2003, plus a supplementary amount—calculated as $334 in 2003, for each dependent child under age 18 and disabled or infirm dependents. No Ontario tax is payable if it is less than the sum of these amounts, and reduced tax is available to people with more than this amount.

The 2002 budget enriched the Ontario tax reduction by increasing the basic amounts for 2003. The benefits of this enrichment will be amplified when the remaining tax rate cuts take place in 2004. As a result, 50,000 lower-income individuals will be removed from Ontario's tax rolls.

Because the Ontario tax reduction is based on family characteristics and Ontario tax, not income, we again have a situation where there is no single income level below which Ontario taxpayers benefit. However, taking the example of a single individual with employment income only, that individual could earn up to $11,980 and pay no Ontario tax.

The taxes on capital gains have also been reduced. In 2000, Ontario reduced the taxable proportion of capital gains from 75% to 50%. The proportion of taxable gains was cut from 75% to 66 2/3% in February 2000 and down to 50% in October 2000. When combined with Ontario's rate cuts, the top marginal rate of Ontario personal tax on capital gains has been reduced by nearly half and the marginal rates of Ontario personal income tax paid at lower income levels has been cut by nearly 60%.

In the example shown in the chart you're looking at, the top marginal rate of Ontario personal income tax was 21.9% in 1995, and 75% of the gains were included in income. As a result, the individual in this case would have paid $164 in tax on $1,000 of gains in 1995. The top marginal rate of personal tax is now 17.4%, and only half of the gains are taxed. As a result, the same $1,000 gain today will generate only $87 of tax. This is a decrease of about 47%.

The combined federal and Ontario marginal rates of personal income tax on capital gains are now broadly comparable across all income levels with the tax regime in the United States.

There has also been a significant package of support for small businesses in Ontario. In 1995, Ontario's small business corporate income tax rate was 9.5%, which was one of the highest in the country. The small business rate is being reduced to 4% by 2005, which is an overall rate reduction of about 58%. At the same time, the income threshold for Ontario's small business rate is being increased, to $400,000 by 2005; that's twice the original level. In 2005, when our small business rate cuts are fully implemented, Ontario will have the second-lowest small business corporate income tax rate among the provinces.

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Moving on to general corporate tax rates and manufacturing and processing rates, in 1995 our general corporate tax rate was 15.5%. Today we're down to 12.5%, and by 2006 the general rate will reach 8%. This is a cut of approximately 48.4%. In 1995, Ontario's corporate manufacturing and processing rate was 13.5%, and by 2006 we will be at 8%, a cut of 40.7%.

Moving on now to property tax, property tax was the subject of probably one of the biggest reforms in Ontario's history. In 1995, the base on which property tax was assessed was inconsistent across the province. It was a major reform and a move to a fairer tax system when the province moved to a consistent basis of property assessment. In 1998, the province took over responsibility for education funding and moved to bring property tax rates for education under control and to ensure a fair and consistent treatment for all school boards. The province introduced a uniform education tax rate for all residential and multi-residential properties which was equal to one half of the previous average education rate. In 1999, the government committed to cut the residential education tax rate by a further 20%, and it implemented the first 10% of that cut in 1999.

On the next slide, we highlight that the business education tax rates were also being reduced, and the government has committed to reduce the business education tax by a total of $500 million.

Moving on to the next slide, the tax cuts on business have been focused on the areas of the province with the highest business education taxes. The tax cut initially focused on municipalities with tax rates above 3.3%, but that target rate has now been lowered to 2.65%. The government has also accelerated these cuts to match municipalities across Ontario which were also reducing their business taxes.

In 1996, Ontario began the process of eliminating the first $400,000 of payroll from the employer health tax. The $400,000 exemption was fully in place by July 1998, and the employer health tax on self-employed individuals was eliminated entirely in January 1999.

There have been sales tax reductions during this period as well. Under some pressure to reduce taxes in the context of rising fuel costs, the government moved to ensure that consumers would realize the full benefits of its tax cuts and took action to give consumers the direct benefit by cutting the tax on auto insurance premiums and on repairs and replacements made under warranty.

A wide variety of initiatives have been implemented to address specific policy objectives, including research and development measures: the Ontario business research institute tax credit, for example; the innovation tax credit; a new technology tax incentive which provides an immediate deduction of eligible costs of qualifying intellectual property acquired by a corporation. Education and training measures have been implemented, including the co-operative education tax credit, a 10% refundable credit of eligible costs incurred in providing a work placement. There has been a school bus safety measure, alternative fuel vehicle and biodiesel measures, measures in support of call centres and farmers, and changes to the land transfer tax as well.

The benefits of the tax cuts have been outlined in several budgets. We'll touch on just a couple here. In the case of this particular family, $60,000 income, two earners with two children, it is now paying $2,125 less Ontario income tax this year than it would have paid without the tax cuts, and in total can look forward to a $2,515, or 55%, reduction in the tax that would otherwise have been payable without the tax cuts that have been put in place. The same family, if it was living in a $200,000 home, would also be realizing about another $84 of benefits on its property tax.

In the next example we see a family with $30,000 of income. This is a single-earner family of four currently paying $1,620 less in Ontario income tax, a saving of 100%. This family, I might note, is continuing to pay federal tax. This family will pay $2,195 in federal personal income tax in 2003.

The benefits of tax cuts also help us on a competitive front. In the next slide you can see the comparison to other provinces. It's a little busy, but Ontario is right in the middle there, with the tallest bar in dark blue. Ontario's personal income tax rates on most individuals in the first two brackets are now tied, as a result of the cuts, for lowest in Canada. By 2004, Ontario personal income tax rates will be the lowest in Canada for individuals in the first two tax brackets. The top marginal rate of Ontario personal income tax on ordinary income is now the fifth-lowest among the provinces.

In comparison with the United States, this chart shows the impact of the changes that have been made. The combined federal-Ontario marginal personal income tax rates are now broadly comparable with those of competing US states for taxpayers earning less than about C$60,000. As a result of the Ontario tax cuts, the top marginal rate is also more in line. Combined federal-state personal income tax in the US ranges from about 38.6% to about 45%. At 46.4%, the top marginal rate of Ontario personal income tax is only slightly higher than that of the States. One thing we are watching and that you can see through this chart is that as one gets into the higher income ranges, Ontario's highest rate of tax cuts into a much earlier income level than is the case in the United States.

Moving on to our next chart, showing the support for small business: by 2005 the small business rate will be down to 4%, a rate reduction of about 58%. The government has extended this rate to more businesses by increasing the income level eligible for the small business rate.

Moving on to the next slide, we can see the comparison with the tax rates in place in the United States and where Ontario's rate will be. When Ontario's corporate income tax rates are fully implemented in 2006, the combined general corporate income tax rate will be more than 10 percentage points lower than the US Great Lakes states' weighted average rate.

In terms of the benefits of the property tax cuts, education property tax cuts are now saving Ontario taxpayers about $650 million per year, business properties are currently saving $400 million per year and homeowners are saving $250 million per year. Our target remains roughly $1 billion of tax savings to businesses and corporations through the property tax cuts that are planned.

For employers who pay the employer health tax, currently about 88% of private sector employers no longer have to file an employer health tax return as a result of a $400,000 exemption, and all other employers pay less tax.

Just by way of context, the federal government's changes are demonstrated in the following table. More than two thirds of the income taxes paid by the people of Ontario are levied by the federal government. While the federal government has cut income taxes—and the changes are not small, but on a relative basis they are modest compared to what Ontario has done, roughly half or less, depending on the particular example chosen.

Finally, on our last slide, when the cuts are fully implemented for the general corporate income tax rates in 2006, Ontario will have cut its corporate income tax rates by twice as much as the federal cuts.

Mr Michael Gourley: My name is Michael Gourley. I'm pleased to provide the committee with an update on the province's borrowing and debt management program. We have about 10 slides. I'll try and get through them as quickly as possible.

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With me today from the Ontario Financing Authority are Mr Gadi Mayman, executive director of capital markets, Mr Bill Ralph, who is director of corporate finance, and Mr Richard Rose, who is the manager of accounting and financial reporting.

The first slide basically shows our long-term public borrowing, as forecast for this year, to be about $13.1 billion. To date, we've completed about $12.1 billion of that planned long-term public market borrowing. The province's issues are generally well received by investors, despite uncertain times in both the domestic and international capital markets. I'd like to describe to the committee today how we've approached the financial markets so far this fiscal year.

We clearly take a flexible borrowing approach to the domestic and international capital markets, monitoring them closely on a daily basis to ensure optimal timing of new bond issues. While the Canadian dollar market is the primary source of financing for the province's long-term borrowing, we will borrow in any major capital market where it's cost-effective for the province to do so. We aim for a smooth debt maturity profile to diversify our interest rate risk for the refinancing of maturing and floating rate debt.

We also structure our debt products to meet the needs of investors and to meet our own borrowing requirements in a cost-effective manner. The Canadian market remains the most favourable source of funding and, to date this year, about three quarters of our public borrowing was raised in the Canadian dollar market. In the next slide, you see that 75% of the borrowing has been done in that market, the gold colour indicating Canadian-dollar-denominated instruments. We use different instruments to achieve cost-effective borrowing, and I would just say, for example, that the US dollar has been the most favourable foreign currency the province has used this year. We've raised the Canadian-dollar equivalent of about $2.9 billion through US-dollar issues this year. While roughly 60% of these issues were bought by US investors, as one might expect, more than a quarter of the US-dollar issues were purchased by European investors, with the remainder being bought by Asian, Middle Eastern and Canadian investors. So even though it is a US-dollar issue, as you would expect, there is a global market for these US-dollar issues by Ontario.

The $11.6-billion borrowing to date excludes debt buybacks. We bought back approximately $517 million of previously issued debt, and financed the purchases with similar amounts of debt issued at more favourable rates.

Looking at our outstanding debt, you can see that as of second quarter Ontario Finances, net provincial debt was $112 billion, as it is forecast to be as at March 31, 2003. The largest component of our net provincial debt is issued in the public markets, with publicly held debt consisting of over $86 billion in outstanding long- and short-term debt. In addition, the province has $26 billion in non-public debt, and this is primarily held by the CPP—the Canada pension plan—the Ontario teachers' pension fund and the public service pension fund. This debt is not tradable in public markets.

The next slide illustrates two of our debt management policies and our borrowing policies. We manage the province's debt and liquid reserves prudently and cost-effectively. Our annual financing plans are prepared by the OFA and take into consideration economic assumptions, interest rate forecasts, foreign exchange forecasts and all of those factors that affect our markets. We strive to be at the forefront of debt management, and we want to ensure that our measurement of our performance is effective. So the cost-effectiveness of our borrowing, of our debt management activities and investment activities themselves are measured daily against benchmarks that have been approved by our board of directors. This ensures that we keep a close watch on all of these indicators and manage our performance accordingly.

As you can see from this slide, we've been well within our exposure limits, that is to say, the limits approved by the board of directors, with interest rate exposure being limited to 25% and foreign exchange exposure limited to 5%. As of December 31, our foreign exchange was 1.6% of total debt outstanding, rather than the limit of 5% that it could have been. As of the same date, our interest rate resetting exposure was at 11.1% of total debt outstanding.

I would like to just take a moment to give the committee an illustration. In fact, there is a US$3-billion, 10-year bond that matured today. So it matures on January 27, 2003 and it was issued 10 years ago. Through a series of financial transactions and management techniques, the OFA has eliminated that foreign exchange exposure and basically saved over that period of time about $700 million. So if we had to repay and had said we were going to take the interest rate exposure instead of swapping and locking in our debts at a Canadian-dollar equivalent, we would have had to pay $700 million more today than we originally borrowed. But we did not do that and that's one of the reasons why we are so careful in the management of the province's debt.

Moving on now to the credit ratings, basically Ontario's recent credit rating improvements have been based on the province's financial record: three consecutive balanced budgets and a fourth projected for this year; improved overall competitiveness of the economy, as Mr Howell outlined, including the tax cuts that Mr Whitehead outlined; and generally the prudent fiscal policy and continuing improvement in the province's debt profile, this having been outlined by Mr Sékaly. The next slide simply shows the nine rating improvements, including four upgrades in the long-term credit rating that the province has experienced in the past eight years.

In the two slides that follow, one deals with the Ontario Electricity Financial Corp. That's an agency of the province responsible for servicing and management of the former Ontario Hydro's debt. For 2002-03, the OEFC is refinancing debt maturities of about $2.7 billion. The OEFC is also responsible for managing the electricity consumer price protection plan as well.

Moving on to the OEFC's debt itself, we see on this slide that the total liabilities have declined by more than $500 million, from $38.1 billion in 1999 to $37.6 billion as of March 31, 2002. The total debt, which consists of outstanding long-term and short-term debt, has declined by $1.1 billion, from $30.5 billion in 1999 to $29.4 billion as of March 31, 2002. Stranded debt, which is the net deficiency of assets over liabilities, was $20.1 billion as of March 31, 2002.

Moving on to the next slide, on August 19, at the Association of Municipalities of Ontario conference, the Premier announced the creation of the Ontario Municipal Economic Infrastructure Financing Authority and the introduction of tax-free opportunity bonds. This whole set of programs will ensure that all municipalities, both large and small, will be able to share in the benefits of opportunity bonds. The Premier also announced a capital injection of $1 billion in seed capital to OMEIFA and that an additional $120 million would be provided from the Ontario Clean Water Agency dedicated to clean water and sewage treatment projects. Legislation was introduced to establish OMEIFA as a crown agency and to provide certainty regarding its governance and accountability, and it received royal assent on December 9, 2002.

Chair, that concludes my presentation.

The Chair: Thank you, sir. That concludes it all, then, Deputy?

We have about 50 minutes and we'll begin with the third party. Mr Christopherson, you have the lead.

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Mr Christopherson: Thank you for that comprehensive presentation. I don't have a lot of questions actually. Recognizing that questions at this point are certainly meant to be for fact-gathering and clarification as opposed to the usual cut and thrust of politics, and since staff aren't in the same position as politicians, I won't at all attempt to move away from that. I just have some very straightforward questions—some clarification actually.

Bob, in the first document—actually it was Phil Howell who made the presentation. Could you just clarify for me a little more and expand on the slide on page 4, where it talks about "Domestic Spending Drives Growth In 2002"? Can you just walk me through that again, please?

Mr Howell: What this slide is showing is the contribution to growth that the different parts of the economy make during the year. We're looking here at the data we have for the first three quarters. I think it was 7.2% growth in the first quarter, 4% in the second and 3.9% today. It's looking within the growth in real GDP represented by those growth rates. What this is saying is that 9.1% of that was accounted for by spending on residential construction and housing. That would include new construction as well as renovation. Four per cent of the growth that came during that period was accounted for by businesses spending on machinery and equipment in factories and so on.

The negative net trade means that, in effect, exports minus imports were a drag on growth over the period, reflecting the fact that the growth of exports was off, as I mentioned in my remarks, reflecting sluggish US growth at the moment. So it's really just a way of looking at the growth that happened during the period and then breaking down who was responsible for the spending that drove that growth.

Mr Christopherson: In your own words, how important is the question of exports and imports in terms of impact on our overall economy?

Mr Howell: Trade is important for a number of reasons, and it's important on both sides of the equation, both exports and imports. If you take a look at gross exports as a share of GDP, that number has grown significantly in recent years. Interestingly, exactly the same thing has happened with import spending numbers, and that partly reflects the increasing integration of our economy, particularly with the US, in the case of Ontario, but also reflects changes in production processes over the period and the significantly increased use of imported components in the production of exports. This has been notable for years in the auto sector, but it has now spread to other sectors. While the gross numbers have risen, you have to understand that there's been a fairly significant rationalization of production processes. Just focusing on that gross number as a share of total GDP, as some people sometimes do, overstates the significance of trade, because it's a huge number.

The point I was making in the presentation is that while trade is certainly very important and will always be important to us and is a significant opportunity for growth—and when you have a situation like we currently have in the Ontario economy, we're definitely poised to take advantage of demand growth in the US, and that obviously contributes to jobs and so on—it's equally important, if your objective is to try to sustain growth on a consistent basis over time, to ensure that you've essentially got the economy firing on all cylinders. And while trade is extremely important in the economy, it's just one cylinder of the economy.

Mr Christopherson: You say it's just one cylinder. If this number continues to be negative, given its overall impact on our economy and how much we export, just how much do we really have sovereignty over our ability to have net growth if exports, particularly to the US, because their demand is down, continue to stay at low numbers and in fact continue to drop? In your own opinion, how much latitude do we have as a sovereign jurisdiction to overcome the drag, as you call it, when export numbers go through the basement?

Mr Howell: Of course, as history shows us, the drop isn't going to be there forever. We know the US economy will pick up, and the presentation suggested that by 2004 there will be quite robust growth in—

Mr Christopherson: That's a guarantee on your part you're offering?

Laughter.

Mr Christopherson: Hansard will note they all laughed.

Mr Howell: It's certainly an expectation on my part.

Mr Christopherson: Oh, well—that and a buck, eh?

Mr Rob Sampson (Mississauga Centre): It's a guaranteed expectation.

Mr Howell: I should also point out that the numbers we were using in the presentation today reflect current private sector consensus forecasts.

So in the first place, obviously trade will rebound. Just to reiterate, though, the point that I think is important is that when you are faced with situations you can't control, and one of the things we can't control is what happens to demand growth in the US, you want to ensure that you have flexibility in your economy so that you're not devastated by relying on just one aspect for your growth. Consequently, that suggests engaging in policies that are going to strengthen the ability of the domestic economy to continue moving forward.

Mr Christopherson: You keep answering like that, Phil, and we're going to make you an honorary politician. You know what that will do to your reputation. Fair enough.

At the staff level, to you, Mr Christie, given the importance of jobs to the economy and the fact that we've got unemployment rates that are higher than they were—right now I think they are around 7%. Even in mid-2000, they were about 5.4%. So our unemployment rates aren't the best, and they should give people some pause for concern.

First of all, a straight-up question. Are there discussions at the staff level, or at the political level that you are aware of, taking place with the automakers in terms of putting in place some kind of auto strategy, given that much of the resolution of the negotiations for a new contract between the auto workers and the manufacturers was that governments at both senior levels would play a significant role in the development of an auto strategy to ensure we have those jobs here, again given auto's overall importance to our economy? Where are we at with that right now?

Dr Christie: First, an observation on the unemployment rate. One of the things we're seeing, I think, on the unemployment rate is that the increase in the participation rate is a big factor behind that. The Ontario economy created a lot of jobs in 2002, and in part because of that, a lot of people came back into the labour force because they felt there was a better chance of getting a job. That's not untypical. When the economy is very weak, people tend to drop out of the labour force because they don't think they can get a job. However, while that's a factor, it's never a cause to be complacent about our unemployment situation and our labour market situation.

The automakers have been in to talk to us in terms of the kinds of things they're looking at. I know they have talked to our Ministry of Enterprise, Opportunity and Innovation, and I know they have been speaking to the federal government because we have, at least at the staff level, compared notes about some of the discussions we've had. To the best of my knowledge, Mr Christopherson, those discussions are ongoing.

Mr Christopherson: But is there any actual plan being worked on? Have you got a directive that you're acting on from one of the ministers saying, "Start pulling something together here because this is a priority and we've got to get it tabled"? Is anything like that happening right now?

Dr Christie: Depending on which automaker, there are different characteristics of a plan, so we're looking at all of the proposals that have been put on the table.

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Mr Christopherson: Another question. The $2 billion in the last budget on the revenue side was to come from asset sales. Many of us felt those were code words for Hydro; we'd get a fire sale, that money would come in and, like the 407, the government would use that as in-year revenue to boost an election platform. I don't expect you to comment on any of this, Bob. I do expect you to answer the question, though. Given that the government was forced to breathe in some oxygen and cancel the sale of Hydro, my question to you is, how much is the loss of that $2 billion going to affect your ability to have a balanced budget? If it's not, then what exactly are the sales, if it's not Hydro, that are being actually sold to generate said income?

Dr Christie: At the time of the budget and afterwards, when asked about the $2 billion, I think the minister indicated that there are a number of assets that are under review that are being looked at. The 2001 budget indicated that we would be going ahead with the disposition of the Province of Ontario Savings Office, just as an example. It's an example of one of a number of assets that are being looked at.

Mr Christopherson: Are you going to reach the $2 billion?

Dr Christie: That's something, in terms of the reporting on this fiscal year's interim results, that will come with the budget. When we produce the budget outlook for next year, we'll also do an interim report for this year and we'll—

Mr Christopherson: But you must have some idea at this point, given that it's in the current fiscal and we're rapidly coming to the close of that time period. Again, I don't want to be unfair, Bob, but there must be some sense within your ministry that you either are or are not getting close to that $2 billion.

Dr Christie: What we look at is the overall—we look at all of our revenue and all of our expenditure. As I'm sure members of the committee know from having seen these things over the years, you can have reasonably significant changes on a line-by-line basis as you go through a year and it's how those all come together at the end. In looking at that one sales and rentals line, where the asset sales are, we look at that as part of the whole picture. There is certainly still active review of a number of assets going on, so we won't know the results of those reviews till we get closer to the end of the year.

Mr Christopherson: Do you still need that total $2 billion to hit your balanced budget?

Dr Christie: As I think the minister and others have indicated, they continue without—as was noted after the Hydro sale, a decision was announced. The continued expectation is that there will be a balanced budget without the sale of that particular asset. All of the expectations on which we're functioning and managing are toward a balanced budget for this year.

Mr Christopherson: Thank you. Shifting gears again, the hydro capping and the debt that's generating: first of all, can you give me a sense of what your projections of the numbers might look like, the range, in terms of the new debt that's being generated as a result of that; and then secondly, what are the plans for the government to ultimately do something about that number which, unless there's a miracle in the magical marketplace, is going to continue ad infinitum to increase?

Dr Christie: I think at the time the changes to the electricity system were announced and the electricity price protection fund was announced, it was indicated that the expectation was that this would be self-financing over the longer term. The expectation is that over the roughly four-year life of that, obviously there will be times when the price is above 4.3 and times when the price is below 4.3. But the expectation is that, roughly, the fund will be in balance by the end of it. A good part of that is a reflection of the availability of monies through OPG from the market power mitigation agreement with respect to those consumers.

Mr Christopherson: Given the fact that we have no control over that, given the current geopolitical climate that exists, given what the price of energy is now and how that will be impacted if indeed there's a war and other things affect the oil supplies, correct me if I'm wrong, but you can only say that you think everything will be fine by the end of four years. But if things don't go well as, say, some of the stock market predictors in 1999-2000 got it wrong—huge—this could turn into a real fiscal crisis. What plans does the government have in place to deal with this if all the assumptions and projections go wrong?

Dr Christie: The assumptions and projections etc have to be based on the knowledge that we have of where we are in the electricity market. We know, for example, that we have Bruce units coming back into production; we will have Pickering units beginning to come back into production. Those are all quite significant additions to the capacity that haven't been available over the last six to eight months. We've also had—as I am told, not being a meteorologist—some of the more extreme weather that we've been subject to for a while.

The planning has been based on reasonable expectations both about additional supply and the effect that will have on price, as well as the other influences on the electricity market. In looking at it, we've tried to make the most cautious, prudent estimate available, but we have taken into account things like the return to service of those various units.

Mike, I don't know if you wanted to add anything.

The Chair: Actually, that'll pretty well conclude it. Thank you.

We'll have to turn to the government side now. All four of you want to speak. You've got a little less than four minutes each if that's what you want. We'll begin with Mr Sampson, then go to Mr Arnott.

Mr Sampson: Thank you for that caution, Chair. I think this question is probably to a combination of Mr Howell and Mr Gourley.

If I got it correctly, part of good planning in finance is indeed to try to make sure you have a strong domestic economy to help insulate activities that hit the import-export side of the balance sheet that you frankly can't control. There was a lot of talk in all the presentations so far this morning about this thing called disposable income. I'm kind of amused about that. I think it's people trying to dispose of my net income more than I get a chance to dispose of it.

One of the bigger expenditures that one has to face with one's disposable income is the cost of borrowing the money to buy the houses, the cars, the furniture, the TV sets and whatever we all tend to dispose our income on. I noted with interest the comment about the PDI component of the provincial interest line over the last number of years, from the early 1990s to now, and that we have actually benefited from a lower rate structure.

Has anybody in your shop done any work on what the net impact has been on where we can dispose of our disposable income, given that the rate structure has gone from here—when the Liberals were in power, I remember we had rates that were in the stratosphere—to now, some 2% or 3%? That certainly has had an impact on our own net incomes after taxes and where we can spend them, and I would dare say sizable, since debt costs and interests costs are—what?—50% of our disposable income category. Have you guys done any work on how that has actually helped fuel domestic spending and helped maintain economic growth in the absence of an export problem?

1130

Mr Howell: We certainly track constantly what some people might refer to as affordability measures. That's used particularly in the context of financing a mortgage for a home purchase. We also track the ability of consumers to carry a debt load. Similarly, businesses' ability to finance using debt is dramatically improved when interest rates are lower.

One of the slides I had up showed what has happened with the consumer, and it gives a good indication of the power of lower interest rates, particularly when you have lower interest rates that you expect to prevail because the inflation environment is low and monetary authorities are unlikely to tighten aggressively.

So you have a situation now that, while the absolute level of debt for consumers in Canada is higher, the cost of carrying that debt is actually lower for consumers than was the case five, 10 years ago with smaller amounts of debt. That's the advantage. That's the same story that happens on the PDI side. I think that speaks to the importance of maintaining low-inflation environments, because it does enable people, with some confidence, to engage in borrowing to finance spending.

Mr Sampson: How do you do that?

Mr Howell: How do you keep inflation rates low? There are a number of different things that are important. You certainly want to ensure you have an environment in which government budgets are balanced to take away that sector of upward pressure on demand for funds. If borrowing is needed to finance deficits, then obviously you'll put upward pressure on interest rates. You want to ensure that markets are able to respond to price pressures quickly, or price signals quickly, so that you don't end up building in inefficiencies that distort prices and let prices persist and feed through into inflation. Basically you want to have monetary authorities who are conscious of the threat of inflation and who manage inflationary threats aggressively when they appear.

Mr Ted Arnott (Waterloo-Wellington): Thank you, gentlemen, for your presentation this morning.

A few months ago the federal government informed us that there had been a major accounting mistake in terms of how they dealt with income tax. They informed a number of provincial governments, including us, that we owed them a lot of money, in the billions of dollars, as I recall. I was encouraged when I read the comments of Paul Martin at that time, after he'd of course left the Ministry of Finance, that he felt the provincial governments deserved a break on this. I'm not sure what status the discussions at the federal level are on this, but I'd be interested in hearing from you where we are on that issue and how it affects our fiscal plan for the coming year and future years.

Dr Christie: Certainly, Mr Arnott. The error that CCRA made was reviewed by the federal Auditor General. Our Provincial Auditor, along with the provincial auditors from a number of the most affected provinces, participated in that review or at least reviewed the federal auditor's work. The result of that was a decision on the part of federal Finance Minister Manley to reclaim, or make a claim on, Ontario's financial position in the amount of about $2 billion, and that was announced earlier last year. When we came to do our public accounts, the way in which the federal government will make this claim on us is through not forwarding monies that they had indicated to us were there, in the amount of about $700 million, and then they'll deduct about $1.3 billion from future personal income tax receipts. As you know, they collect on our behalf and then remit to us. So because they have Ontario taxpayers' money, they have the ability to withhold it in satisfaction of their claim on us.

In the public accounts—we discussed it with our Provincial Auditor, who was actually quite helpful to us in working both with the federal government and in looking at the management of this error on the part of CCRA—we had to revise prior years' financial position in light of the claim that the federal government had made. In doing so, we were very clear that this did not impair our ability to continue to dispute with the federal government the legitimacy of what they were doing, because we do continue to dispute it and have continued to have discussions with them on this matter. We also indicated in our public accounts that booking it was felt to be the cautious approach to financial reporting; that booking it also did not in any way detract from the right to take any legal action we might contemplate, and we are in the process of seeking advice on that.

Mr O'Toole: There are so many questions. I appreciate the expertise here this morning. It's helpful in the very short time all of us get to hear from the experts who actually write this stuff.

One issue I'd like a general comment on, because of the limited time, is the Hydro One debt issue and Pickering and the unknowns there. I live there and I know personally from professional engineers etc that all four reactors will never come up; number 1, no, never; 4 and 3, yes; 2, maybe. These are very important numbers. I just throw that out to you.

The other one is the new municipal financing authority, OMEIFA or whatever it's called. Where does that $1.2 billion show? Is it in the accumulated debt, the $112 billion, or is it anticipated to show up as straight into debt? Where does that number show?

Another one is the anticipated multi-year funding for a number of major policy areas: health, education, universities, hospitals etc. We all know that multi-year funding is predicated on some formula, some basically federal component. It would be interesting to know what numbers we're using. Is it population? Is it just inflation? Is it a GDP factor? What are we doing to forecast the anticipated federal revenue to make those commitments, and are they commitments or are they just more rhetoric with the federal government?

The other one is the new accounting principles. I'm interested in those, more or less I think in an educational mode. The IFIS system will show a whole bunch of new debt that currently is shown in some other way in our financial reporting mechanisms. Depreciation and those things will have to show as against receivables. Could you perhaps try to educate us, as generally members of the public—those are our qualifications here—what to expect in terms of the anticipated accounting conundrums as this new mechanism comes forward? Because many people, including us, won't understand it. I've had a couple of opportunities to hear about it. So I'll just throw those out.

There is one other thing. Part of the percentage of the debt has grown—Mr Phillips will make that case, I'm sure—but we show it as decreasing in terms of a percentage of GDP, I think, or growth in the economy. In real numbers, is it up or down? We're adding money every year to that.

1140

Dr Christie: If I could perhaps make a couple of observations and then ask others to bring their expertise to bear.

With respect to the absolute amount of debt, abstracting from the CCRA or setting that to one side, debt has been paid down in the amount of about $4.5 billion since 1999. The numbers prior to 1999 and from the last few years are actually shown every year in the budget. There's a 10-year table at the back that is quite useful in terms of showing the history of those things.

With respect to federal revenue for health care, the request that all Premiers have made of the federal government is that they restore Canada health and social transfer funding to the proportion of our overall spending on health and social services that we were at in 1994-95, when they began cutting. That formula has been the basis of what Premiers have put forward consistently now for a number of years. What comes out of the discussions with the federal government we'll obviously look forward to.

Perhaps I'd ask Gabe to say something about accounting principles in IFIS and then ask Mike to talk about OMEIFA.

Mr Sékaly: In terms of the integrated financial system, our new accounting system is being built on an accrual basis, which follows the guidelines set out by the Canadian Institute of Chartered Accountants. Basically, where it differs from the cash system we've had in the past, is, for example, if you go out today with your credit card and buy a briefcase but you only pay it next fiscal year—you pay the bill three months from now, which is in April, the next fiscal year—under the cash system, the expense would show up when you pay the bill, but under the accrual system what happens is that it shows up when you get the economic benefit today, when you go out and get it.

That's the difference between the cash and the accrual system. We've had that for our public accounts and our budget since 1995. The estimates the Legislature votes on every year have been on a modified cash system but as of April 1, 2003, will be on an accrual system. Again, the new financial system is on accrual basis, so it will facilitate that. The reason we hadn't moved before is because we needed this new financial system to be able to implement accrual-based appropriations. The crosswalk between the budget, public accounts and the estimates that you vote on is going to be very clear. There won't be many differences.

In terms of why it's being brought about, why accrual accounting is important—and I can give you a copy of this. This is the federal auditor's report, December 2002, on Financial Management and Control in the Government of Canada. The federal auditor lists why accrual accounting is important in government in terms of helping users appreciate the full scope of government resources, obligations, financing etc and the impact on the activities. It provides a more complete picture to legislators to hold government more accountable in its stewardship of assets etc. I can leave this copy with you in terms of some additional information.

The Chair: Mr Beaubien, you have about 15 seconds.

Mr Beaubien: You mentioned that growth is generated by strong domestic consumer demand. I think it's a recognized fact that the industrial sector is not investing tremendously in machinery and equipment. You also mentioned rising productivity being key to maintaining our GDP. Mr Christopherson alluded to the fact that with the latest round of automobile negotiations there may be some role for government to play—I'm trying to make this quickly—and also with the weak Canadian dollar and the impact it has on the Canadian economy. How do you see it coming together? Sorry for being so quick.

Dr Christie: Perhaps we'll get the expert down here to answer the question.

Mr Howell: I see it coming together positively in terms of the outlook. A number of the factors that you're describing that are critically important to driving productivity growth depend on businesses having the confidence to invest. That confidence comes from a variety of sources. Obviously it comes from being able to look at markets and seeing that there are people out there who are going to buy their products. It also comes from believing that they're going to earn a reasonable rate of return on their invested capital. Obviously, corporate tax rates are one factor that figure into that decision.

Similarly, you want to ensure that there is a broader range of factors in place in the economy that make businesses comfortable in investing. Ultimately that is what does drive productivity growth.

With respect to the dollar, there's no question that we have an advantage at the moment because of the level of the dollar. But it's not a question of trying to keep the dollar at a specific level or to try and stop the movements of exchange rates on international markets as they respond to the demand and supply forces of the currency. Rather, I think you always want to strive to ensure that you have an environment that allows the economy to respond quickly and flexibly to whatever is thrown in their face.

The dollar has been going up recently. It's not going up rapidly and it's not eating into the advantage that we have because we have a whole host of other advantages that are in place and allow businesses and consumers to continue to take advantage.

The Chair: Thank you, Mr Howell. We move to the official opposition. You'll get your full 16 minutes because we'll run a couple of minutes over.

Mr Phillips: Thank you. I've got quite a few questions that I'm not going to be able to get in. How do I get answers to those?

The Chair: I'm sure if you table them with the committee we can make sure that the—

Mr Phillips: Can I phone somebody on the staff there to get responses to these?

Dr Christie: If, as the Chair indicates, there are specific questions supplementary to the ones you had forwarded to us, by all means pass them along and we'll do our best to respond.

Mr Phillips: Let me begin. The first question is on the hydro rebates. I gather OPG and Hydro One have virtually closed their books for the calendar year. They must have allocated a certain amount of this mitigation fund. You must have an estimate now of what the rebates are going to cost, at least until the end of December. Can you give us some indication of whether the revenue has been generated to pay the rebate? If not, what's the issue there? How much is the rebate to the end of December and how much has been generated?

Dr Christie: This is the gross amount paid in rebate cheques?

Mr Phillips: I assume you've got an estimate now of what the rebates are going to cost and I gather you've got an estimate from OPG of how much revenue they've generated. Did they generate enough revenue to cover the rebate cost?

Dr Christie: As noted earlier, we have looked at the rebate program as a program that exists over the life of this protection fund. So we're looking at it as a longer-term proposition. We're not doing it on a day-by-day basis.

Mr Phillips: But you must have an estimate. Are we talking about tens of millions of dollars or hundreds of millions of dollars?

Dr Christie: I don't have a figure for that. I haven't seen information from OPG or Hydro One recently on this. But we'll certainly make inquiries of when their interim results will be available.

Mr Phillips: When are they available?

Dr Christie: We will inquire as to when those results would be available.

Mr Phillips: I'm a bit surprised we don't have an estimate from you, actually, of what the rebates are going to cost and whether there is a significant shortfall. Four years is not acceptable. You may think it is, but I think the public want to know where we stand on this thing. Is it going to be a significant shortfall? Is it going to add significantly to the rebate, not over four years but over the short term? But you will get back to the committee on that.

1150

Dr Christie: You've asked about Hydro One and OPG results. We'll find out when those might be available and get back to you on that.

Mr Phillips: And the rebate: how much the estimate of the rebate cost to the end of December is and how much is available to cover that.

Dr Christie: I don't know that we have that information, but I understand the question.

The Chair: Mr Phillips, if I may, just to clarify, the questions, because they're tabled at committee, are directed through research, and they will endeavour to get the answers from the ministry.

Mr Phillips: Good. The second thing is, on the revenue forecast, the minister today said she wanted advice from us on multi-year funding and whatnot. This irritates me to no end. The revenue forecast we have for next year is one number that's eight months old. The minister is looking for advice from us, and all we have on the revenue forecast is one number eight months old, and today we can't get even an estimate of where we stand on this year's revenue. Mr Christopherson asked about the asset sales, and we can't get an estimate on that.

Can you give us any more information on revenue outlook than just the one single number that now is eight months old? Can you table that for us?

Dr Christie: I think that what we have available, as you noted, are the figures in last year's budget. We have also indicated each year what the impact of changes in GDP growth rates are on revenue and on spending etc. So that's the information we have generally provided in that regard. I think that has been—

Mr Phillips: Well, it's a political one. It's insulting, actually, to us to be asked for multi-year funding advice and to have a number that's eight months old and that is one single number.

My third question—and then my colleague has some—on the capital spending front, you've indicated a different way of reporting that next year. This year you show capital spending of \$2.7 billion, and then you subtract the net investment to get it to \$2.1 billion. What impact does the new accounting have for next year? Is it going to be a substantial reduction in the reported net capital expenditures?

Dr Christie: Perhaps I could ask Gabe to respond to that.

Mr Sékaly: Actually, when I talked about the new change in capital, tangible capital assets, we actually implemented it this year. The number you've stated in the budget is the new accounting. That is the new accounting for tangible capital assets that was in the budget this year, where we show the depreciation or the amortization for the capital. So we have implemented that change as of April 1, 2002, and it will be in the voted estimates next year for April 1, 2003, because it will now be on an accrual basis.

Mr Phillips: In last year's budget you indicated you were going to bring more capital on line with this policy. That's not the case?

Mr Sékaly: What we've brought on so far is our major capital, which is transportation, infrastructure, buildings and land, which is about 90% of the government-owned capital. Remaining capital will be brought on line to this new system once our new financial system is fully up and running, which will be in a couple of years.

Mr Phillips: I have one quick question, if I could, to change the subject completely. Public debt interest costs in 1994-95, just before the new government took over, were $7.8 billion and today they're $8.5 billion, which surprises me a little bit. It's up $700 million after eight years and with dropping interest rates. Why would it be that public debt interest costs today are $700 million more than when the government came in in 1995?

Dr Christie: I think, as you've noted in the past, Mr Phillips, the government's plan when it came in was to eliminate the deficit over a period of years, which it did. In fact, I believe it eliminated the deficit a year earlier than planned. But of course that meant, particularly given the height of the deficit from which that plan began, in the intervening years there were still deficits, albeit declining ones, and those resulted in some additions to the debt on which interest had to be paid. There have been, as you noted, substantial savings on the refinancing of debt included, and those are also reflected in that number.

Mr Gourley, if you'd like to expand on that in any way.

Mr Gourley: My only comment would be that the debt in that year was in the deficit, but the debt was increased in the order of $12 billion. In 1995, the government was looking at a forecast deficit of $11.3 billion and it ended up at about $8 billion. Those numbers alone begin to explain that there was still lots of debt there. There was debt at the time. If the government had been able to balance the budget immediately, then the PDI numbers would more be able to reflect a reduction in the interest rates, but because we were taking on $12 billion a year in terms of new debt, and you had to move from that point to complete the government's plan, additional debt was incurred. So the $700 million can be explained. I think it was Mr Sékaly's presentation showing it as a share of GDP. It has declined dramatically. The burden on the overall economy of the province's debt is about half of what it was at that period of time.

Mr Monte Kwinter (York Centre): Mr Howell, can I get your definition of what "real disposable personal income" is?

Mr Howell: It's personal income net of tax payments and then converted into real dollars.

Mr Kwinter: In your slide you talk about "Sustaining Economic Growth: Lower Taxes Support Disposable Income." You show that for 2003-04, the real personal disposable income is 2.6% per capita, as opposed to real consumption at 2.6%. In other words, all the money people are getting in disposable income they're spending. That doesn't take care of debt. You also show another slide saying that they have far more flexibility because the servicing of the debt is coming lower. Do you have any statistics that show what the per capita debt of the people of Ontario is?

Mr Howell: I can get that information. I don't have it here. We can provide that.

Mr Kwinter: The point I'm making is that when you show they're spending as much as they're making, which means they have no money to pay down their debt, it doesn't make any difference what the service cost of the debt is. They don't get further and further into debt, but I think it's a significant number that we should know about, because that really is going to impact on the ability to sustain the economy.

Mr Howell: As I indicated earlier, debt levels are high right now if you're looking at them in an absolute sense. They're higher now than they have been in the past, in dollar terms. Of course, incomes are also much higher, and real incomes, so nominal incomes—because debt's always denominated in nominal terms—are higher, obviously, than the real income as well. Combine that with the ability to finance that debt given much lower interest rates and you have a situation that's demonstrated in another one of the slides in my presentation that shows the ability of consumers to carry that debt load has been improving over the past 10 years. I'll leave it at that.

Mr Kwinter: I take your explanation, but I don't understand. If your indicator is that all the money they get in real disposable income is being spent in real consumption, then there's no money left to service the debt other than going further into debt.

Mr Howell: Part of what people are spending money on is their debt servicing as well. That's a service that consumers consume. It's not all goods.

Mr Kwinter: I'd like to ask another question of Michael Gourley. When you talk about the stranded debt, I notice it's gone up 0.1% for 2002. Do you have an indication as to what it would be right now, when we're 10 months into the fiscal period 2002-03? Is that stranded debt going up or is it going down?

Mr Gourley: That slide is—how should I say?—a bit problematic, in the sense that it rounds numbers. The first 20.0 is actually $20.034 billion and $20.016 billion, and then 20.1 is actually $20.085 billion, so it's rounded up. There's not really a $100-million difference, although there is a $60-million or $70-million difference in the two numbers. At this point in time, it really depends on the outcome of both the results of Ontario Power Generation and Hydro One and a couple of other factors. But those are the two primary factors. I don't know whether it's going to go up. Certainly the projection is that it will go down slightly, but that may be $15 million; it may be not a substantial amount of money.

Mr Kwinter: My last question: could I get an estimate of what the GDP of Ontario is as part of Canada's GDP?

Dr Christie: We can provide that.

Mr Kwinter: Do you have an approximate—

Dr Christie: We can't provide the exact number, but it's approximately 40% to 42%, or something like that.

Mr Kwinter: OK, could I get that?

Dr Christie: Yes.

The Chair: All those outstanding inquiries will be given, through research, to the ministry. That way, all committee members will have the benefit of the response.

Time is up, even with the overtime. Thank you, gentlemen. We'll recess until 1 pm, at which time we will begin with the expert witnesses. Committee is recessed.

The committee recessed from 1202 to 1303.

The Chair: Ladies and gentlemen, we will resume the committee and come back to order. This afternoon we deal with three expert witnesses. Are there any questions, first of all, from committee members? No.

CANADIAN FEDERATION OF INDEPENDENT BUSINESS

The Chair: We will begin with the delegation from the Canadian Federation of Independent Business, Catherine Swift and Judith Andrew. Welcome, ladies. We'd appreciate it if you would just state your names for the record so Hansard can use them as a trigger.

Ms Catherine Swift: Yes, indeed. I'm Catherine Swift, president of the Canadian Federation of Independent Business. I'm accompanied by my colleague Judith Andrew, who is vice-president for Ontario at the CFIB.

Thank you very much for inviting us here today. I am here in the so-called expert witness capacity. I'll try to live up to that lofty title. Judith will actually be back tomorrow to give a little more issue-specific brief for the committee.

I guess I'd like to generally talk about the economic landscape from the small and medium-sized business perspective, what we see happening over the next year or so. One thing I'll just mention is some of the components of the folders that we've handed out. There is a copy of the PowerPoint presentation that we're going to speak to. As well, on the left-hand side of the kit—we tried to keep these down to a dull roar, but we hoped this would be useful information as municipal issues are taking on a greater import for all of us, it seems, these days.

We included a recent survey we did of local leaders. This was sent to mayors and councillors across the province of Ontario. There is a blank of the survey itself, and there are also a number of charts with the results of this survey. In many instances we have actually compared the views of our members with the results we got back from the local government leaders.

There is also a copy of a report called The Path to Prosperity. This is quite a detailed report that we collaborated on with the Royal Bank and the Canadian Manufacturers and Exporters late last year. I'll be just briefly speaking to it, but it's actually quite an interesting report that I would recommend anyone who wants to get into the whole productivity and innovation area a little more might want to read in their spare time, such as it is.

Finally, we've included a report that we did last year that was submitted to the Romanow commission, and Michael Kirby's Senate committee as well, on the small business perspective on health care issues.

Speaking to the general economic climate, from the outset certainly we have seen yet again very positive results from the small business community. As many of you know, we regularly survey small firms on their expectations for the economy generally. When I was looking over what I said here last year, I was thinking I'm starting to sound like a broken record, because we've continued to get quite an optimistic outlook from our members. I guess what is worth noting is that over the last 18 months in particular, the small-firm community remained much more optimistic—in fact, at times we were asking ourselves if we were crazy, because we were the only ones out there among all the so-called economic gurus and the Bay Street gang and everything who were saying that things weren't all that bad. This is sort of post-September 11, 2001. Now, 18 months or so later, the small business group clearly was very prescient because, as you know, we had a record year for job creation in the Canadian economy last year. Ontario also enjoyed considerable growth in job creation and the economy. This was, of course, while stock markets were doing some pretty ugly things.

I'd just like to briefly flip through some of the slides. First of all, I think you're all aware of it, but it's always worth reiterating the importance of small business in the economy. Over the last roughly three decades, we've seen the small and medium-sized business sector move from about a quarter of the economy to roughly half. Clearly, what goes on in the small business sector now has a greater impact on overall economic trends than it used to. It was always important, but now we find, more so than ever, that small business can actually be a real stabilizing influence when the large corporate sector is going through the kinds of gyrations we've seen over the last little while, and also, of course, from the job creation standpoint.

This goes over almost a decade of StatsCan data on job creation. We see year after year—and it does vary, of course, from year to year—a significant chunk of net new employment consistently coming from small business, even in some years when the large corporate sector is shedding employment at a pretty good clip.

We did an interesting chart; this is a new one we did recently. We've started referring to our sector as the non-stock-market economy, because we have seen the stock market just in dire straits, as we know, for quite a while now. But if you look at these different indices here, we compared the TSX with the index of small business expectations, and we have superimposed also Ontario; the purple is our national number, and we've superimposed the pink there, the Ontario one, on that to show difference from the national. But as you can see, when you compare it to what's going on in the stock market, you've got pretty divergent behaviour, to put it mildly. As I alluded to earlier, we did indeed see a very good year in our economy generally last year, despite the fact that the large corporate sector was being buffeted about by stock market unpredictability.

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Just by way of interest, too, we did some tracking of our index that we've computed now since the late 1980s. Up until the last 18 months or so, we used to do this index annually. We started doing it quarterly recently because we found economic decision-makers were finding it a very useful additional tool, as well as all of the other more conventional statistical measures. As you can see, our CFIB index has a very good history of reflecting what ended up happening in the economy. So it's been a good predictor, and as a result we're finding it used more and more by everybody from the David Dodges at the Bank of Canada to federal and provincial finance ministers, economists and so on, because it really does add an additional piece to the overall economic statistical world that's useful and isn't really provided by a lot of the other official data sources.

In terms of our outlook for 2003, in the fourth quarter we actually saw an uptick in our overall index of expectations. It was already at a pretty optimistic level and, as I mentioned, in the fourth quarter we actually saw it increase a bit. So that was welcome news, needless to say. Our members are expecting quite a good 2003.

If you can move to the next slide, Judith, we asked how they would compare their performance in terms of the last year and also their expectations for the next three- and 12-month period. As you can see, the vast majority, by far, foresee a stronger year in 2003.

In terms of sectoral expectations, we just break this out, and these data are for Ontario explicitly. As you can see, there are the different sectors there. There is certainly some variation. Most sectors are reasonably optimistic, but there are differences among the sectors with some of the service sectors, education, health. Manufacturing is also reasonably optimistic, which bodes well because there have been a couple of years of lesser, I would say, optimism in that sector over the last little while.

We also broke this down regionally to give you an indication of which parts of the province were more and less optimistic. Again, there are reasonably consistent expectations that things will be either the same or better in 2003 than in 2002, but there are some differences as well, not surprisingly, among different parts of the province.

We also ask our members in this survey what they are planning to do with respect to their wages paid and prices charged. As you can see, there are about a quarter, roughly, or actually closer to about 30%, who are looking at increases over—inflation has bopped up a bit recently, as we know, but the trend line of inflation still is around 2%, 2.5% or so, so they're looking at wage increases, for example, exceeding that, and roughly around the rate of inflation another 30-odd per cent. As you can see, there are really very little decreases seen in the area of wages—and prices for that matter, but wages are seen to be going up more than their prices.

With respect to the kind of policy priorities that fall out of this for this year that our members are concerned about, they are mostly the usual suspects that are of ongoing concern. There is no question that there is pressure on government spending right now at all levels, as we've seen, but the whole notion of maintaining fiscal balance is always a concern to our members, and I guess a little more acutely now, given the pressure that they know is on the spending side.

The things that have really kept the economy afloat over the last 18 months have been both consumer and small business confidence and the resulting job creation. Going back into deficit positions for governments is not conducive to maintaining confidence levels in either group, as we've found out in the past.

Certainly we always look at where spending can be reallocated, given that obviously health care is going to be attracting quite a bit more spending in the near future, but our members still believe there are areas where government spending can be reallocated.

We continue to be, I guess, surprised at policies that increase costs at all levels of government, and something that our members find particularly problematic are things such as union-only procurement practices, just for example, in the public sector. We just find these are inexplicable practices that should be eliminated, or really governments are not doing what they can to contain their costs.

The whole area of debt repayment: when we actually ask our members what they would do with any given surplus dollars of government revenue, their number one choice continues to be debt repayment.

Then there's the issue of municipalities, which I want to get to a little bit later.

The next chart speaks to various municipal finance measures. This was a survey we did about mid-last-year. Given the pressure on the financing side at the municipal government level, you can see that this whole notion, which some municipalities are pushing for, of some kind of additional taxing powers, whether it be a sales tax or an income tax or whatever, not surprisingly is not popular among our members, but they certainly do recognize that there is some scope for redistribution of existing tax revenues. Of course, the fuel tax area has been one that some other provinces have successfully used to allocate a certain portion to the municipal level of government. Clearly our members were quite supportive of that approach under the existing tax pie, as it were. Not surprisingly, the notion of any area of new fuel taxes was not well received by the small business community. You can see there some of the other areas that were supported by our Ontario members with respect to reallocation of property taxes on business, which has been a bugbear for some time.

Moving to the next slide, these are our Ontario members' priorities. Some of them are similar to our members elsewhere in the country. For example, total tax burden is number one right across the country. But the cost of local government is especially high here in Ontario, so that is something we've seen as different elsewhere in the country. As a result, we've put a fair bit of focus on the whole property tax area and rejigging that so that the small and medium-size firms are not anywhere near as hard hit as they are under the current system. Most of the other priorities there are pretty similar. Availability of financing has come up recently, and I want to speak to that more a little bit later.

Within the tax envelope, other than property taxes, which remain a leading concern, our members have always found that a medium-term approach to tax planning permits them to have some confidence about what's going to be happening in the future so that they are not faced with some different plan from year to year. We've recommended to all levels of government as a result that the more one can stick to things like three- to four- to five-year plans, at least that provides a climate of certainty for firms that want to invest or create new employment or whatever, so they know what's going to be hitting them not just this year but in the more medium term.

Payroll taxes are always a priority for our members. The small business sector is more labour-intensive than larger firms. Also, for large businesses, given that it seems they're often laying people off these days—naturally the payroll tax component is not as important to a business that's laying people off as it is to a business that is growing their complement of employees.

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Here in Ontario, WSIB is an ongoing issue. We have felt the Ontario government has played a useful role in keeping pressure on the federal government in the EI and the CPP area. Of course, this is supposedly the last year CPP is supposed to increase, according to current federal government plans, so we're hoping to see some stability and, in fact, overall reduction in the federal payroll tax area, combined EI and CPP, over the next number of years.

Of course, in the whole area of tax administration, we've done an awful lot of work, notably recently with the retail sales tax people, but elsewhere as well. Retail sales tax has been particularly problematic and confusing for our members. There has been some useful work done there, but more needs to be done.

The study I mentioned earlier that we collaborated on with the Royal Bank and the manufacturers' association, the so-called Path to Prosperity that we've included in the kit—this is just one chart out of it. It is a fairly in-depth study. We actually used a public opinion firm to poll small business owners in Canada and the US so we could do a comparison as to their orientation as business owners. How much did they want to grow their business, how risk-averse or receptive to risk were they and so on, and what did they feel were the barriers to growing their business? What we were trying to look at was why we don't have more small firms in Canada evolving more into the medium-sized business category. This has been kind of a conundrum for quite a period of time.

This is just one chart, and I would recommend anyone interested in this area to have a look at the whole study because it really was quite an interesting study. A lot of stuff didn't shock us, but there were some findings that we found kind of interesting. This chart exemplifies one of them, where you actually see Canadians feeling that they were certainly very interested in growth relative to their US counterparts. Other elements of the study showed that Canadians were certainly as entrepreneurial—perhaps a little bit more risk-averse, and that's not that shocking, I guess, but not that much. But notable was the difference in terms of the barriers to their growth that were external to the firm. The Canadian group felt that more acutely than the US. Of course, there were a range of different barriers, but one of the ones that came out pretty clearly was financing, relative to their US counterparts. So that was kind of an interesting finding. We have certainly seen, over the last little while, an increase in the concern of our members just over access-to-financing issues. So we're very much hoping we're not going to be seeing another credit crunch like we had in the early 1990s, which was very destructive.

There are always issues, but we've actually had a few years of fair stability, I would say, in the small business financing area, but we're seeing that concern jump. Ontario is particularly vulnerable, and maybe the next chart sort of shows it. This is a tracking that we do, and this is obviously over almost 20 years now, back to 1984. We're seeing a record high level of concern nationally. That last thin bar on the right-hand side is Ontario. This happens to be data from the third quarter of last year. So we've definitely seen a pretty significant increase in concern over financing issues.

We believe this is for a number of different reasons. There's no question that the banks' exposure in some of the telecom and high-tech areas caused them to retrench, but where they're retrenching, naturally, is in areas like small business, where the risks are not as pronounced. But we've seen over the years many, many times how some sector that the banks have put a fair bit of attention on comes back to bite them when it turns down and they tend to have to cut back, or they believe they have to cut back, on their more regular customers, who didn't cause the problem in the first place. So I just flag it out there as an issue.

Of course, mergers are back. In fact, I'm in Ottawa tomorrow with the federal finance committee talking about bank mergers, because we're seeing mergers resurfacing. In the view of small business, we don't currently have sufficient competition. Last time mergers were contemplated federally was back in 1998, and since then, we've actually had a subsequent merger of TD and Canada Trust that, if anything, has made the market less competitive. So if there was no public interest case to have mergers approved in 1998, we think there's even less of one today before we see some competition injected into the market. So that's something that's certainly of concern to our members in a big way.

Just to show you what's happened, too, with some of the major financial institutions, this compares some data from 1989 to 2002. Certainly, in the case of the Royal Bank and the CIBC in particular, we see a huge change in market share. This kind of change in market share doesn't happen by chance. If it's a couple of percentage points or so, fine, but the kind of market share reductions that we've seen in these two leading institutions in Canada is not by accident. They have a deliberate strategy to unload a lot of their small business portfolio, and often it's concentrated in certain sectors or certain regions. We view that as alarming because of the lack of competitors. When a couple of big players make a conscious decision to withdraw from the small business marketplace, it causes major issues.

Just to briefly comment—and there's a lot more detail, of course, in our study—on health care, basically we did a pretty comprehensive survey on the issue which was very well received by our members. Maybe one would think it's not a traditional business issue, but we simply felt too much government money was wound up here to not go to our members and at least ask their point of view. We got almost 15,000 responses to it, which was a very positive feedback. We asked a range of questions. One was on general satisfaction with the system overall. As you can see here, Ontario more or less ranks third in the country with respect to satisfaction levels. That was kind of interesting. It may be higher than a lot of people might think. But a lot of this actually does track a lot of the public opinion data you might be aware of. Although there are issues in the system, most people still actually have a relatively high level of satisfaction. Public opinion polls have shown very much the same thing, as you're probably aware.

When we asked about financing options, there clearly is a preference, not surprisingly, toward reallocation of existing areas of government spending. There is still a fair bit of support for the whole area of user fees among our members. We've sort of polled our members on that over the years, and there still is about two thirds that either support or strongly support having some type of user fees. As you can see, the whole notion of dedicated funds, as opposed to just more monies coming out of the general income tax or payroll tax pot, is preferable to the small business members.

When we asked them what options they would prefer to improve the system overall—again, I suspect that most Canadians would fall into these categories as well. Naturally, improved efficiency—just throwing money at the system is not sufficient, but I think everyone would agree with that—as well as preventive measures. But there was also clearly an appetite for a greater role for the private sector in health care generally. I guess one of the big fictions is that we don't have private sector participation in health care now. Of course we do, and have for many, many years in Canada. But when we asked how privately provided health care should be financed, the majority felt some partial public payments—so partial public payment and partial private payment. Only 12% favoured the option of full public payment. So the majority felt that private sector participation, with a portion of that being covered by the public system, was the preferable option.

This is an argument that's often bandied about. Usually, you hear it with respect to large firms. We asked if our health care system currently provides the business with a competitive advantage. As you can see, we actually got quite a proportion who said no. So we've often felt that the publicly funded health care system certainly does, in notable cases—the auto industry is a classic example that's often held out there, because basically all taxpayers are paying for the system, not just the employer. That clearly does provide an advantage to some large firms. But it's a lot cloudier in the small business perspective, and even those who are active in the US market did not feel that it was the kind of competitive advantage that a lot of people seem to think it is.

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I just want to speak really briefly as well about another large issue for our entire membership, which is the whole problem with labour shortages. This is in all areas; it's not by any means just in any one sector or region. It does vary somewhat, but we are finding it cuts right across all regions of the economy and all sectors as well. Of course, our challenge is that different governments really have to start getting their act together to be able to effectively deal with that, since we have training issues, obviously, at stake, education issues and ones that push into more than one area of jurisdiction. There is certainly variation with the unemployment rate, where the shortage of labour moves in an opposite direction, inversely, to the unemployment rate, but we're also finding labour shortages are persistent even in regions and sectors with relatively high unemployment numbers.

Getting into the whole education area, we actually have some interesting results on our members' satisfaction with education institutions. This is quite positive, really. Pretty much across the board—we compared some data from 1997 to 2002, and the satisfaction levels with all components of the education system increased somewhat over that period. I think that could be seen to be a pretty positive trend in terms of how small firms are perceiving the extent to which the education system is at least meeting some of their needs.

Finally, a leading issue that we're continuing to hear about is the whole area of input costs. Naturally, input costs can cover a wide range of things, but one of the key ones here in Ontario that has arisen recently is electricity pricing, which has hit small firms hard. I know there's currently contemplation of whether that ceiling for the lower capped electricity rate should be changed. We're actively suggesting that it does need to be increased to truly include the small business sector. The whole area of fuel prices: naturally, with some of the international instability right now, the uncertainty there is pretty well established and perhaps unavoidable to some extent, or certainly not within our control here in Canada, but the tax area is within government control and could be acted upon.

Insurance costs deserve mention. We saw, on average, insurance costs increase about 30% last year for our average member, which is huge, and in some instances doubling, tripling and quadrupling. But the average was about a 30% increase, and what we're hearing generally is that another year of similar increases is what's in store for 2003. The other alarming thing is that some businesses can't get insurance at all, at any price. So there are clearly some very serious problems here that aren't only factoring in on the price side, but businesses becoming uninsurable for a whole range of different reasons. September 11 events definitely started some of these issues, but there's more to it than that. I just raise that as an area of concern to keep an eye on and something that, if we start hearing talk about mergers with banks and insurance companies—which we have heard some talk about—might want to be taken into account.

Overall, we have seen some increases in inflation, but I think, barring the energy sector, which is being subjected to some fairly major fluctuation right now, interest rate levels look like they're going to remain manageable as well for the foreseeable future.

Just to briefly summarize: maintaining fiscal stability and maintaining their confidence levels is a huge issue for small business.

Debt paydown remains a priority, and continuing on the tax reduction agenda that has already been announced and, ideally, injecting certainty into that debate as well.

Overall, a good economic outlook should mean less pressure on the social spending side since employment rates are very much viewed to stay quite high. Job creation among our members continues to look quite positive for the next year or so, so that relieves pressure on the social system.

The potential of a credit crunch in the next little while is out there and bears watching.

In the area of municipal government, a possible realignment or at least some changes in the allocation of tax revenues is another looming issue of importance.

The area of health care spending, which will get a lot of focus in the upcoming federal budget as well as in provincial budgets, naturally, must be accompanied by measures to improve efficiency and accountability in that system.

Finally, factoring the small business impacts into any area of public policy formulation: we always feel that's important, but when we're now talking about half the economy, I would think everyone should agree that should be thought of before major changes are made in areas of policy affecting the business sector, and small business in particular.

I'd be happy to try to answer any questions you have.

The Chair: That leaves us with about 21 minutes, seven minutes per caucus, beginning with the government. Mr Arnott is first.

Mr Arnott: Thank you very much for your presentation. I appreciate your advice. I have a couple of really quick questions, if I have time for two. One is concerning debt retirement or debt repayment. In 1997, I brought forward a private member's resolution in which I called upon the provincial government to commit itself to a long-term debt repayment plan over a 25-year period. I continued to raise that issue in 1999 in our Blueprint, our election document or platform. The government committed to paying down $2 billion of debt over this term of office. In fact, I think we've paid down about $4.5 billion, which is a lot of money, but when you look at a debt of about $110 billion, we have a lot of work to do.

You mentioned that in your surveying with your membership, you're consistently getting back a result that debt repayment should be a very high priority. Yet on page 7—I'm not sure what the slide number is—under "SME Ontario Priorities for Action," it appears that the total tax burden is a more serious, immediate problem for your members than government debt/deficit. So there's a bit of an inconsistency there. Could you explain that or attempt to explain it?

Ms Swift: Yes, I certainly can. Out of interest, back in the early to mid-1990s the debt area was number one right across the board for our members across the country, actually. Again, that was when we saw the most acute sort of debt crisis facing us. In the survey I was referring to, where it was prioritized as the number one issue, we asked, "How should any surplus dollars be spent?" It was actually just under 50% who said, "Debt reduction." About another 40% said, "Tax reduction." So that was the ranking if you were looking at every surplus dollar. This particular chart is a general poll, where we just asked a whole range of different issues, and the members prioritized them. So they're slightly different. They still give you a pecking order, but they're a slightly different way of getting at the issue, which is why you get a slightly different result.

Mr Arnott: In fact, when I've surveyed my constituents, it seems that people overwhelmingly prefer greater steps toward debt retirement as opposed to greater efforts toward tax reductions. As much as they appreciate tax cuts, they want to see long-term, consistent fiscal discipline to pay down the debt so that we'll leave our children and grandchildren a stronger financial and fiscal position in the province.

Ms Swift: It's also a short-term versus long-term kind of orientation in a way. If, say, your tax environment is totally uncompetitive, so you're really hammering your economy today, then that inhibits—it's a balancing act, as we all know, with these things. I guess the concern is that a lot of governments these days seem to feel they've already done what needs to be done on the debt retirement side, and even the tax reduction side. I've heard, certainly, some federal politicians say, "Oh, we've done the tax thing."

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If the US goes through with the recently announced changes that Bush mentioned a couple of weeks ago—we don't know what's eventually going to actually be implemented, but that's going to put the pressure, unfortunately, on Canada again to look at restructuring elements of the tax system.

The other thing with respect to debt, of course, is—we don't anticipate this happening, but say interest rates shoot up—we're going to have a great big debt problem again. Right now, the fact that interest rates are so low is giving us maybe a false sense of security. It's great to see progress on the debt, but this is where I think Canadians—small business and others—are rightly worried that if we have another interest rate spike of some kind, suddenly that debt is going to start eating up more and more and more. We're still allocating far too much money to debt repayment. As we know, we could all find much better uses for that money.

Mr Beaubien: Thank you very much for your presentation. Just one quick question, because I want to leave time for my colleague Mr O'Toole. On page 5, with regard to the regional outlook for the year 2003, you show Windsor at 74% and yet southwestern is almost at the bottom at 48%. Windsor is part of southwestern Ontario. Why the discrepancy?

Ms Swift: We excluded Windsor, though, as you can see. We excluded the major cities that were singled out from that. That would explain, from a methodological standpoint, the differences.

Mr Beaubien: Probably because of the auto industry.

Ms Swift: Yes, exactly.

Mr Beaubien: OK, thank you very much.

Mr O'Toole: I always look forward to your presentations because they do kind of bring together all of these various reports that we get from Judith and yourself over time.

Just to reinforce a couple of things you said; then I have a little question. Consumer confidence obviously in our presentation this morning—you might want to avail yourself of a copy—showed as one of the stimuli or the current motive for the health of the Ontario, if not the Canadian, economy, and also business optimism is sort of up in the 2002 fourth quarter as well. Maybe that isn't said directly in your presentation, but I just want your comment on what more can be done. You know we've committed to a multi-year discipline with respect to the tax on small business, and that is, the threshold amount has been doubled to qualify to $400,000; also, moving it from 9.5% over the longer term to 4%. We recognize that the largest growth in the economy is attributable to small business. Is there more specifically that we can do?

Ms Swift: I think on the tax front those are positive measures that should be followed through. Whenever a government does announce a multi-year policy, it's not a good idea to change it in midstream, in general, just because people do plan on a longer time horizon. Especially once something is announced, I think it's pretty essential to follow through with what is announced.

I would say right now a focus on some of the regulatory burden, even more so than has been done in the past, would be incredibly important as well. I know there are efforts underway with red tape reduction and so on, but I think there are probably more gains, given that we know that government budgets generally over the next couple of years are likely to be under more pressure than they have been maybe in the past few years—I would think measures to cut back on that regulatory burden—they don't cost government that much; that's the one thing. Tax reductions: those revenues will not be flowing into government coffers. That's not a bad thing from our standpoint, but governments may find more bang for the buck over the next little while to look at measures that are so-called cheaper for government to implement from a revenue-forgone standpoint but that nevertheless will really help productivity and the economy. Because we're still struggling in our economy with productivity performance—

Mr O'Toole: I see that in one of your charts.

Ms Swift: Sorry?

Mr O'Toole: I see that one of your charts shows that those burdens are more of a problem than any other of the three factors you measured.

Ms Swift: Yes. When we did our US-Canadian comparison, that was one that came out in spades. The regulatory load in Canada is very onerous, and a lot of it is collaboration between different levels of government, which we haven't always been that good at in this country.

The Chair: The official opposition. Mr Phillips.

Mr Phillips: Following up a little bit on the comment you just made on the comparison to the US, you mentioned that the overall tax burden is a challenge. The government handouts and charts this morning show that for small business—ie, income $320,000 a year or less—the combined federal-provincial corporate income tax is around 22%.

Ms Swift: Corporate income tax? Yes.

Mr Phillips: In the US, the weighted average of the neighbouring states is about 36%. So it's quite dramatically lower. You mention here that the tax issues are property tax and payroll tax; I think those are the two. In terms of priorities, recognizing we're now at 22% versus the US at 36%, should our priority be to lower corporate income taxes, or should they be to focus on trying to get property taxes and payroll taxes changed?

Ms Swift: We've always viewed corporate income taxes as the lesser of evils, simply because companies are making money to pay corporate income tax, so obviously any monies going to taxation aren't going back into the business in one way or another. But the more onerous burdens are those that are insensitive to profitability. The firm that's losing money but still has to pay a whopping great increase in their property tax, that could put the business at risk, whereas corporate income tax—sure, it's not a bad thing to reduce them, but it doesn't have the same impact.

We would say that certainly in Ontario property tax is clearly a principal issue right now that we would recommend be the priority, at least for this province.

Mr Phillips: To touch on another subject, I don't think the minimum wage has changed in seven years or so.

Ms Swift: Quite a while, yes.

Mr Phillips: And I think somebody on minimum wage—that's under $7—is making maybe $14,000 a year. Do you have any thoughts for us in terms of whether the minimum wage should be adjusted at some stage, recognizing that it has been seven years since it was adjusted? I'm wondering whether at $14,000 a year you can actually sustain yourself. Do you think we should give any consideration to looking at the minimum wage?

Ms Swift: We've done our survey. I don't think we've done anything really recently, but maybe it bears looking at. In the kinds of labour markets we've got right now, where our members are crying for people, much more so than anything else, I think instead of making a decision to just increase minimum wage for the sake of it, or because it hasn't been done for a few years or something, it would be very interesting to see some studies as to actually who is paying minimum wage. I would suspect it's few and far between—students, perhaps, or whatever. My 16-year-old I think gets slightly more than minimum wage for his part-time job.

I think you would find that an increase in minimum wage wouldn't have much impact because nobody is paying it anyway. They're paying considerably more. This is what we found with some older research but, like I say, it's a bit old now; I'd want to update it. I'd like to see some data as to actually what is going on right now and who is getting paid what before making any kind of recommendation on minimum wage. I think too, with respect to other provinces, we're still up there in the top few of other provinces, the last time I checked, anyway.

Mr Kwinter: Catherine, on page 7 you talk about the small and medium-sized enterprises' views on municipal finance measures. You talk about, "Use existing fuel taxes to pay for local transportation infrastructure (eg roads, transit)." Are your members calling for a dedication of those taxes to those items, or are they just saying generally, "Don't raise taxes somewhere else to pay for that; use what you get from the"—

Ms Swift: Our members generally favour the principle of having the kind of transparency in the tax system so you're raising a certain amount of money with the knowledge that it's supposed to go to, whether it's health care or road infrastructure or whatever. So I would think a partial allocation of some fuel tax revenues directly, to be restricted to those uses, would provide a stream of predictable monies that can then be used by municipal governments for those uses. We haven't asked that specific question, but given how they have felt on similar issues in the past, that's what I would think.

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Mr Kwinter: Another area that you raise is the lack of skilled labour. Have you and your members done anything about the utilization of foreign-trained skilled labour and the underutilization in our workforce?

Ms Swift: Yes, definitely. That's a really big issue. We actually have some pretty good survey data that we're going to be releasing over the next little while—we're just crunching the numbers right now—where we got into some real detail as to what types of skill sets are being looked for by businesses, because "lack of skilled labour" really simplifies it too much; it's more mismatches. There are geographic factors. Even in not highly skilled areas, people are having trouble finding people to employ. So there's all manner of different things happening here.

But there's no question that the whole notion of the difficulty in bringing in skilled immigrants or, let's say, immigrants with the appropriate skills is a very, very difficult issue. We've heard frequently, naturally, of differences between provinces in terms of accreditation of different kinds of professions and how that fits into the mix. We definitely could do a lot better on immigration policy to permit people who already have credentials to use them more quickly in Canada than we do currently.

The Chair: Thank you. We move to the third party.

Mr Christopherson: Welcome again, Catherine and Judith. It's good to see you once again.

Let me just say at the outset that even though it has only been one day and it's at the federal level, it looks like Jack Layton is having an effect: we have Liberals asking questions about minimum wage. Hope abounds across the land. Anything's possible.

I wanted to follow up on Gerry's question on the labour shortage issue. You mentioned coordination specifically, I believe.

Ms Swift: Different levels of government?

Mr Christopherson: Yes, at the coordination end. You spoke about immigration policies and a number of other issues that are clearly federal responsibilities. There are some that are very clearly provincial, and I think it's easy to see where they would, if they worked together, complement each other.

It seems to me that where the rubber hits the road for small businesses is actually where they interact with municipal governments if they're playing a role, and if they can, what that would be. Because at the end of the day, large corporations—General Motors is looking into their own answers as well as tapping into what they can through government. I know in other segments the large players are out there themselves; they have the resources and the infrastructure in the company to do that. But with small business, somewhere one of the three levels of government has to interact with them. The reason I raise this is that I know there's a major effort going on in Hamilton trying to do that.

I'm wondering what you think the most effective transference of the coordination between the three levels of government and small business should be. Where should it be taking place? Exactly how can that happen?

Ms Swift: Well, I don't think there's one answer; I think there are probably several, simply because I think you're right that there's no doubt there's a greater role for a local government type of interaction.

Something that we as an organization have been trying to promote with school boards—they are arms of government but they're not government per se—as well as business, particularly sectoral groups, is having a lot more interaction with the education community, with the student community directly to try to identify needs better, educate students as to what the needs are so they can maybe partway through secondary school say, "OK, this is how I'll plan my career, because I'd like to work in this area."

It's very labour intensive to do that kind of thing, but I think you'll find it gets very difficult to have a global solution, because there is no global solution. This is a very micro type of problem that is being faced by all sectors, to varying degrees. Some are definitely finding more problems than others.

But there's very little work being done at the municipal level right now across the board. I think there are exceptions where some municipalities are definitely getting involved in this. It has been more provincial, and even federal in many ways because of the monies that are spent in the EI fund for training. But I know that as an organization we have partnered up with other business groups. The technology these days helps a lot because small firms can go on the Internet and perhaps get information about available resources that they couldn't get before and so on. I think, unfortunately, there is no one easy answer to that, but there's a whole range of different solutions. Municipal can be effective, but so far I would think the provincial level is probably more frequently where that happens, even for small businesses, right now.

Things like the Passport to Prosperity program that we've been involved in—that's a niche sort of area, and school boards are involved in that too. So you have the stakeholders, for lack of a better word, involved, in that case, in helping students get some exposure to the working world, and of course ultimately that often leads to jobs for these people. It's at least another element to their education. So those kinds of programs and apprenticeship programs and all of those types of things that are really within the provincial purview we recommend doing more of.

Mr Christopherson: A different subject: the federal government. Former Finance Minister Paul Martin made a well-received speech at the FCM in Hamilton at a convention in the summer. I was there and I was as ecstatic as anybody to hear the pronouncement of a new deal, if you will, for municipalities. But given the question that Ted Arnott asked and some of the results in here, I just wondered, first, what you think about, and secondly, if you agree there's some merit in that, how you would rank it in terms of importance, the federal government, given that they are running surpluses, actually having a direct relationship with municipalities, particularly in terms of assisting with funding for infrastructure.

Ms Swift: I remember that speech well. We've also had numerous meetings with Paul Martin and asked him about that speech and exactly what he meant, and I think you'll find it was kind of short on detail but long on good-feeling sentiment, shall we say. I don't know exactly what he meant by his new deal, but from other conversations I've had with him, the notion of any grandiose new revenue-raising capability is not in the cards for municipalities, at least from what he said.

However, our membership realizes there are some pretty key issues at the municipal level, that something's got to give in terms of the different governments, but I can't see it being anything other than a collaboration among the three levels of government. From everything I've heard from them, I don't see the feds changing the current relationship or the current balance between the three levels of government involvement in things like infrastructure spending.

Mr Christopherson: I know one of the criticisms I had in the past was that things weren't focused enough and targeted enough in terms of the money they transferred, similar to the arguments they make about health care. I think that was why there was at least some musing about the possibility of having a direct relationship, if it wasn't possible to work something out with all three, that again made sure the money went where it was supposed to. If you were a small business person anywhere near Herkimer Street in Hamilton, for instance, when we had the major water main burst, there was a day's work, business, jobs lost to everyone involved. That is not efficient, that's not productive and that doesn't serve anybody. The money's got to come from somewhere, and if we all agree that it can't come from increased property taxes, it's got to come from somewhere else. Probably the most obvious one is a relationship with the feds.

The Chair: Thank you, Mr Christopherson.

Mr Christopherson: End of my time?

The Chair: That's the end of your time, sir.

Mr Christopherson: All right. Thanks for your answers.

The Chair: Thank you, ladies. We appreciated your input. Your perspective is always welcomed, I know, by everyone.

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BANK OF MONTREAL

The Chair: Our next presenter is the Bank of Montreal Financial Group. We have Mr Egelton, senior vice-president, deputy economist. Would you please take the stand and also formally state your name, if you would, sir, for the purposes of Hansard. Welcome. There will be one hour. Whatever time is left over after your presentation will be used for questions in rotation.

Mr Rick Egelton: Thank you very much. I'm Rick Egelton from the BMO Financial Group. What I've been asked to do or what I will in fact do here this afternoon is briefly take you through our outlook for the North American economy. I'll start off with the United States, go into Canada and then Ontario and say a few things about budget-setting and what I think the priorities should or shouldn't be going forward.

We have a fairly bullish outlook on the economy for North America. I think we've been more bullish than most people. We're particularly bullish on the Canadian economy. We think Canada will outperform the US economy over the next little while. We think Ontario will do reasonably well within that context. I think the best way to proceed is to take you through our outlook for the US. That sets the stage for where we see Canada and Ontario going.

If you flip to the third page, which starts off with the US flag, the US economy, interestingly enough—if you read the media or watch CNBC, you'd think the US economy is mired in perhaps one of the deepest recessions they've ever had. If you look at the chart in terms of GDP growth, in fact they went through an extremely mild recession in 2001 and last year the economy grew about 2.7%. So while the US economy isn't growing gangbusters, it's performing not badly.

What's happening in the US is that there's a tremendous dichotomy between businesses and households. Households are spending significantly. The housing market is the best ever. We just had existing home sales out this morning; 2002 was a record year. It was also a record year for auto sales. So the consumers are spending, and spending fairly significantly. What we are seeing in the US is tremendous retrenchment on the part of businesses. They're cutting back in every conceivable manner. Inventories have been pared to extremely lean levels. They are very reluctant to hire and take on new staff, and capital spending has been cut off massively.

So you have a household sector that's performing actually quite well and a business sector that is extremely weak. Overlaying that, you have a manufacturing sector in the United States that has now suffered 29 consecutive losses in employment on a monthly basis in a row. That has never happened before as far back as the data, and the data go back to 1939. I presume in the 1930s you had a period of that type of weakness in manufacturing. So it's interesting in the US that they have this situation: consumers are spending, businesses aren't and the manufacturing sector has been hit really hard.

However, we're relatively optimistic going forward on the US for a couple of reasons. Number one, if you flip the page, inventory levels right now are extremely lean, and we don't think firms can continue to operate with inventories at these levels. What that means is that going forward, as they rebuild inventories, they will need to increase production at a rate that's faster than their sales in order to put more product on the shelf. Second, interest rates are really low, and that is one of the reasons why housing and auto sales have done so well. It's a reason we think will support business investment going forward. Third, profits have come back—not back to where they were prior to the recession, but the profitability of US businesses has improved.

So you have the need to rebuild inventories, a very low level of interest rates, improved profitability and lastly, to the extent that the President's new budget package is enacted in some way, shape or form similar to what he has proposed, you're going to get a fair bit of fiscal stimulus in the second half of this year. We think all those things will lead to an economy that grows much more quickly.

If you flip the page, by the second half of this year we see the economy exceeding 4% growth in the US. That's a fairly strong economic performance. We think the characterization of that economy will be different than last year in the sense that what you're going to see going forward is a much better business performance in terms of stronger capital spending, a bigger build in inventories and a somewhat softer environment for housing markets and, what's important to Ontario, auto sales. We don't think auto sales can be sustained at current levels in the United States. In fact, we were looking at the data and there are something like 1.2 licensed vehicles for every licensed driver in the US, which strikes us as a fair number of vehicles on the road. It's hard to imagine you can continue to see people buy more and more cars at that level.

Inflation in the US we think will remain relatively benign. On the interest rate front, we think the Fed will remain on the sidelines, probably through to the summer. The Fed funds rate is now 1.25%, and if you think back to Economics 100, when you have interest rates lower than the rate of inflation, that's a very stimulative interest rate policy. That clearly can't be sustained indefinitely. So we see the Fed starting to raise interest rates this summer, probably raising rates in the neighbourhood of about 175 basis points this year, up to 3%, and another 200 basis points in 2004. The reason for the significantly steep rise in interest rates is that you need to move rates back to some more normal level. With 2.5% inflation, a normal rate of short-term interest rates is probably about 5%, about two and a half percentage points above the rate of inflation.

We think long-term interest rates will rise in the United States as well. They are currently just over 4%. One of the amazing things in the US has been that people have gotten out of equities because they don't like the equity market. As investors around the world have sought safety, they've put their money into the US bond market, because that's the safest instrument they can find. Because of that, that has really depressed yields on long-term government bonds. As the economy improves, as people have more confidence in equity markets, you'll see money flow back out of the bond market into equities. Equities should perform better and long-term interest rates should rise as money flows out of that market.

All in all, we have a fairly bullish outlook for the US based on the economic fundamentals. The big risk, of course, for the US going forward is, first, that businesses remain reluctant to invest, and that will slow down the pace of the recovery, and, second, whatever happens in Iraq and whatever implications that has for world oil prices.

I have a couple of charts here on commodity prices. If you look at the chart "Energy Markets," we have oil prices in blue, natural gas prices in red. Our guy who does oil prices told me that he could probably give me a credible scenario for world oil prices this year of $40 a barrel and he could give me another credible scenario for oil prices at $18, which isn't particularly helpful, but I think what it does do is give you a sense of the risk in terms of the oil market and how important it is in terms of what happens in Iraq: what that does to oil prices, and if there is a conflict, how long does that conflict go on and so forth.

What we've assumed in our forecast is that there is a significant spike in oil prices and then it comes down. So in a sense what we're assuming is a very quick resolution to the difficulties in Iraq, and that will not have a permanent impact on oil prices. Economic fundamentals would suggest oil prices at around $23 or $24 a barrel, and that's where we have prices going down in the near term.

For the rest of the non-energy commodity prices, we have them bouncing back fairly significantly in 2003 and 2004, mainly because of the rebound in world economic growth.

From a Canadian perspective, we look at our major trading partner and we see stronger growth this year, starting probably in the spring but more likely in the summer, an environment of rising interest rates and an environment of stronger commodity prices, all of which, by and large, is pretty good for the Canadian economy.

The Canadian economy has performed remarkably well over the last couple of years. We generated over 500,000 jobs in 2002. That was at a time when the United States actually shed jobs. Manufacturing employment in Canada last year grew at almost 6%. It fell, as I said, in the US every month of the year. So we have a much stronger performance in Canada than in the United States.

If you want to think of what industries did well, it's on the next page. We have manufacturing from December of last year to October, which is where we have the data. It was manufacturing, really, that led the way, and the construction industry was quite strong as well, running off the strength in housing starts. That's very different from the US, where you had a manufacturing sector that really struggled. Manufacturing in Canada did remarkably well. We think the primary reason for the strength in manufacturing in Canada and the weakness in manufacturing in the US is the high value of the US dollar and the low value of the Canadian dollar. That was a tremendous boost to manufacturing in Canada during that period of time.

I've had a number of people in the past say that low interest rates didn't seem to be working. If you look at motor vehicle sales in Canada, they were at record high levels last year. So clearly the low interest rates are working. You're seeing incentives as well from the major auto producers, but at the same time those incentives are made possible by low levels of interest rates. If you have zero interest rate financing, it's a lot easier to do when interest rates are low than when they're high.

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Housing markets are extremely strong—the best year of housing starts in over 14 years in Canada. The good thing on the housing market as well is that it's not quite like it was in the late 1980s, where we saw strength in certain municipalities across the country. This is widespread right across the country, and it's being generated by the low levels of interest rates and the tremendous improvements to mortgage affordability. So we think the housing market not only is strong but will remain fairly strong going forward. We've also seen an improvement in the export environment as the US economy has improved.

Going forward for Canada, we see a fairly bullish outlook in 2003, with growth of above 4%, starting in the spring of this year, driven by a number of factors: (1) an improvement in the US economy; (2) an improvement in the profitability of Canadian businesses, which will allow them to invest; and (3) continued decent growth in consumer spending. Don't forget, in the US we actually had declines in employment last year. In Canada we've had a significant increase in employment. With that increase in employment comes an increase in income, fairly significant purchasing power and an increase in consumer spending. So that will lay the framework for what we think will be fairly strong growth this year.

We think inflation in Canada will remain under control. We've had a number of factors. There has been a lot of talk lately about inflation being driven up. Core inflation is 2.7%. If you net out the impact of higher auto insurance premiums on inflation, it's 1.7%. So really it's not, in our judgment, a situation where you have widespread cost pressures but rather you have a couple of special factors really driving up inflation rates.

We think the Bank of Canada will resume tightening, probably in April of this year. The governor was speaking last week, and it's clear from his remarks that they're fairly eager to start raising interest rates again. They're worried the Canadian economy is perhaps operating closer to its full capacity. They're worried that may translate into sustained increases in inflation. Clearly the Bank of Canada will start raising interest rates later this year, and raise them fairly significantly. The Bank of Canada overnight rate now is 2.75%, and we see it topping out at 5% some time next year.

Bond yields will rise, as will US government bond yields.

Finishing up on Canada, I just want to say something about the Canadian dollar. This is something where I think most Canadian forecasters have not really cloaked themselves in glory over the last number of years—we would be one of them—and who continue to view the Canadian dollar as being undervalued and continue to be wrong in our forecast. We're seeing now significant strength in the Canadian dollar and significant weakness in the US dollar, and we think that will continue.

The reason we think the Canadian dollar is undervalued is that if you look at the chart here on the current account balance—Canada in the red and the United

States in the blue—the current account measures the balance of trade between a country and the rest of the world. Anything below the zero line means you're importing more than you're exporting, and above the zero line means you're exporting more. The US now is running a record current account deficit of 5% of GDP. Like an individual, when you spend more than you earn, you have to borrow money. That means there is about $450 billion worth of capital coming into the US to finance that deficit. Canada now is running very high current account surpluses, which are very unusual. The reason for this is not that we're more productive than the United States—in fact, quite the contrary; I think the US has a more productive economy than Canada—or that we're smarter; the reason is that our currency is low, which makes it easy for us to export. Their currency is highly valued, which makes it very difficult.

If you flip the page, you see the net international indebtedness of the two economies, the US in the blue and Canada in the red. Canada throughout its history has had a net international indebtedness of about 30% to 40%. The US typically, since basically the end of the Civil War, has been a net creditor country. The US now is a net debtor to a greater extent than Canada, as a share of the size of their economy. That has never happened in our countries' histories before. If the US continues to run a big current account deficit, their net indebtedness will continue to increase, meaning that blue line will continue to go down like this. And if Canada continues to run current account surpluses—that means we're accumulating foreign assets—our line will continue to go up like this. We don't think that's a sustainable situation and we think the currencies will adjust. We have the Canadian dollar rising at the end of 2004 to just over US70 cents.

The risk to that over the next couple of years is probably that the Canadian dollar could be even stronger than that. The risk in the very near term, if there is a war with Iraq, I think could be some weakness in the Canadian dollar as investors look for safety. When investors want safety, they tend to move out of peripheral currencies like the Canadian dollar and move into more liquid currencies. But we're fairly bullish on the Canadian dollar going forward and really, by extension, fairly bearish on the value of the US dollar going forward—a pretty benign outlook for Canada based on strong US economic performance, good fundamentals for Canada.

Fiscally—I didn't put any charts in here—as a federal government we're the only G7 country running a budgetary surplus. We'll probably run a surplus this year of around $7 billion to $10 billion, not counting what measures will be coming out in the February budget. The United States will probably run a budgetary deficit this year of about $250 billion to $270 billion. So we're clearly moving in opposite directions on that front. Canada fiscally, at least at the federal level, is performing quite well.

Moving to Ontario, we think the Ontario economy will continue to perform relatively well. Ontario has really been one of the growth leaders in terms of the Canadian economy over the last number of years, along with Alberta and Newfoundland, the latter two driven mainly by higher oil prices. In 2003, we think Ontario's economy will improve, but it will somewhat underperform the national average, mainly because of what we think will be a reduction in auto sales in the US, and that will have a slightly negative impact on the Canadian auto industry—but really a pretty strong performance; in 2004, Ontario once again growing slightly faster than the national average, and fairly steady gains in employment for Ontario. Representing 40% of the Canadian economy, the two economies, by and large, are going to move together.

In terms of the fiscal situation in Ontario, I want to just say a few things in terms of the priorities and that type of thing going forward. The way we tend to look at the fiscal situation, the way investors tend to look at it, is the fiscal situation of the country as a whole, the federal government and the provinces combined. When you look at it that way, Canada has now been upgraded to a AAA-rated country. Its debt burden as a share of GDP is roughly in line with Germany and France, other AAA-rated countries. We have a higher debt burden than the United States and the UK and a significantly lower debt burden than Italy and Japan, who are no longer AAA-rated countries. We're kind of in the middle of the good pack in terms of debt burdens, but we have a way to go in terms of reducing it.

If we look at Ontario and put it in the Canadian context, what you can see is that Ontario is AA-rated and its debt levels are roughly in line with those of Manitoba, Saskatchewan and BC and significantly higher than Alberta's. What I would suggest is that in terms of debt burdens in Ontario going forward, one of the goals should be to continue to reduce that debt burden as a share of GDP. I don't think it's in a situation right now where you have a fiscal crisis, as we did earlier this decade, both provincially and nationally, but you are in a range where I think it would be prudent to reduce it further. We see, going forward, a status quo situation on the fiscal side in terms of the budgetary balance, the fiscal position remaining largely in balance, ie, either a small surplus, a small deficit going forward under the current policies of the government.

On the tax side—and I just stepped in here at the end of your previous speaker talking about potential tax cuts coming from the US. In terms of tax-competitiveness, the things that we think are important, especially for a province like Ontario, one is how competitive you are internationally—and "internationally" means the United States—and how competitive you are within Canada, and "within Canada" really means that Quebec, Alberta and British Columbia are the key provinces that we think you need to be competitive with.

Clearly, on the personal tax side Canada is extremely uncompetitive with the United States. If you look at the lowest-taxed jurisdiction in Canada, which is Alberta, it is not competitive on the personal tax side with the high-tax jurisdictions of the United States, which would be

California and New York. So even our best province has a higher tax burden on the personal side than the worst state.

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On the personal tax side, I think Ontario is very competitive within Canada at low income levels. In fact, at income levels of $50,000 and lower you will see Ontario ranking, along with Alberta, as the lowest-taxed jurisdiction in the country. As you move up the income levels, Ontario's tax-competitiveness starts to erode because the tax system in Ontario is far more progressive than it is in most other jurisdictions. Going forward, as labour and capital—as labour particularly becomes more mobile, particularly within the country, I think it's important to keep that competitiveness in line.

The one area where Canada is very competitive with the US is on the corporate tax side. We think general corporate tax rates for large corporations are competitive with the United States. In fact, when the federal government is finished with its corporate tax reductions, average corporate tax rates in Canada will be lower than in most states in the United States. In this regard, we think Ontario is in fairly good shape. The only province with a lower general corporate tax rate than Ontario is Quebec, and if Ontario continues to follow through with the proposed reductions in the corporate tax rate, we think that will have a significant impact going forward.

We think really the best thing governments can do to provide prosperity and a strong economy going forward is to lay out a framework so that businesses feel confident about investing, that the jurisdiction is the place where they want to make significant investments. In order to do that, we think you need regulations that are reasonable and well understood, and we think you need a tax environment that allows businesses to take risks and that is competitive internationally and within the country. We think that on the corporate tax side that has largely been achieved and will be reinforced if the general corporate tax reductions follow through.

On the personal tax side, obviously, we think there is more that needs to be done in terms of, first, following through the personal tax cuts that have been previously announced and, second, even going beyond that over the long term, but at the same time keeping in balance with reductions in the debt levels as a share of GDP going forward.

Over the late 1990s, we were basically telling the federal government in our representations the same type of story I'm suggesting here this morning. We had always put much more emphasis on getting debt burdens down than we have on taxes. If you have to choose between the two, in the near term I think debt burdens are extremely important to get down, because if you don't get them down, over the long term high debt levels are high taxes. There's no way of getting around that. And in the near term, low debt levels provide you with a tremendous amount of flexibility. In fact, if you look at the United States, one of the reasons they have been able to implement fairly significant tax cuts over the last couple of years in order to help the economy along is because their debt levels were so low. That enabled them to do that. We don't really have that luxury of running a significant deficit like the United States, simply because our debt burdens are that much higher.

But all in all, going forward, we think the economy for Ontario and Canada is quite robust, quite strong. We think the outlook is very robust. The main risks to the outlook for Canada I think lie outside our borders, with what may or may not happen in the Middle East, in Iraq, and the impact that may have on oil prices and on the evolution of the US economy. But we as a country and as a province have continued to outperform the US over the last couple of years. We think that will continue going forward.

Back in the early 1990s, I was with the federal Department of Finance in Ottawa, and one of my jobs back then after a federal budget was going to New York and trying to convince investors that it was a wonderful budget and they should go long on Canadian assets. It was at a time when we were running a $45-billion deficit, when we had high rates of inflation, and we were dramatically underperforming the US. I had one person tell me at the end of the meeting, "Do you know what? Your story is reasonably good, but my boss told me if I lose another nickel on Canada, he's going to fire me." There was a tremendous amount of negativity toward Canada. That has really changed.

We're the only G7 country running a budgetary surplus. We have fairly strong growth; we've been outperforming the United States over the last number of years; we're running trade surpluses. The situation in Ontario is much stronger; we have a much stronger economy in Ontario. Alberta is doing quite well. We've seen a significant improvement in the investment climate in British Columbia. So as a country, I think things are looking much, much better than they were a decade ago. In fact, just based on economic fundamentals, I would say they're looking stronger than they are in the United States. If you were to extend this thing out and look at it over the next 10 years, we think the prospects are that the economy will perform better over the next 10 years than perhaps any decade we've had since the 1960s.

So we think things are looking good. There are a number of speed bumps on the road, and they mainly emanate out of the United States. And there are things we can do wrong. We've spent a lot of time putting our fiscal houses in order, not only federally but provincially and right across the country, and you can certainly blow that. But I now sense, at least among the Canadian public, a strong desire to avoid running budgetary deficits again, and I think that's a very good thing. As long as we continue to run balanced budgets or small surpluses, our debt burden both provincially and federally will continue to fall.

The Chair: That leaves us just about 10 minutes for each caucus. We'll begin with the Liberals, the official opposition.

Mr Kwinter: Thank you very much, Mr Egelton. There's no question that you're a lot more bullish than some of your counterparts. I have an analysis done by six different economists, and every one of them is not quite as bullish as you are, which is fine.

I have a question. I recently attended the Council of State Governments in the United States, down in Richmond. Literally, to a state, they were all crying doom and gloom and complaining that they have to run balanced budgets. They claim that they're not going to be able to unless they do one of two things: raise taxes or sell assets. One of the things you talked about is that the bumps in the road could be what's happening in the US economy. I want to ask you about your statement regarding the fact that businesses are negative in the United States about what's happening. Manufacturing inventories are at their lowest levels, yet consumer spending is high. It would seem to me, particularly when you take a look at the graphs which show exports are down and imports are high, that aside from the building industry, the housing industry, which is very, very buoyant and at record levels in the United States, a lot of the economic activity is in imports, and that is really what has affected the balance of payments in the United States.

This morning we had the people from the Ministry of Finance showing that exports from Ontario are down and that the economy, again, as it is in the United States, is consumer-driven. They're buying things, but our export business is down, which indicates to me that when you consider that the United States is our biggest customer, we're not selling as much to the United States, but other people are. How do you think that's going to impact us in the long term, if we have a situation where our biggest export market, it seems to me, is being filled by other than Canadian products we've normally been selling them? Do you have any thoughts on that?

Mr Egelton: Yes, a couple of things. One of the things we have to bear in mind over the last number of years—people here are fixated on the value of the Canadian dollar against the US dollar. But what has happened is the Canadian dollar has actually performed pretty well against virtually every other currency. So while we have become more competitive against the US because our currency has fallen with respect to their currency, other currencies actually declined even more than the Canadian dollar against the US currency. For example, the euro—if you remember, it came into being at $1.19 and fell to 87 cents against the US dollar. That gave them a tremendously competitive edge. So we have lost competitiveness, to some extent, against third countries.

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But by and large, I think we have really held our own in terms of how we're performing in the US and how we're performing against other countries. We've seen exports from Canada to the United States weaken off late in 2002 and that was because the US economy in late 2002 weakened off, but really what we've seen from, I would say, the mid-1990s right through to the end of much of last year is the Canadian exporter taking market share in the US. If you think about it, we've now gone through a three-year period where we've outperformed the US, we had fairly strong economic growth last year in Canada despite the fact that commodity prices outside of energy were depressed and despite the fact that our strongest trading partner was growing fairly slowly, yet we continued to perform pretty well. Now, part of that was because they sold a record number of automobiles, and automobile exports and parts are a big part of the Canadian economy, but I think we have still held our own reasonably well against third countries into the US marketplace.

So going forward, as long as the Canadian dollar stays within reasonable levels, I'm pretty confident that we will continue to perform fairly well going forward and continue to maintain our share of that market.

Mr Kwinter: Could you tell me your views on the automotive sector? We've heard a lot about how there have been no greenfield investments in Ontario for many years, that there seems to be a trend to consolidate and a lot of that is going to the southern United States. Have you done any projections on what that impact is going to be on the Ontario economy?

Mr Egelton: We have not done any projections on what it'll be in the Ontario economy. We've looked at the overall auto sector, and what is clear is that there is worldwide overcapacity in the auto sector. I think what you've been seeing over the last number of years, what we find a little bit bizarre, is that you have a fairly weak economy and you have auto companies struggling and yet they're offering these incentives in order to get sales up to record levels, and that's basically because their fixed costs now, I think, have become fairly significant.

We think going forward that you are clearly going to have to take some of that capacity out of the world. There is excess capacity in the world. You're going to see some consolidation, and some of that capacity is going to have to come out. That I think is one of the reasons why we haven't seen a significant amount of investment in Ontario.

At the same time, Ontario still accounts for a disproportionate amount of auto assembly. If you look at the Canadian share of the North American market for sales, we certainly produce more than our share of production. I think the reason for that is, costs are lower here than they are in the United States. But clearly there is going to have to be some capacity taken out of the auto sector worldwide.

Mr Kwinter: Do you have any views on what impact the hydro situation is going to have on Ontario's economy? The current status as we see it now, with the non-sale of Hydro One, the freezing until 2006—what do you see as the economic impact of that in that time frame?

Mr Egelton: I don't think freezing prices in nominal terms at levels of where they were six years ago is something that will instill confidence in the business community, or anybody else for that matter. So on the one hand, you can say there's some price certainty, and the prospect of continued lower rates going forward is a good thing, but arguably setting prices—and I'm not an expert on electricity, but I think you'd be hard-pressed to find an economist who would argue that setting prices flat in nominal terms for a number of years is going to encourage new supplies to come on stream, is going to encourage business investment, is going to give people a sense that there'll be enough power going forward to supply the needs of the province. So it doesn't strike me as a situation that's all that sustainable.

Mr Kwinter: What I was really trying to get at is our competitiveness. When I was the Minister of Industry and Trade, one of the top items on my list when I was selling Ontario as a venue for investment was our cheap hydro. You might argue that it's still very cheap because of the freeze, but that only applies basically to consumers. Businesses—that's a free market, and one has got to affect the other. Do you think it's going to have a serious impact on our competitiveness?

Mr Egelton: I think it's one of many, many things that go into our competitiveness. I wouldn't want to underplay it and I wouldn't want to overplay it, but I think it's simply one element in terms of the overall tax structure of the province, the overall growth rates of the province, the overall rates of return that people can get. So do I think this is going to cause people to pull out of Ontario or anything like that? I don't think so, but I think it's certainly something that businesses are probably concerned about going forward.

The Chair: You have about a minute, if you like, Mr Kwinter, or are you finished?

Mr Kwinter: No, that's fine.

Mr Christopherson: Thank you for your presentation. Very interesting. I'll start with auto. You focused a bit on that and talked about the importance of it, and so did previous presenters. You talked about the fact that there's excess capacity worldwide and that's got to give and we're already starting to pay some of the price in Ontario. I know in the last round of negotiations there was an attempt to offset that, but nonetheless we're still losing decent-paying autoworker jobs that help sustain the consumer demand that you and others have pointed out is keeping things going.

Given the fact that they're doing all these sales—because they're trying to keep their overall sales up, and that can't hang on forever—and given the importance here and given how bullish you are on everything, I'm a little confused as to how you're discounting the negative impact of the auto industry on our overall economy to allow you to still remain so bullish.

Mr Egelton: Over the next couple of years we think, for example, auto sales in North America will come down, but they will still remain relatively high. We don't think you're going to see auto sales, for example, in 2003 at 2002 levels. So we think you're going to see a modest retrenchment in terms of auto sales. Auto production, we think, in 2003 will be lower than it was last year. In 2004 it will be slightly lower again, but still at a fairly high level.

Your question is, how is that consistent with an economy that's growing?

Mr Christopherson: Exactly.

Mr Egelton: While it's a very important part of both the Canadian and Ontario economy, overall in terms of GDP, auto parts production is probably only around 2% or 3% of GDP. What we see happening going forward is that other aspects of the economy will improve quite significantly. We see business investment growing quite significantly over the next couple of years; we see exports of other goods rising quite significantly; we see a much stronger resource market going forward in terms of natural resources because of higher prices.

So what we've seen over the last year, for example, was the very low level of interest rates allowing the housing sector and the auto sector to perform exceptionally well and offset some of the weakness we are seeing elsewhere in the economy. As those other areas of the economy pick up in 2003 and 2004, you'll see housing and auto sales kind of come off a little bit.

Mr Christopherson: But in the real economy, in a lot of those trade-offs of new jobs versus existing jobs in the auto industry, the income level and therefore the disposable income and therefore the impact on the overall economy is lessened. So it's not exactly the same to create a new job in a new sector that doesn't pay as much as a lost auto sector job, in the real economy.

Mr Egelton: It depends on the job. If you were replacing auto sector jobs with jobs at fast-food restaurants, obviously you're losing income. But if it's high-tech industries that are performing significantly well, which we think they will increasingly perform better, outside—

Mr Christopherson: Job for job, though?

Mr Egelton: In terms of income?

Mr Christopherson: No, number of jobs for jobs. I would disagree that some of the high-tech jobs are going to pay well. I just find it hard to believe that if you lost a whole whack of autoworkers, you're going to have that many more new decent-paying jobs elsewhere.

Mr Egelton: I don't think we're suggesting that you're going to have this tremendous reduction in the next one to two years in terms of the auto sector. What we're saying is you're going to see auto sales come off a little bit, maybe 4% to 5%, over where they were last year. That's going to translate into less output and less jobs, but we're not looking at a decimation or anything like that of the Ontario auto sector and the number of auto jobs. I think there'll be fewer auto sector jobs over the next couple of years than there were last year in Ontario, but there'll be more high-technology jobs; there'll be more jobs in other sectors. Some of those jobs, as you point out, won't be as high-paying and won't be as good, and some will be. High technology jobs, by and large, are pretty high-paying.

Mr Christopherson: I'm going to try and get in two questions, if I can, so that maybe you can respond to them in your answer, because the Chair watches that clock like a hawk.

Interjection.

Mr Christopherson: Rightly so, Chair.

You pointed to the two sort of twin pillars: the auto industry and housing. Let me now shift to the housing end of it. It seems to a lot us lay people, having gone through the tech bubble, the stock bubble that we went through, that a whole lot of that same exuberant optimism has now gone over to the housing end of things. I'm curious, number one, how long do you think that can sustain?

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One of the things that identifies a bubble from a natural lift in things is that things get all out of whack. The value of houses—correct me if I'm wrong—I think now is even greater than the last big jump up. We're now hitting levels that have never been hit before. A lot of people, even though their RRSPs have gone down, because they've seen the value of their homes go up, feel that they really aren't as badly off as they otherwise would be if it had stayed the same. What happens if that housing industry drops off—either the war triggers it or something else triggers it? That whole business where there are people out there ready to buy your house—I remember the last time this happened, I was one of those suckers. I was in that thing, so this thing has real meaning to me. I know the motivation of standing there wanting to get that offer in because you're competing with others and you want to make sure you get your chance. If that evaporates, where are we? What's the wealth effect on people in terms of how they see things?

If I can, before you answer that one, I want to link my question, because I'm watching the Chair.

The other one is, everybody keeps talking about inflation, inflation, inflation. Fair enough. I hear all the good arguments for that, and yet what I see is evidence of deflation. Again, reading a number of periodicals, you see where we now have the effect of China in terms of their ability, more and more, to provide manufacturing that we used to provide in North America a lot cheaper. Now they're members of the WTO. By being a member of that, they are into the trade game more, and more and more we're seeing many sectors where the prices are falling because they're able to produce these in China because of the cheaper labour costs and then export them into North America, which undercuts our manufacturers. We've got two things happening at once: we've got falling prices happening, and then arguably we're losing jobs and investment if it's happening over in China.

In addition to that, the sale on autos is actually a lowering of the price because it's coming off the profit margin, so prices are actually going down there. And if I can link that also to the high debt load of people who bought these houses, when I look at your chart and see how high you're predicting interest rates to go—at least on the American fed side, and I would expect the same to happen with the Bank of Canada—people could be caught in one hell of a squeeze.

I don't want to be Mr Gloom and Doom, but does not all of that suggest that things are very precarious at best, and that any of these scenarios that do come through, which are not stretches, really could trigger some pretty horrible things?

Mr Egelton: We've done a fair bit of work on the housing market. Obviously for us it's pretty important. There is a real fundamental difference between what's happening now and what happened, say, in Toronto in the late 1980s. The fundamental difference is that what happened in the late 1980s was that housing prices got so high that mortgage affordability—for example, mortgage payments as a share of an individual's income—went into the stratosphere. In many instances, people were stretching themselves to buy the house, but they bought it because they felt, "If I don't buy it this year, it's going to go up next year."

Mr Christopherson: Got the T-shirt.

Mr Egelton: What has happened now is that mortgage payments as a share of income are at the lowest level they've been in 15 years. The reason prices are going up is because housing is so affordable because interest rates have come down so much.

Mr Christopherson: But what happens to these people after the interest rates go back up, especially if they're in the auto sector?

Mr Egelton: We did an analysis looking at what would happen if interest rates went up as we have in our forecast, which is 225 basis points, and if housing prices went up another 5% to 10% over the next year. On average, that would be sufficient to raise mortgage payments as a share of income from very low levels to about the average they've been over the last 15 years.

What that means is that would cool off the housing market, so to speak, so you're not going to get 10% or 12% increases in housing prices. They're going to come back down, say, into the 3% to 4% increase range, but it's not going to result in the huge decline in the market that you saw in Toronto. The Toronto market in the late 1980s was the classic bubble, and it was only happening in a couple of markets across the country. What you're seeing now is housing strong in every market across the country, and the reason for that is that it's well supported by low levels of interest rates. Housing is very affordable for Canadians. That's why housing starts are so strong, and a 200- or 250-basis-point increase in interest rates won't result in a huge decline in housing prices; it will simply slow down the rate of increase in prices. If you were to get something like 700 or 800 basis points, that's a different story, but I think that's pretty unlikely.

On the deflation side, in any large economy you're always getting some prices going up, some prices going down. On average, as I said earlier, consumer prices year over year are up about 2.5%. You take out auto insurance and it's still up 1.5%.

The issue of countries like China producing manufactured goods at below what we can produce or what the United States can produce I think has been going on in one form or another for many years, with many different countries. I think what we're seeing is low-productivity, high-labour-content goods. The production of those goods is gradually being shifted from industrialized countries like the United States and Canada into developing countries, where the costs of labour are much cheaper. That has been happening for a long time and will continue to happen. It's one of the reasons you see the costs of manufactured goods—things like refrigerators, stoves, VCRs, DVD players—remain fairly cheap. I think that will continue.

When you look at overall prices, you're going to have prices increasing. Prices of high-labour-intensive goods are probably declining; prices of service goods, which have a high domestic labour content, will continue to rise in price. We don't think you're near a deflation scenario or anything like that. What we think you're seeing is that for some high-profile goods there's tremendous international competition, and those prices are going to be kept low.

The Chair: Now your time is up.

Mr Christopherson: OK. Thanks very much for your answers.

Mr Beaubien: Thank you very much for your presentation. I have a quick question and it deals with inventories. You mentioned that they're very low, and I think in your projection you say that's good because that means they're going to build them up. The converse of that is that you could take the negative aspect and say, "Well, maybe people are not going to be buying." If you look at what's been driving the economy, it's consumer belief and consumer spending. You mentioned also that in the States they have 1.2 cars for every licensed driver. I think also in the States statistics will show that 40% of consumer spending comes from remortgaging their houses. Especially when we look at the weakness of the Canadian dollar compared to the—granted, there is, especially in the past few months, some indication that the American dollar is getting weaker for a number of reasons. But how do you tie all this up together, with the low inventory, consumer spending basically driving the economy? If we look at the inventory from a negative aspect as opposed to saying, "We're going to replenish it," from your point of view—but if I look at it, there are enough cars, there are enough chesterfields, there are enough fridges. What's your comment? What's your reaction?

Mr Egelton: I'll deal with both the US and Canada because the situations are quite different. In the US, we think this year you're going to see a lot more employment growth. We think one of the things that happened last year was that, because firms were in such a precarious financial position, they were really reluctant to take on new employees. So over the course of the year you actually had employment declines in the United States. This year we think you're going to get employment growth. That'll put money into people's pockets as you have job creation. That will put them in a position to continue to spend.

We think that consumers are not going to lead the economy. You're going to see consumer spending, for example, grow at a rate that's probably slower than the economy in general for precisely the reasons you mentioned. Because much of the past financing had been done by people refinancing their mortgages, debt levels in the United States are relatively high. So I think what you're going to see, for example, if income grows at 4%, consumer spending will, say, be up at 3.5% or 3%. So consumer spending in the US is going to trail the overall economy because people will want to rebuild their balance sheets somewhat. Nonetheless, they're still in a position where they're able to spend, but they won't spend as much on autos and housing next year.

In Canada, on the other hand, we've had tremendous growth in jobs; income has been high; consumers' debt levels are not in as bad shape as they are in the United States. Consumers' balance sheets are looking reasonably good. I think the Canadian consumer is in a pretty strong position to be able to spend at a decent pace going forward.

Mr O'Toole: Thank you very much for, I think Mr Kwinter said, a very bullish, optimistic view. Roughly 4% is I think what you said —I hope you're right—based on the fundamentals, the US economy and, since we're a net exporter, all those things.

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I have a detailed question. I just want to comment on a couple of things. I'm very interested in your impressions on the interest rate argument. I understand interest should exceed inflation. As you said, that's economics 101. I just wanted to feel whether it's cost of living—there seems to be some artificial pressure on interest rate increases. We've seen the repercussions of that in the early 1990s, where it got into some trouble and slowed the economy down unnecessarily. I liked David Dodge's remarks last week, I think it was. It was quite interesting to pay attention to that.

What I'm really interested in: I worked for the auto sector for 30 years, and for the last 10 years they say there has been overcapacity. I put to you—and our next presenter, Hugh Mackenzie, is no stranger to that—that actually payroll really hasn't changed in the auto sector; there are just fewer people sharing it. It's called "productivity improvement factors," 3% and 4%. Actually, it's just fewer people on the payroll. I worked in personnel/labour for about 15 years. Where there were 100 people, there are now 25. The payroll hasn't changed, and I would put to you that Buzz Hargrove—he knows it all. He knows that when they get the 4% increase or all of the overtime and the benefits and the days off, at the end of the day there are fewer people sharing it. So I think they're compensating for that by becoming competitive. Certainly it's an argument I expect in the next couple of minutes.

I am interested, though, and my question is this: you talked about the value of the current account deficit. I would have to say I'd have to get the primer on that, because I'm not really trained too thoroughly in this area. You're saying that Canada has a current account surplus and the US has a deficit. Just answer to help me understand it: if the value of our currency increases, what happens to that in relative terms, by just changing the value of the currency, which is a monetary policy that we have no control over, really?

Mr Egelton: The current account really is simply the difference between what we sell to the world and what we buy from the world. So if we're running a current account surplus of, say, $20 billion, that means the value of the goods and services we sell to the world is $20 billion higher than the value of the goods and services we buy from the world. In the US it's the reverse: they're buying more than they're selling, to the tune of over $400 billion. That's a huge amount. As an individual, if I make $50,000 a year and spend $60,000, I have to borrow $10,000. If I do that year in and year out, I'm borrowing $10,000, a year and that adds up after years to higher indebtedness.

What happens around the world in most economies when you start running large trade imbalances, it means you're importing a lot more than you're exporting. You end up borrowing internationally. That means people are holding more and more of your assets. That's what is happening in the United States. At some stage people will say, "I have enough US assets in my portfolio. I'm going to sell them," and that brings the currency down. When the currency falls—say, for Canada, we're running a large current account surplus. The value of the Canadian dollar, say, rises very sharply. That makes our exports more expensive. So somebody buying Canadian exports in Ohio will say, "Wait a minute. The price has gone up in American dollars." That's what they're interested in. So the Canadian dollar rises. The price they see in Ohio is a higher price, and they say, "Maybe I'm not going to buy that any more. I'll buy it from the guy down the street." That's what happened in the late 1980s.

Mr O'Toole: You're helping me. I just want to know one thing. For instance, if I'm a net exporter—in fact, I'm growing my economy in export—the people eventually have to get paid in Canadian dollars, so all the money for that product eventually puts pressure on the currency. In fact it really has a tendency to increase the value of the currency by having a surplus, because more people need Canadian dollars to pay the Canadian workers.

Mr Egelton: Right.

Mr O'Toole: So monetary policy has a significant impact almost contrary to what you've explained to me: that if the US is running a deficit, that means people are shedding it. In my view; the dollar itself is being diluted.

Mr Egelton: That would normally mean, if the US is running a big deficit, downward pressure on the value of the US dollar. What's offsetting that, and what has been offsetting that the last couple of years, is that people want to hold US assets. I'm a big investor in Germany and I think, "I want my money in the safest thing I can find. That's US-dollar treasury bills."

Mr O'Toole: It doesn't matter. It's insensitive to the trade issues here, you pointed out.

Mr Egelton: Yes.

Mr O'Toole: I appreciate it. There may be other questions on the other side, Chair. If not—

The Chair: Any other questions?

Mr O'Toole: Actually, I will ask one more question. I want to know your solution with respect to—this is really going back to the interest rate and its implications going forward. Again, it's the federal government. A couple of presenters, including the Canadian Federation of Independent Business, the small business people, suggested the same thing: that, going forward, there probably would be some pressure on the cost of money. How do you see that affecting some of your assumptions here on the 4% growth?

Mr Egelton: Included in our assumptions on 4% growth is the fact that the cost of money is rising. If, for example, we said interest rates in the United States are going to stay at 1.25% and they're going to stay low in Canada, we'd have even stronger growth. I don't think the economy would be able to sustain that. That's what Mr Dodge was really warning about last week: unless we raise the cost of capital to something more reasonable, you are going to have excess demand and inflation pressures in the country.

Mr O'Toole: Yes. It would have a big impact.

Mr Beaubien: Just a small comment, if I may. I would like to thank Mr Egelton for his presentation, because I think he's right. The fundamentals are good.

The Chair: That concludes your time. Thank you, Mr Egelton. We appreciate it.

Mr Egleton: Thank you.

UNITED STEELWORKERS OF AMERICA

The Chair: Our next presenter, from the United Steelworkers of America, Mr Mackenzie, research director. Welcome, Mr Mackenzie. As you probably know, there is one hour. Whatever is left over from your presentation will be divided up amongst the three parties for questions.

Mr Hugh Mackenzie: Yes, I do. Thank you. Let me convey my thanks to the committee for having me back again. I always enjoy this and I look forward to the discussion. I am going to try and keep my remarks as brief as I can because I think there are lots of things we can be talking about.

Just to give you a bit of an overview of what I'm going to say, I'm going to first spend some time talking about my sense of where the government's fiscal balances look right now for the current fiscal year; present a bit of a sense of where I think it's going next year, given my view of where things are at now; and then I want to spend a bit of time talking about what I see as the stresses on the budget balance of the government over the next couple of years.

First of all, looking at this year, we've been getting some mixed signals from the government about what the fiscal balances are. There have been a number of things at play over the last 12 months or so that have an impact on this. When the government released its budget last May, it was projecting a magical zero surplus, zero deficit number. Included in the estimates of that perfect balanced budget was the assumption that sales and rentals this year would hit in excess of $2.4 billion, about $2 billion of which was to be the proceeds of the sale of Hydro One. Given the events that have taken place since then, that's one area where one might think there is a bit of concern about what's going to happen to the government's fiscal balances for this year.

In addition to that, we've had a couple of significant moves by the government on the spending side, most notably the government's decision in December to embrace at least the first phase of the Rozanski recommendations on elementary and secondary education funding, which come to the tune this fiscal year of about $500 million.

If you look just at the numbers that have been presented by the government so far, it would look pretty bleak, because you've got a bare-budget balance, you've got a significant hole being dug on the revenue side with the decision not to sell 50% of Hydro One, and you've got these pressures on the expenditure side.

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In fact, though, we've had a government and a Premier actually sounding quite sanguine about all of these potential stresses. When the government announced its response to Rozanski, the $500 million for this fiscal year, Premier Eves was, I thought, almost cavalier in his response to concerns about the government's fiscal capacity to do this thing, that there was easily enough in the reserve funds to carry it. And just recently the announcement that Hydro One's privatization was not going to take place, to the tune of about $2 billion in this year's accounts, kind of rolled by without so much as a whimper about what the fiscal implications of that might be.

On the expenditure side, I think it's worth pointing out that as of the most recent Ontario Finances, which was as of the end of September, the government was still showing about $1.8 billion in unallocated reserves, so I think I can take the Premier at face value that there probably was enough in the reserve funds at the time to deal with the Rozanski implications. But I think the real question and the real story is, why is there not a more anguished reaction on the budget side to the decision not to sell half of Hydro One, to the tune of $2 billion? I was curious about that myself.

As I usually do for this presentation, I cranked up the little model that I have of the Ontario budget system, and what I think it reveals, to my satisfaction anyway, as a reasonable explanation as to why there isn't a blind panic over there across the street, is that the budget, as it was released in May, contained significant underestimates of revenue in a couple of key areas: significant underestimates of personal income tax revenue, less significant but still significant underestimates of corporate tax revenue and some modest underestimates of sales tax revenue.

I preface this by saying that the projections that I put together for the re-estimates of revenue for 2002-03 were based on an average of the most recent economic forecasts of the five largest chartered banks. Those forecasts were all done, or at least were published, by the chartered banks toward the end of the fourth quarter of 2002, so they're relatively current. You'll see, down at the bottom of the rather ugly-looking chart that appears on page 3, I've got a listing of what those assumptions translate to. I'm basing this analysis on an assumption of inflation at around 2.2% in 2002 and 2003, real growth this year higher than next year, at 3.6% and 3.3%, which as I said is the average of the chartered bank numbers and I think is a little on the low side compared with what some of the non-chartered-bank forecasters have been suggesting Canadian and Ontario economic growth might look like in the current year and next year.

But with those assumptions about economic growth and inflation, I generate significantly higher revenue from personal income tax and corporate income tax than the government's estimates were at the time of the budget, and those higher estimates basically take care of whatever fiscal hole might be created by the government's decision not to sell Hydro One.

Looking forward to next year, I've put together what I would describe as kind of a base case, based on what we know, of the government's fiscal situation. In other words, I've taken into account some of the bigger cost pressures on the expenditure side that we know about, and on the revenue side I've made the assumptions I've described earlier that are detailed on page 3 of these notes. Incidentally, just for completeness, the estimates that I've put together on the revenue side assume that the health transfers from the federal government will increase from last year to this year by the $275 million that they were originally scheduled, from the September 2000 agreement, to increase. They make no assumption about what the outcome of the ministerial meetings and then the federal budget announcements expected for late February will be. So it's sort of status quo with the built-in escalators on the health revenue side.

I'd also point out that in my base case I assume that the schedule of corporate income tax reductions that the government suspended in the last budget will resume in this next budget. It has relatively little impact on the budgetary situation of the province this year. Because of the way the timing works, the reductions that were suspended were to take effect this past January 1. If the schedule is reintroduced, the likelihood is that they will be scheduled to take effect next January 1, which means they could only affect three months of this fiscal year, one quarter of this fiscal year. So the implications of that are relatively limited this year.

The more interesting action is on the expenditure side. I'll just highlight three of the key assumptions that I've made in putting those numbers together. One is that with respect to elementary and secondary education I'm making the assumption that the government continues to implement fully the recommendations of Rozanski. Unless we want to get into this, I don't want to go into this at great length. I've gone through a fairly detailed analysis of Rozanski's recommendations, including his proposed phase-in and the new investments and all of the other stuff associated with it, and based on pretty conservative assumptions about the cost drivers that influence Rozanski's recommendation to keep the funding formula benchmarks up to date with inflation, I'm estimating that about $1.3 billion in new funding will be required in fiscal year 2003-04 in order to continue the process of implementing the Rozanski recommendations. That number is a bit higher than some of the numbers I've seen elsewhere, but those numbers have not taken into account Rozanski's recommendation for annual updating of the benchmarks to keep the benchmarks current. And I'll remind people that the $1.08 billion plus the $340 million that the government brought in for salary adjustments only brought the system up to date for 2002-03; they didn't speak to 2003-04. That's the biggest single expenditure pressure that I see in the stuff we already know about.

I'm assuming that the government is eventually forced to increase funding for post-secondary education to take into account the double cohort. Based on the estimates right now that the number of students accepted by Ontario universities will be about 10,000 higher than in a normal year, that translates into a need for about a 4% increase in the budget for post-secondary institutions. I've taken that into account in preparing these projections.

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The third unusual increase that I've taken into account is what's become now the normal expectation that health expenditures will run ahead of the rate of inflation. In this case, for the sake of simplicity and perhaps to anticipate some of the pressures that will come from Romanow, I've projected health expenditures to increase at twice the rate of inflation.

I've made fairly, I guess, expansive but I think realistic assumptions about what is going to happen on the expenditure side if the government does follow through on what appear to be the commitments they've made.

When you shake all of it out, we end up looking at a modest surplus of about $400 million in 2003-04. This is assuming that the government does follow through on the need for these additional investments in the three areas I've specifically identified and increases its commitments at about the rate of inflation in other areas of the provincial budget.

That surplus would roughly double if the government were to decide to suspend the tax cuts for corporations for another year beyond the year they've already suspended them. As will become clear as I go on here, I believe that's something the government should be doing.

Let me highlight very quickly the key elements of the stresses that I see on the provincial budget. I've already mentioned in the current year the return of the budget line item for sales and rentals back to a more normal figure of about $400 million a year from the Hydro One-influenced $2.4 billion that was in the last budget. I've mentioned the corporate tax cuts. I've stressed that this year the impact is relatively limited. I would be remiss if I didn't point out that this is a bit of a sleeping dog, because the schedule of tax cuts that would be resumed if the government decides not to continue the suspension of those cuts would by mid-decade have a negative impact on provincial revenue of about $3 billion a year.

I want to stress that one very much gets the feeling in looking at the corporate tax cut program that the only reason we seem to be proceeding with this is because somebody said we were going to. If you look at comparisons across North America of corporate tax rates, we're right in the thick of the race to the bottom in corporate tax rates. One of the things I found very interesting in the public reaction to Bush's plans to reduce taxes in the United States is that there was—I don't know if this is quite the right way of phrasing it. There was quite a bit of silence, I would say, on the corporate tax comparison side because, when you combine state and federal taxes in the United States and provincial and federal taxes in Canada, there really isn't much of a story to be told about any further pressure on Canada to reduce corporate tax rates, and that's even before the federal government gets into the meat of its planned corporate tax cuts. So I think we're in real danger of overachieving ourselves in the corporate tax cut game to the detriment of our capacity to pay for public services that we badly need.

Another point I want to make about revenue-side risks—and I'll say right off the top that for most economists who are looking at this, it's difficult, so I'm not alone—other than making the bland statement that if there's a war in Iraq it will have an economic impact, people are all over the map about whether that economic impact will be positive or negative. As I said, people's woolgathering about what that impact might be is pretty inconclusive. But it is a risk factor that I think one has to take into account in some way, at least in having a bit less certainty about what the growth numbers are going to look like.

I'd feel terribly guilty if I didn't remind people that one of the things which, and this is particularly important when you start to look at some of the pressures that exist on the expenditure side—we have a huge hangover in reduced fiscal capacity left over from the era of rapid tax cuts in Ontario. The current tally in lost fiscal capacity is about $14 billion a year. Incidentally, $700 million of that is in the interest costs alone on the money that was borrowed to provide tax cuts when we were running a deficit. It's just a huge hangover on our fiscal capacity.

On the expenditure side, probably the biggest uncertainty is what the implications of Romanow's recommendations are going to be and whatever deal is made coming out of it. To the extent that the additional financing that flows from the implementation of Romanow does not require the province to make any new investments in health, it's obviously going to be a windfall on the revenue side, because there will be increased revenue coming to Ontario, courtesy of the federal budget, with no obligations to increase spending. To the extent that the implementation of Romanow compensates the provinces dollar for dollar for increased spending, it will have no impact on the overall budgetary balance. As unlikely as that seems when you state it that way, when you've got the combination of the pressure on the federal government to increase its share of health spending and the specific recommendations for new investments that are contained in Romanow, it's at least conceivable that the package of things that comes out of Romanow will end up being budget-neutral. In other words, there will be a mixture of an increase in the federal share of spending, which will displace provincial dollars, and then there'll be some sort of cost-shared improvements that will be mandated by the implementation of Romanow.

In effect, the increased dollars on the cost-shared side will compensate whatever leverage the federal government insists on getting on the expenditure side to produce neutrality. To the extent that the federal government says, "We're only giving you money for new things," and therefore is looking for leverage of provincial dollars, health could have a negative impact on balances going forward. We'll have a much better idea of what that looks like within the next few days, I would think, as these discussions between the federal government and the provinces continue, although given the posturing that's taking place on both sides, I think we'll really only know for sure when we read the federal budget.

I've mentioned the Rozanski recommendations. The analysis I've done indicates that over the four-year period Rozanski covers—that includes last year and the next three years—when you take into account his recommendation that the benchmarks be kept current every year, the implications of Rozanski for elementary and secondary education funding are about $3.5 billion over that four-year period. I've taken into account the first big tranche of that in the projections that I've done, but I think it's worth emphasizing that implementation of Rozanski will require an investment of another $800 million in each of the following two fiscal years as well. So it's a really substantial lump of money that we're looking at going into elementary and secondary education if the government does follow through on its commitment to implement Rozanski.

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Ticking off through the major stresses on the expenditure side, there are basically no voices out there disagreeing with the notion that we have a significant problem in the funding of physical infrastructure in this province. I'm part of a working group associated with the Toronto City Summit Alliance, which is that coalition of businesses and community leaders in Toronto that are looking at prescriptions for the greater Toronto area's economic future. The numbers that are coming out of that exercise for the GTA alone are kind of mind-boggling. For example, in transportation they're estimating that the difference between what's currently going into infrastructure funding and what's needed in infrastructure funding in the GTA alone is about $800 million a year. Another estimate looking at sewer and water says that for the GTA alone we're looking at $120 per capita per year for the next several decades to repair and then maintain the sewer and water infrastructure. We're looking at another number in the neighbourhood of $600 million a year to deal with that stress.

We see every day the evidence of the inadequacy of the response to the issue of affordable housing and homelessness. It's sad to say, but it just seems like every week we get another story that highlights the extremely difficult situation that Ontario's failure to deliver affordable housing has exacerbated. Again, ticking off the list, it's hard to know when the string runs out, but we're now into our eighth year after a 22% cut in social assistance payments in which there has been no increase. At some point you have to think that the fallout from things like the Kimberly Rogers inquest will eventually generate some pressure from the government to move in that area, although there's certainly not any indication of it so far.

Again, on the expenditure side, the government has been quite sanguine about the implications for the provincial budget of the hydro rate freeze. Given the way the auditor has looked at the government's handling of the relationship between the province's finances and Ontario Hydro's finances over the past two or three auditor's reports—I can't predict what the auditor's going to say, but I would think the auditor might have something to say about that particular approach to financing what is clearly a political decision of the government, and might have a view about whose budget that ought to end up in. I don't think it's the least bit far-fetched to suggest that there might be something unhappy for the government coming out of the way the auditor looks at that. Over the past two or three years there have been several multi-hundred-million-dollar items that have been in effect rewritten by the auditor because he didn't like the way things were being accounted for.

Walkerton: I don't think I need to say anything else. There is a significant financial implication of that. While the official position is that municipalities are not responsible for sewer and water services, many of the smaller municipalities in the province just do not have the capacity to finance the infrastructure improvements that are going to be required.

Transit funding is another big issue.

I raise maybe an arcane topic but it's something that, as a resident of the city of Toronto, concerns me. As I think members of the committee know, at the same time as the province brought in current value assessment in Ontario, it also brought in a requirement that commercial and industrial tax rates fall within a certain band and prohibited municipalities from increasing their commercial and industrial tax rates if the ratio of their commercial and industrial tax rates to the residential tax rates was outside that band. The effect of that is that the city of Toronto basically has to finance 100% of the cost pressures for its public services on one third of its tax base, because the other two thirds are effectively covered by the freeze.

The point I'm making here isn't that that was a good idea or a bad idea; it's simply to say that the decision to push commercial and industrial tax rates toward residential tax rates across the province was a provincial tax policy decision but they didn't fund it. That tax policy change was not funded. The cost implications of that change were effectively imposed on municipalities. Toronto is the one that everybody knows about, but other municipalities have been put in the same position. At a time when there is a significant squeeze on all parts of local government budgets, this is a serious problem.

This year I'm spending a lot of time stressing the expenditure-side pressures, for one simple reason. If you look at what has been happening in the area of public services in the province over the last four or five years in particular, what we've seen is that in area after area of public services, when public attention gets focused on it, we discover the negative side, the downside of the cuts that were imposed in the mid- to late 1990s.

The first up to bat, I think it's fair to say, was the health system, where we had the spectre of the government providing subsidies for downsizing of nursing staffs in the two or three years after mid-decade and then providing subsidies to try to attract nurses back into the profession in the last three years.

I would put the education funding system and the implications of the Rozanski report on that in the same category. We had three or four years of quite dramatic cuts in the resources that were available—actually, more like five years of significant cuts in the resources available for elementary and secondary education. If we shed light on it, we discover that there's a huge gap that needs to be filled if we're to fulfill the promise that elementary and secondary education might provide.

The image I have for public service issues in the province, and the reason why I'm placing the emphasis on the expenditure side, is that the image is like walking into a dark room that hasn't really had any light on it for quite a while, and we're walking around the room with a flashlight. No matter where we look in the room, we find an incredible mess that has emerged over the previous few years. What we're finding is that in almost every area of important public services, when the light is shone on it, there are significant issues that need to be dealt with. I think that this government and the next government, whatever political stripe it is, face enormous pressures resulting from the cuts that have taken place in public services in the last part of the decade of the 1990s. With that, thank you.

1530

The Vice-Chair (Mr Ted Arnott): Thank you very much, Mr Mackenzie, for your presentation. We have some time for questions and I'll turn first to the New Democrats.

Mr Christopherson: Thank you, Hugh, for your presentation—always enlightening. It's something you didn't talk about, but I want to take advantage of you being with the Steelworkers and representing Steeltown to ask you what you see, over the short term at least, in terms of steel as an industry, as an important part of the economy. We've talked a lot about auto; we haven't talked specifically about steel. I'd like to hear what you have to say about that.

Mr Mackenzie: Let me try and divide this into three areas. One is the strength of the economy and the relative strength of the Canadian and American economies; the second is the state of trade issues between Canada and the United States; and then looking specifically at the Canadian industry.

The health of the auto sector is of particular importance to the Canadian steel industry, not only because the auto industry is a significant direct customer of the Canadian steel industry but also because quite a lot of the sales of the Canadian steel industry to steel service centres in fact find their way into the auto sector. Direct sales account for between 25% and 30% of all the steel made in Canada. Directly and indirectly, I suspect it's probably well over a third of the steel that's produced in Canada. That's a significantly greater dependence on the auto sector than the steel industry in the United States has, interestingly enough. The state of the auto industry generally is of significant importance to the steel industry in Canada.

One of the offsetting factors in that general state-of-the-auto-industry question is that the transplant plants—the Toyotas and the Hondas—are beginning to source more parts here the longer they are here. I think Stelco supplies exterior body panels to Honda now, and Dofasco supplies exterior body panel steel to Toyota in Cambridge, whereas 10 years ago, structural changes that benefited the transplants at the expense of the domestic industry would have had a much more negative effect on the steel industry in general and the Canadian industry in particular than is the case now. But it's clearly an issue that's of concern, because all that metal running around in those cars, among other things, helps keep Canadian steelworkers working.

The second issue I wanted to touch on was steel trade issues. Frankly, we have been very fortunate in the Canadian steel industry that the United States took effective and decisive action to deal with its steel trade problem. The reason I say that is because steel as a commodity in North America is largely priced in US dollars. The most important factor influencing the price of steel in Canada, and therefore the returns that steel companies make, is the price in the United States. The United States took action pretty aggressively and, I think as important as the aggressiveness of the action, gave a real signal to importers of steel into the United States that they weren't going to let the industry go completely down the drain. It's had a significant positive effect on prices for steel in the United States and in Canada. You can see the impact in the bottom lines of all of the Canadian steel companies.

I stress the United States both because it's the most important driver of price but also because Canada's response has been pathetic. This is, I guess, both my personal view and the view of the union, so I won't qualify it. It has been pathetic largely because Canada's trade administration system is not well designed to take into account the extent of the integration between Canada and the United States that has taken place since the Canada-US free trade agreement came into effect in 1989. What I mean by that is that we have a very conventional kind of approach to trade administration. It's based largely on looking at volumes of product that come into the country and looking at fluctuations in volumes of product. It tends not to worry a lot about the underlying pricing structure of the product that comes in and therefore is not able to make a lot of distinction between commodity imports from third countries and regular industrial relationships that exist across the border with the United States.

The result is that when Canadian trade bodies look at steel trade, they look at the huge volumes that come in from the United States, because a huge proportion of our imports of steel come from the United States, and they say either, "There can't be any injury here because most of the steel is coming from the United States and it's fairly traded," or they say, "We're going to impose a penalty, but we'll have to impose a penalty on the United States as well because the United States is such a huge proportion of our trade in steel." Until we're able to reconfigure our trade laws so that we're able to make a distinction between the kind of trading relationship that exists with another economy that is integrated with ours, like the American economy, and trade with third countries, we're going to find ourselves in a position where our trade laws are essentially unenforceable.

So that's a risk, and it's a double-edged risk. On one hand, we're not doing a very good job of defending our own market against unfairly traded steel. To the extent that we're not able to do that, we're flirting with disaster with the Americans, because the Americans are looking at us and they're saying, "We took these actions to defend our market against unfairly traded steel. You got a significant benefit out of that. What are you doing to protect your market from the same pressures from offshore that we took action to deal with?" They have an argument about redirection of imported steel, which I'm not terribly excited about. It's more of a political thing, where the Americans are saying, "We did this. We got everybody mad at us. We've taken these actions that have gotten France and Germany and the EU and Japan all going to the WTO to complain because they don't like what we did, and you guys are just sitting back there getting all the benefit and not doing anything." So they're not terribly happy. That's a risk, because if the Americans get unhappy with us, they'll just say, "Why should we exempt you guys?" and then we're in big trouble, because 30% of our product goes to the United States.

Mr Christopherson: I'll ask another question. I haven't raised this yet and nobody else has, but I think it's significant. Minister Runciman acknowledged the other day after meetings—I think he was in Washington—that he was told directly by US officials that if there's war, the one thing we can expect is that the border is going to shut down or, at the very least, be restricted in terms of its flow. Things will slow right down based on the national security issues that the US will then perceive to exist. What are your thoughts on that, how long can that hold and what are the sorts of things that could happen if that does indeed transpire?

The Chair: I would ask if you'd make that answer brief, sir. We're running out of time.

Mr Mackenzie: Sure. There are two questions there. One is how long I think it will last. I don't think it's sustainable for a great length of time, because to the extent that they do slow down traffic across the border, there are significant players in the American economy that depend on the flow of goods, including people in the defence industry in the United States who depend on shipment of products under the defence production sharing agreement into the United States to supply the US defence industry. But in particular the auto industry is so heavily integrated now that we see it every time there's a labour dispute in the auto sector. No matter where the dispute takes place, it has ripple effects through the whole industry with that company. So I think there will be enormous pressure.

1540

Having said that, if there is a significant slowdown in transborder activity, it will have a very quick negative effect on the Canadian economy in general and the Ontario economy in particular. Some 80% of our trade is with the United States; 80% of our trade crosses that border. A substantial proportion of that amount crosses the border in trucks at Ontario border points, largely Sarnia-Port Huron, Windsor-Detroit and Buffalo. So it would have a significant negative effect, although I don't think it would be very long-lasting.

The Chair: We now move to the government side: Mr Beaubien and then Mr O'Toole.

Mr Beaubien: Thank you very much for your presentation. A couple of comments. I would have to agree—

Mr Mackenzie: I'd be very disappointed if you didn't have some.

Mr Beaubien: I think the fundamentals are good, as the previous presenter pointed out. You mentioned the $700 million in interest that we have to carry because of the debt that was added. If I recall, in 1995 one group said, "We'll get rid of the debt in five years," another one said four years, and the other one said three years. So I'm sure there would have been some debt load carried over by any of those particular groups at that particular point in time. I don't think it takes a space scientist to realize that if you're facing $11.3 billion and you're going to phase that over a period of years, whether it's three, four or five years, you have to add it somewhere else. So consequently I think any ordinary person would agree that it would add some additional debt to—

Mr Mackenzie: If I can—

Mr Beaubien: I didn't interfere with you when you spoke, so let me finish my statement, please.

Mr Mackenzie: Sure.

Mr Beaubien: I think any reasonable person would agree that it would add debt to the provincial debt.

The second point I want to make is that on page 7 you mention the exposure of local budgets to cyclical fluctuations and economic activity. I agree there's an awful lot of infrastructure deficit in the province of Ontario. But having had the pleasure and the honour to be involved in 15 municipal budgets—15 of them—we have a municipality where water mains don't break all the time, the sewers are working, the water is being pumped from Lake Huron very well, and we deal with our waste problems. Over the years, yes, there are some economic fluctuations, so you have to put a little bit away on a good day so that when it's rainy you have a little bit of money.

We have some municipalities, and you're quite right, that have a tremendous amount of problems with their infrastructure. We have the largest municipality in Canada that can't deal with its waste diversion. I have small municipalities in my own riding that deal with 80% of their waste stream. They do it, yet we operate under the same funding, the same Municipal Act. So my comment is, why is it that some municipalities can do it and others can't?

Mr Mackenzie: Let me just respond to both of those points.

First, on the debt, I was actually uncharacteristically conservative when I put that number together, because the $700 million is in fact a measure of the interest on the value of the tax cuts that were implemented during the period of time when the budget was in deficit. So it's not looking at the interest on the total debt that might be attributed to the tax cut; it's simply looking at, in a given year, the tax cuts were worth X number of dollars and the budget was in deficit. Therefore, to the extent that the deficit in that year exceeded the value of the tax cut in that year, that amount of money is attributable to that tax cut. It's just very simple arithmetic, but I think it's pretty conservative.

With respect to the municipal budgets, it's very hard to make these kinds of comparisons because there are a million and one issues that lie behind these things. The fact is that the largest municipality in the province was dealing with the implications of amalgamation. As I pointed out, probably the most significant stress on the budget in Toronto right now is that in order for the municipality to increase its revenue from taxation by 2%, say, to match the rate of inflation, it has to increase residential property tax rates by three times that percentage. Thanks to the provincial policy of freezing commercial and industrial tax rates, the municipality basically has to increase its taxes by triple the percentage that its costs are going up in order to make the budget balance.

As I said, there are lots of reasons why these things happen but I think the bottom line is that there is a significant infrastructure funding problem. It is not limited to Canada's largest municipality by any means. It's a very serious issue. When you drill down below the surface, what you discover is that Ontario is probably the only jurisdiction on the planet in which there is no senior level funding for transit. Canada is one of the few jurisdictions in the world in which there is no federal government funding for affordable housing. That's being partially rectified in the most recent federal initiative but it's still pathetically inadequate compared with what's needed. Ontario effectively has no affordable housing program. Those pressures all come home to roost.

I think one of the things people haven't paid adequate attention to, and in particular this government hasn't paid adequate attention to, is the extent to which these problems are interrelated with each other. You cut social assistance by 20% and you find the number of children who are given up into care goes up dramatically. Now we've got the report in the paper today that children's aid societies are significantly in deficit. These things are connected to each other and I think it just underlines the risk associated with fairly simplistic approaches to public policy having perhaps unintended side effects.

Mr O'Toole: I have a couple of comments. I always appreciate your input at these meetings because, as you say, it's the policy alternative group.

I think if I was to characterize what we try to do versus what you think should be done, it's which came first, the economy or the quality of life? I think you have to look to the Third World to find the answer. Without the economy, you don't have the other.

Trying to use the metaphor you used, using a flashlight to look at a room that's in darkness and that things are, as you described, an incredible mess, in fact, I would put it to you, without being trite and/or accusational, that in what we call the dark decade they must have been blindfolded, because 20% of all their spending was debt. In fact, if you extrapolate your $700-million equation, it's clear if you look at all of the costs and the cost of borrowing money going forward, it wasn't sustainable, and I think the people of Ontario recognize that.

Even to address some of the issues in the brief time you've allowed, the current value assessment thing has been talked about for 15 years. Both the Liberals and the NDP talked about it and then backed away because it was too difficult to do. Even to the extent of reports, which I'm sure you may have had a role in—the Fair Tax Commission and the disentanglement report—both talked about the same issue of who pays for what. So to say that we recklessly went at restructuring would be absolutely being blindfolded yourself as an economist; I'd be surprised. Even the extent of your comment on the steel industry and your failure to support the free trade or NAFTA agreements is a contradiction. If you look at it even in light of Kyoto—I asked that question of many of the people—

The Chair: Quickly, please.

Mr O'Toole: I have no question, actually.

The Chair: Then you'll have 15 seconds to wrap up, sir.

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Mr O'Toole: The point is that with NAFTA, for instance, your industry and the auto industry have been pleading to be exempted from it, as has the cement industry. Now that steel you talked about will be coming from a Third World country.

I'm also interested in your view of the freeze on hydro rates. We've been subsidizing them for 20 years. I was on a program recently with Mr Phillips and Mr Prue from the NDP, and they said they'd like to see—

The Chair: Your time is up.

Mr O'Toole: —rates go with the market, as well as water. How do you see those—

The Chair: Your time is up, sir, and unfortunately, Mr Mackenzie, you'll have to answer that question in another manner. We go to the official opposition.

Mr Phillips: I appreciate Mr Mackenzie being here, and I do have some questions because I think that's why you're here. In the budget, the government decided they would abandon the Taxpayer Protection Act and they delayed the four major tax cuts for a year, from January 1, 2003, to January 1, 2004. In my opinion, that was to get through the election, because they did not want to forgo that revenue. As a matter of fact, they put out a document with Mr Eves's picture on it—this was their own document—and it said, "How can the government justify breaking the Taxpayer Protection Act by delaying tax cuts?" and then they quote Moody's, which said, "To meet the target of a fourth balanced budget, the government delayed, for one year, scheduled reductions in a number of tax rates." So there's no question in my mind why they did that and why they had to do it, and I applaud them for doing it.

I appreciate your numbers, because you do a lot of analysis. You haven't done, though, the 2004-05 numbers, and that is where the major tax cuts come back into play. You mentioned in your remarks here the corporate tax, but the bigger one is actually the cut in personal income tax, which the government says is about a $600-million number. Others believe it may be somewhat higher than that. I think $300 million is the elimination of a big part of what's called the fair-share health levy, which the government put in in 1996 and is planning to eliminate starting January 1, 2004—eliminate for a portion.

So there is a $600-million personal income tax cut scheduled for January 1, 2004, a $250-million cut in education property tax and the continuation of, we think, a $500-million tax cut to fund private schools—the government says $300 million. You do not mention those in your remarks here. Have you done any calculation on the impact those other three tax cuts would have in 2003-04 and have you done any projections for 2004-05?

Mr Mackenzie: The 2003-04 analysis takes into account roughly $400 million. I think I take into account everything except the private school thing, because I just can't get a handle on it. Keep in mind that that's only one fiscal quarter.

Mr Phillips: Three months, yes.

Mr Mackenzie: I'm working from memory here, but the full-year number of the stuff that would take effect pretty much immediately is about $1.8 billion, I think, and then by mid-decade, the cumulative effect of all these things is about $2.9 billion, in current dollars. So you're right. Just beyond the horizon, there's significant reduction in fiscal capacity on our way. I've done the 2003-04-05 numbers. It just wasn't relevant to what I was doing today. I'd be happy to share them with you.

Mr Phillips: That would be helpful to me. I don't know whether the rest of the committee might find it useful, but I would find that helpful as well if you could forward it. All this has to go through the committee.

The Chair: Just forward it to the clerk. We'll get it through the research people.

Mr Phillips: You indicate that revenues would grow this upcoming fiscal year by roughly $3 billion, which is slightly higher than the kind of formula one uses: per GDP, real growth is $590 million. Is that because of your estimate of the mix of the numbers?

Mr Mackenzie: Yes. The rule of thumb that everything is going to grow at the same rate works generally. There are a couple of areas where it understates a bit. Even with indexing of income tax brackets, we do still have bracket creep. The brackets don't creep because of nominal growth, but they do still creep because of real growth. Income taxes as a share of a given amount of money are going to go up as the economy grows. That's one bit of acceleration that you get.

The other thing is that coming out of a low point in corporate taxes, corporate taxes tend to grow much more rapidly than the economy on the way up. There's a delayed effect; there's an echo effect from a downturn because of the carry-forward of losses in the corporate income tax system. But once those losses are worked out of the system, it tends to jump back to a higher level much more quickly and that will form part of that as well.

Mr Phillips: You show public debt interest dropping a little more quickly than the government. You've done some calculations on this?

Mr Mackenzie: Yes. This is almost in the nature of a confession. I'm sufficiently anally retentive about this that I actually have gone through the schedule of debt of the province. What we're seeing now is that 10-year bonds that were floated in the early 1990s at fairly high interest rates are being replaced by bonds that pay a much lower interest rate. So in effect, even with a fixed amount of debt, simply the refinancing activities are producing a lower interest burden.

I haven't actually done this in detail, but I think you'll find that when you look back at the ministry's forecasts of debt service costs, there has been a pattern of slight overstatement of interest costs repeatedly over the last few years. I think that's because it's one of the areas of prudence that they give themselves. I think they implicitly assume that debt is going to be refinanced at its current cost of borrowing, and then, when they're able to place the debt at a lower interest rate, they get some advantage out of that.

Mr Phillips: You've touched on it here, the hydro rebate plan, which I asked staff about this morning. I think Ontario Power Generation and Hydro One have closed their books on their fiscal year and must have provided some estimate of how much money OPG has in what's called its mitigation fund to fund the rebates. Have you—

Mr Mackenzie: I haven't looked at it in any detail.

Mr Phillips: You've not had a chance to take a look at it.

Mr Mackenzie: The only point I would make—I'll just reiterate what I said earlier: the government has indicated with some self-assurance that a policy of financing the rebate through increased debt of Ontario Hydro will pass muster with the auditor. I ain't so sure. As the auditor has pointed out on a number of occasions, the complexities of the restructuring of Hydro and its implications for the provincial budget have drawn the auditor's attention on a number of occasions in the past three or four years. I'm not sure I'd be as confident as the government is that the auditor is going to let them handle it that way.

The Chair: With that, Mr Mackenzie, thank you for joining us today and offering us your perspective.

This meeting will adjourn until 9 am tomorrow morning, at which time we will resume for day two.

The committee adjourned at 1600.

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