Annual Financial Report

of the Government of Canada

Fiscal year 1995-96

Canada

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This, the third edition of the *Annual Financial Report* of the Government of Canada, covers the government's spending and revenue performance for the past fiscal year (April 1, 1995 – March 31, 1996), and discusses the factors affecting these results. Historical data, which in previous years were included in the *Annual Financial Report*, are now presented in a separate document entitled *Fiscal Reference Tables.*

This report responds to recommendations by the Auditor General and the House of Commons Public Accounts Committee. They felt – and the government agreed – that Canadians need more timely access to understandable, relevant information on the government's financial activity. Only with such information can Canada's citizens play an active and effective role in guiding government decision-making.

The financial data in this report are based on the audited results which will appear in the *Public Accounts of Canada*, scheduled for tabling in the House of Commons this fall.

The Honourable Paul Martin, P.C., M.P.
Minister of Finance

Department of Finance Canada | Ministère des Finances Canada

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REPORT HIGHLIGHTS

The federal deficit for 1995-96 was $28.6 billion. This is the shortfall between government budgetary spending of $158.9 billion and budgetary revenues of $130.3 billion. The deficit of $28.6 billion was:

- $8.9 billion lower than the 1994-95 deficit of $37.5 billion;
- $13.4 billion lower than the 1993-94 deficit of $42.0 billion; and
- $4.1 billion lower than the deficit target of $32.7 billion for 1995-96.

For the second consecutive year, budgetary revenues exceeded program spending – total spending less interest charges. This “operating” surplus in 1995-96 was $18.3 billion, up from the $4.6 billion recorded in 1994-95.

Developments in financial requirements, excluding foreign exchange transactions, largely mirrored the decline in the deficit, as the net source of funds from non-budgetary transactions remain virtually unchanged from 1994-95. Financial requirements amounted to $17.2 billion in 1995-96, down $8.7 billion from 1994-95.

The government’s fiscal strategy is to set two-year rolling deficit targets, base these targets on prudent economic planning assumptions, and to back these assumptions up with sizeable Contingency Reserves. As in 1994-95, the Contingency Reserve included in the 1995-96 deficit target was not required. This accounted for $2.5 billion of the $4.1 billion improvement in the 1995-96 deficit outcome compared to the target of $32.7 billion, as set out in the February 1995 budget. The remaining difference reflected lower-than-expected public debt charges and program spending, which more than offset lower budgetary revenues.

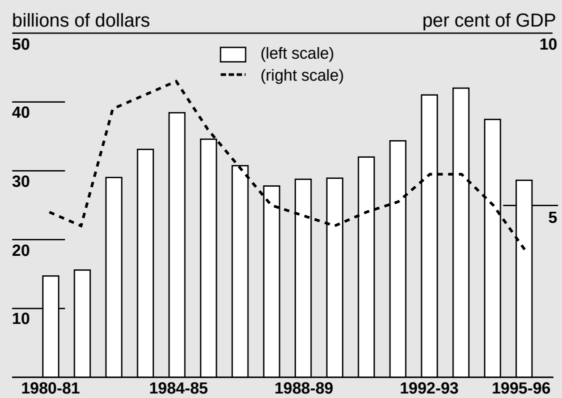
The decline in the deficit from $37.5 billion in 1994-95 to $28.6 billion in 1995-96, in combination with modest economic growth in 1995, resulted in a sharp drop in the deficit to economic output (GDP) ratio, from 5.0 per cent in 1994-95 to 3.7 per cent in 1995-96. The ratio in 1995-96 is the lowest since 1976-77.

Table 1

Financial highlights

	1995-96	1994-95	1993-94
	(billions of dollars)		
Operating results			
Revenues	130.3	123.3	116.0
Program spending	-112.0	-118.7	-120.0
Operating balance	18.3	4.6	-4.0
Debt charges	-46.9	-42.0	-38.0
Deficit	-28.6	-37.5	-42.0
Non-budgetary transactions	11.4	11.6	12.2
Financial requirements (excl. foreign exchange transactions)	-17.2	-25.8	-29.9
Financial position			
Total liabilities	622.8	582.9	544.1
Financial assets	48.5	37.2	35.9
Accumulated deficit (Net public debt)	574.3	545.7	508.2
Financial results as % of GDP			
Deficit	3.7	5.0	5.9
Accumulated deficit	74.0	73.0	71.3

The deficit and the economy



Source: *Public Accounts of Canada* and Statistics Canada.

Each Canadian's share of the deficit – adults and children – was $958 – down from $1,268 in 1994-95. This reflected government spending equal to $5,323 per person and government revenues equal to $4,364 from each individual.

The net public debt

The 1995-96 deficit brought the federal government's net public debt – the accumulation of annual deficits and surpluses – to $574.3 billion.

- This was an increase of 5.2 per cent from 1994-95 – the smallest annual change since 1970-71.
- As a share of Canada's economy, the accumulated deficit reached 74.0 per cent, up from 73.0 per cent in 1994-95. Ten years ago, the debt-to-GDP ratio was 50.8 per cent.

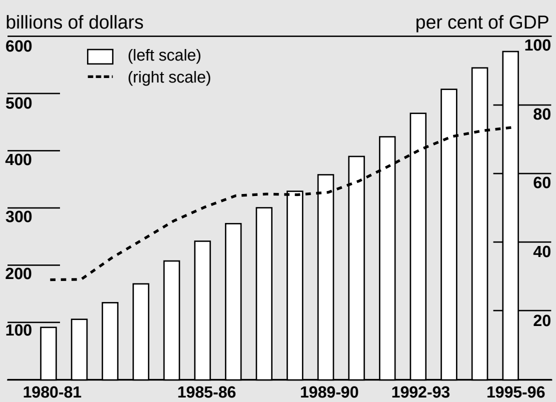
The net public debt at the end of 1995-96 reached $19,235 for each Canadian – up from $18,477 a year earlier.

Deficit down from 1994-95

The deficit declined by $8.9 billion between 1994-95 and 1995-96.

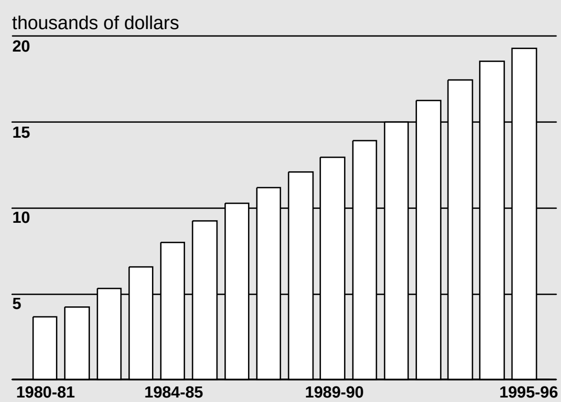
- Revenues increased by $7.0 billion or 5.7 per cent. About $4.2 billion of this increase was attributable to higher levels of economic activity, $1.6 billion was due to measures introduced in the 1994 and 1995 budgets (primarily due to the increases in corporate income tax rates, the increase in the gasoline excise tax, and the elimination of the $100,000 lifetime capital gains exemption), with the remainder attributable to special one-time factors, such as taxes paid on filings relating to the previous taxation year and recoveries from the Canada Pension Plan Account, due to overpayments made in previous years.
- Program spending declined by $6.7 billion or 5.7 per cent. All of this decline was attributable to the restraint measures introduced in the 1994 and 1995 budgets.
- In contrast, public debt charges rose by $4.9 billion (11.6 per cent), reflecting both the increase in the stock of debt and the lagged impact of higher interest rates over the March 1994 to April 1995 period. The average effective interest rate on the interest-bearing debt rose from 7.7 per cent in 1994-95 to 8.1 per cent in 1995-96.

Net federal debt and the economy



Source: *Public Accounts of Canada* and Statistics Canada.

Net debt per capita



Source: *Public Accounts of Canada* and *Statistics Canada.*

ECONOMIC DEVELOPMENTS IN 1995

The main factors affecting the financial results are:

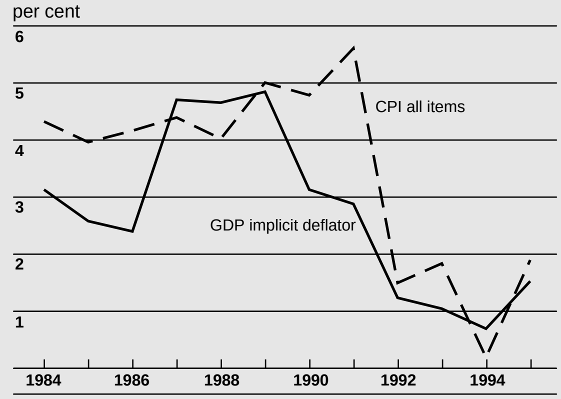
- variations in economic conditions;
- the interaction of the tax system with economic developments; and
- the impact of budget actions.

This section briefly looks at economic developments in 1995.

Economic growth slowed in 1995. Real GDP – which excludes the effect of inflation – grew 2.3 per cent, down from a strong 4.1 per cent pace in 1994. Growth slowed for two main reasons. First, the slowdown in the U.S. economy over the first half of 1995 dampened Canadian exports. Second, Canadian short-term interest rates followed U.S. rates up in late 1994 and early 1995, and the rise in interest rates restrained domestic spending.

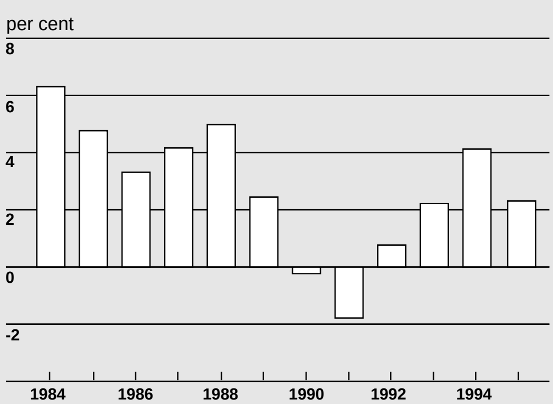
Inflation pressures in 1995 remained weak, keeping inflation well within the Bank of Canada's target range of 1 to 3 per cent. The consumer price index (CPI) inflation rate rose to 2.1 per cent in 1995 up from 0.2 per cent in 1994. However, the CPI inflation rate in 1994 was depressed by the reduction in tobacco taxes implemented in February 1994. Excluding this tax effect, CPI inflation in 1994 was 1.5 per cent, quite close to the inflation rate in 1995. The CPI inflation rate rose early in 1995, largely due to a rise in world commodity prices and the lagged effects of the earlier exchange rate depreciation on consumer prices, but fell back by the end of the year.

Prices and costs



Source: Statistics Canada.

Real GDP growth



Source: Statistics Canada.

Table 2

Key economic indicators

	1995	1994
	(year-to-year per cent change unless otherwise indicated)	
Real GDP	2.3	4.1
Inflation		
CPI	2.1	0.2
GDP implicit price deflator	1.5	0.7
Nominal GDP	3.9	4.8
Personal income	3.3	1.9
Labour income	3.2	2.7
Corporate profits	13.1	34.4
Personal expenditure on goods and services	3.0	3.6
Employment	1.6	2.1
Interest rates		
3-month Treasury bill rate (%)	7.0	5.4
10-year government benchmark rate (%)	8.2	8.4

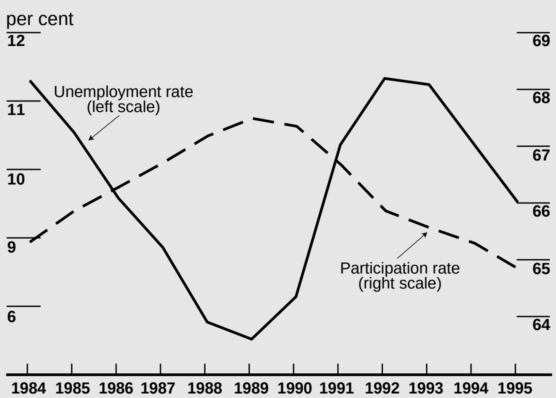
The GDP deflator, the broadest measure of Canadian prices, increased 1.5 per cent in 1995 after rising 0.7 per cent the previous year.

The key economic variables affecting the federal government's financial results are personal income, the unemployment rate, corporate profits, consumer demand and interest rates.

Personal income, the tax base for personal income tax collections, advanced by 3.3 per cent in 1995, up significantly from the 1.9 per cent growth experienced in 1994. About 60 per cent of the increase in personal income came from higher labour income. Labour income increased by 3.2 per cent in 1995, up from 2.7 per cent in 1994. Employment and wage gains contributed roughly equally to labour income growth in 1995. Employment was up 1.6 per cent in 1995, somewhat slower than the 2.1 per cent growth recorded in 1994. However, labour income per employee rose 1.5 per cent in 1995, compared to only 0.6 per cent growth in 1994.

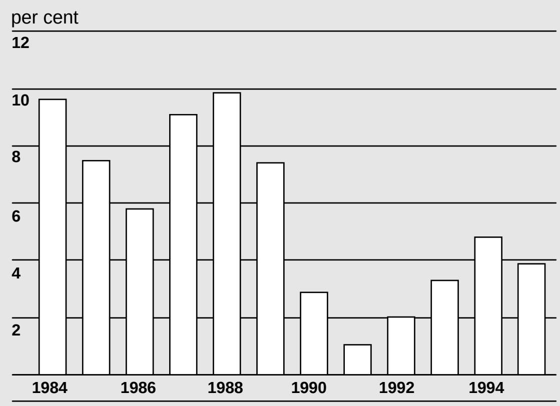
About one-third of the gain in personal income came from interest and other investment income. Personal interest and investment income rose 9.6 per cent in 1995, up from 1.0 per cent the previous year. As well, unincorporated business income grew 1.6 per cent in 1995, down from 2.3 per cent in 1994.

Unemployment and participation rates



Source: Statistics Canada.

Nominal GDP growth



Source: Statistics Canada.

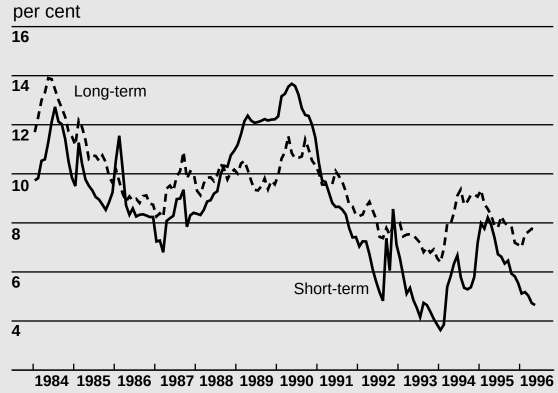
The unemployment rate fell in 1995, as employment growth outstripped labour force growth. The unemployment rate averaged 9.5 per cent in 1995, down from 10.4 per cent in 1994. Labour force growth slowed in 1995, reflecting the continued decline in the labour force participation rate.

Corporate profits increased 13.1 per cent in 1995, after increasing 34.4 per cent in 1994. The continued profit growth reflected excellent cost control, increased productivity, higher export prices and a slight depreciation in the Canadian dollar (which raised prices set in world markets when expressed in Canadian dollars). Profit's share of GDP rose to 8.2 per cent in 1995, well above its trough of 4.9 per cent at the end of 1991, but still below its long-run average from 1961 to 1994 of 10.0 per cent.

The value of personal spending on goods and services, a proxy for the applicable tax base for the Goods and Service Tax and other indirect taxes, advanced by 3.0 per cent in 1995, down slightly from the 3.6 per cent increase recorded in 1994. Growth in spending on durable and semi-durable goods slowed in 1995, while remaining largely unchanged on services and increasing on non-durables.

Short-term interest rates increased to an average of 7.0 per cent in 1995 from 5.4 per cent in 1994, partly in response to higher U.S. rates. Short-term interest rates peaked at 8.3 per cent in March 1995 but finished the year at 5.5 per cent. The 10-year government benchmark rate, which fell about 2 percentage points over the course of 1995, averaged 8.2 per cent in 1995 compared to 8.4 per cent in 1994. The Canadian dollar averaged 72.85 U.S. cents during 1995, slightly below the average value of 73.21 recorded in 1994. However, the exchange rate rose during 1995; it stood at 73.3 U.S. cents at the end of 1995, up about 2 U.S. cents from its value at the end of 1994.

Interest rates



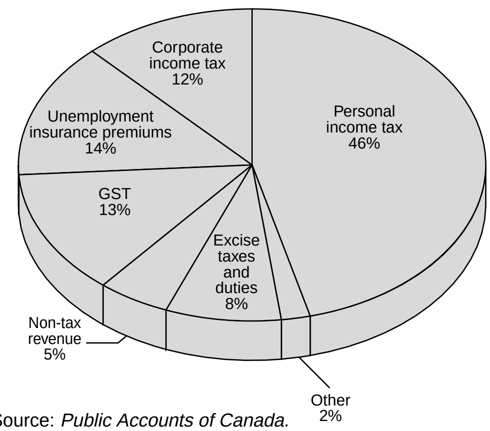
Source: Statistics Canada.

BUDGETARY REVENUES

Table 3 shows budgetary revenues on both a budget or “net” basis as well as on a “gross” basis. The results on a gross basis are often more reflective of the underlying economic developments, whereas the net figures reflect the way in which the figures are presented to Parliament. The difference primarily relates to two factors:

- certain expenditures determined through the income tax system, such as the Child Tax Benefit (which is netted from personal income tax collections) and the low-income GST Credit (which is netted from GST collections); and
- certain revenues that are credited back to departments for specific services, such as the Air Transportation Tax (which is netted from air navigation expenditures).

Net revenue for 1995-96



Source: *Public Accounts of Canada.*

Budgetary revenues, on a gross basis, amounted to $142.5 billion in 1995-96, an increase of $7.4 billion, or 5.5 per cent, from the level reported in 1994-95. The strength in revenues in 1995-96 primarily reflects the improvement in economic activity.

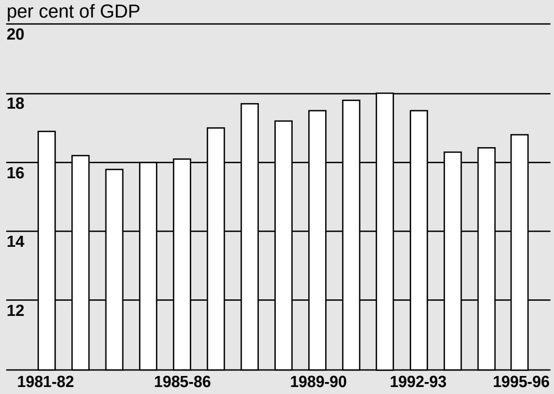
On a net basis, budgetary revenues amounted to $130.3 billion, an increase of $7.0 billion, or 5.7 per cent from the 1994-95 level. The somewhat stronger growth in net collections, compared to gross collections, was attributable to a decline in tax expenditures in 1995-96 from the level reported in 1994-95.

Table 3

Budgetary revenues

	1995-96		1994-95	
	Gross	Net	Gross	Net
	(millions of dollars)			
Income tax collections				
Personal income tax	65,195	60,167	61,676	56,329
Corporate income tax	15,955	15,955	11,604	11,604
Other	2,105	2,105	1,769	1,769
Total income tax	*83,255*	*78,227*	*75,049*	*69,702*
Unemployment insurance premiums	18,510	18,510	18,928	18,928
Excise taxes and duties				
Goods and Services Tax	19,174	16,375	19,602	16,786
Customs import duties	2,969	2,969	3,575	3,575
Energy/other	7,943	7,260	7,317	6,728
Total excise	*30,086*	*26,604*	*30,494*	*27,089*
Total tax revenue	131,851	123,341	124,471	115,719
Non-tax revenue	10,659	6,960	10,608	7,604
Total revenues	*142,510*	*130,301*	*135,079*	*123,323*

The tax bite



Source: Department of Finance.

As a percentage of GDP, net revenue, or the "tax bite" at 16.8 per cent, was up slightly from the 16.5 per cent recorded in 1994-95. Most of this increase was attributable to the strong growth in corporate income tax collections.

The major components of budgetary revenues are:

- personal income tax collections;
- corporate income tax collections;
- other income tax collections, primarily consisting of non-resident taxes;
- unemployment insurance premiums;
- Goods and Services Tax;
- sales and excise taxes and duties, which include customs import duties, excise taxes on motive fuels, and excise taxes and duties, primarily on tobacco and tobacco products; and
- non-tax revenues, which include return on investments and other non-tax revenues.

Personal income tax collections, on a net basis, were up $3.8 billion, or 6.8 per cent from 1994-95. The higher collections in 1995-96 primarily reflected the improvement in economic activity. Personal income tax collections in 1995-96 were also positively affected by higher taxes paid on filing related to the 1994 taxation year and recoveries from the Canada Pension Plan Account for overpayments in previous fiscal years.

Corporate income tax collections were up $4.4 billion, or 37.5 per cent, rising above their pre-1990-1991 recession peak. Most of the increase in 1995-96 was attributable to higher corporate profits. Increases in the large corporations tax and corporate surtax, announced in the February 1995 budget, and the recording of certain tax liabilities in 1994-95 resulting from court decisions, also impacted on the overall year-over-year change.

Unemployment insurance premiums declined $0.4 billion, primarily due to lower premium rates which were reduced in both 1995 and 1996 from their previous year's levels.

Total excise taxes and duties declined $0.5 billion or 1.8 per cent from year earlier collections.

- Goods and Services Tax (GST) collections were down $0.4 billion or 2.4 per cent on a year-over-year basis. The decline in net GST collections was largely attributable to timing factors. Total GST received, prior to the payment of refunds, rebates, and the quarterly low-income credit, were up 3.6 per cent, in line with the growth in retail sales. However, refunds and rebates were up 11.0 per cent, primarily reflecting lags in the processing of refunds and rebates pertaining to 1994-95.
- Customs import duties were down 17.0 per cent, as the growth in imports in 1995 was more than offset by reductions in tariffs as specified under international agreements.
- Energy taxes rose 15.2 per cent, largely reflecting the increase in excise rates announced in the February 1995 budget.

- Other excise taxes and duties, which primarily consist of taxes and duties on tobacco and alcoholic products, were virtually unchanged from 1994-95, as the effect of increases in tax rates on tobacco producers offset declines in other components.

Non-tax revenues were $0.6 billion lower, due largely to much lower Exchange Fund Account revenues.

- The revenues of the Exchange Fund Account are comprised primarily of interest on foreign currency reserves, the valuation gain or loss stemming from exchange rate developments and net proceeds from the sale of gold. Exchange Fund revenues in 1995-96 amounted to $1.1 billion, $0.7 billion lower than recorded in 1994-95. The lower revenues were attributable to lower net proceeds from the sale of gold.

BUDGETARY EXPENDITURES

Table 4 presents budgetary expenditures on both a gross and net basis. Gross budgetary expenditures include certain expenditures that are determined through the income tax system, such as the Child Tax Benefit and Low-Income GST Credit. In addition, gross expenditures exclude certain revenues which are directly related to the services being provided, which on a net basis are credited directly to the department providing the service.

Total budgetary expenditures, on a gross basis, by the federal government amounted to $171.1 billion in 1995-96, a decline of $1.4 billion or 0.8 per cent from 1994-95. Gross program spending fell by $6.3 billion. In contrast, public debt charges increased by $4.9 billion.

Table 4
Budgetary expenditures

	1995-96		1994-95	
	Gross	Net	Gross	Net
	(millions of dollars)			
Transfer payments to persons				
Old age security benefits	20,430	21,034	20,143	20,511
Unemployment insurance benefits	13,476	13,476	14,815	14,815
Child Tax Benefit/Low-Income GST Credit	8,014	0	8,138	0
Total	*41,920*	*34,510*	*43,096*	*35,325*
Transfers payment to other levels of government				
Established Programs Financing	9,480	9,480	10,177	10,177
Fiscal arrangements	10,231	9,814	9,689	9,296
Canada Assistance Plan	7,191	7,191	7,266	7,266
Total	*26,902*	*26,485*	*27,132*	*26,739*
Other transfer payments				
Agriculture	924	924	1,355	1,355
Indian Affairs and Northern Development	3,664	3,664	3,418	3,418
Industry Canada/Regional Agencies	2,467	2,467	2,236	2,236
Human Resources Development	2,521	2,521	2,477	2,477
Foreign Affairs	2,380	2,380	2,544	2,544
Other	6,187	6,187	7,945	7,945
Total	*18,143*	*18,143*	*19,975*	*19,975*
Total transfer payments	*86,965*	*79,138*	*90,203*	*82,040*
Crown corporation expenditures				
Canada Mortgage and Housing Corporation	1,940	1,940	1,987	1,987
Canadian Broadcasting Corporation	1,619	1,170	1,500	1,093
Other	2,481	1,211	2,254	1,923
Total	*6,040*	*4,321*	*5,741*	*5,003*
Defence				
Personnel	4,225	4,225	5,192	5,192
Capital	2,529	2,529	2,535	2,535
Other operating	3,539	3,181	3,336	2,966
Total	*10,293*	*9,935*	*11,063*	*10,693*
All other departmental spending				
Personnel	12,522	12,522	13,963	13,963
Capital	1,513	1,513	1,849	1,849
Other operating	6,889	4,584	7,676	5,191
Total	*20,924*	*18,619*	*23,488*	*21,003*
Total program expenditures	*124,222*	*112,013*	*130,495*	*118,739*
Public debt charges	46,905	46,905	42,046	42,046
Total budgetary expenditures	*171,127*	*158,918*	*172,541*	*160,785*

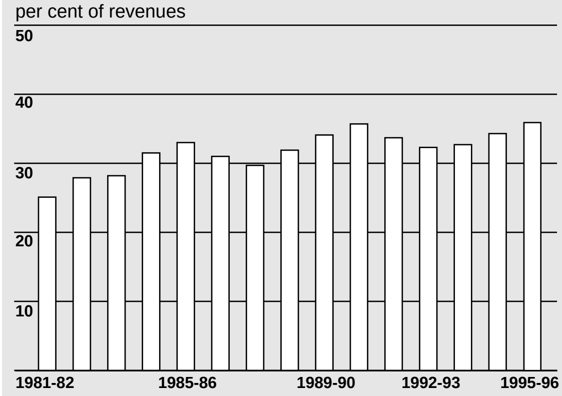
On a net basis, budgetary expenditures amounted to $158.9 billion, $1.9 billion, or 1.2 per cent, lower than in 1994-95. The smaller decline in gross expenditures was attributable to higher gross Crown corporation expenditures in 1995-96 than in 1994-95.

As a percentage of net budgetary revenues, net budgetary expenditures, or the "expenditure ratio" stood at 122.0 per cent, down from 130.4 per cent in 1994-95. This implies that an amount of net expenditures in 1995-96 equal to 22 per cent of revenues had to be financed by borrowings.

Public debt charges increased 11.6 per cent, or by $4.9 billion in 1995-96. Of this increase about $3.0 billion was due to the increase in interest-bearing debt (unmatured debt and pension liabilities), up $36.2 billion, with the remainder due to the increase in the average effective interest rate on the government's debt. The average interest rate on the interest-bearing debt in 1995-96 increased to 8.1 per cent, from 7.7 per cent in 1994-95.

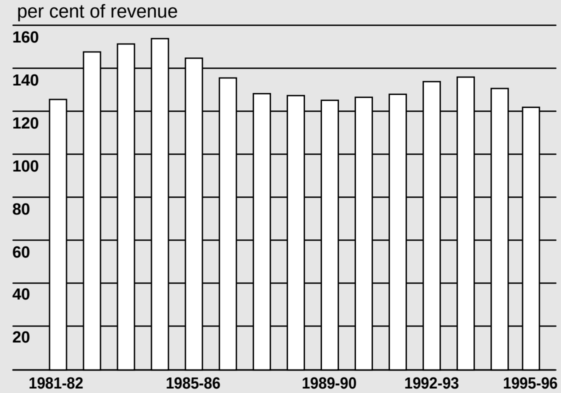
As a percentage of budgetary revenues, public debt charges rose from 34.1 per cent in 1994-95 to 36.0 per cent in 1995-96. This means that the government spent 36 cents of every revenue dollar in 1995-96 for interest on the public debt.

The interest bite



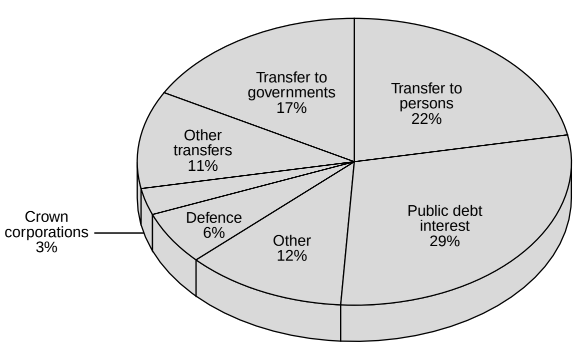
Source: Department of Finance.

The expenditure ratio



Source: Department of Finance.

Total net expenditure for 1995-96



Source: *Public Accounts of Canada.*

Net program spending – net budgetary expenditures less public debt charges – fell by $6.7 billion in 1995-96 or by 5.7 per cent. This decline was attributable to the expenditure reduction measures announced in the February 1994 and 1995 budgets. This is the third consecutive year in which program spending has declined.

As a percentage of net revenues, program spending, or the "program share" amounted to 86.0 per cent, down from 96.3 per cent in 1994-95.

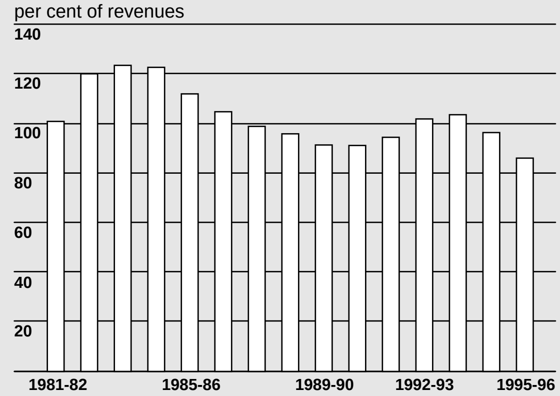
Program spending can be divided into the following components:

- transfer payments, of which the largest portion goes to persons and to other levels of government, particularly to the provinces;
- expenditures related to certain Crown corporations;
- defence; and
- operating and capital costs of government departments and agencies, excluding defence.

Net transfer payments declined by $2.9 billion or 3.5 per cent in 1995-96, reflecting:

- lower unemployment insurance benefits (down $1.3 billion). About one-third of this decline was due to the improved labour market situation – the number of unemployed dropped by 74,000 in 1995-96 – with the remainder due to the structural changes announced in the February 1994 budget, including the restructuring of benefit entitlements for new beneficiaries, the increase in minimum entrance requirements from 10 weeks to 12 weeks, and changes to the benefit rate structure.
- lower transfer payments to other levels of government (down $0.3 billion), due to lower cash transfers under the Canada Assistance Plan and Established Programs Financing (EPF). In the February 1994 budget, entitlements under the Canada Assistance Plan for 1995-96 were frozen at their 1994-95 levels. As part of the entitlement is paid in the form of tax point transfers, which grow in line with the growth in personal income taxes, cash transfers in 1995-96 declined. Entitlements under EPF are also paid in the form of tax point transfers and cash. For 1995-96, total EPF entitlements were legislated to grow in line with the growth in the economy minus three percentage points. With the value of tax transfers growing roughly in line with the economy, cash transfers decline.
- declines in most other transfer payments administered by departments, largely due to the impact of the Program Review reductions announced in the February 1995 budget. The objective of the Program Review was to review all federal programs in order to bring about the most efficient and cost-effective way of delivering programs and service, appropriate to the federal government's role in the Canadian federation. The Program Review resulted in fundamental reforms to Canada's transport system, to agricultural subsidies, and to subsidies to business. The "other transfer payments" component declined by $1.8 billion in 1995-96 from the level reported in 1994-95, representing a decline of 9.2 per cent.

Program share



Source: Department of Finance.

Some increases were reported within the transfer component of government spending:

- elderly benefit payments were up $0.5 billion, primarily reflecting increases in the eligible population;
- increased funding to Indian and Inuit programs by the Department of Indian Affairs and Northern Development (up $0.2 billion); and
- spending by Industry Canada and the regional agencies was up $0.2 billion, all of which was due to spending under the Canada Infrastructure Works program. Total spending under this program amounted to $0.8 billion, double the amount in 1994-95.

Expenditures related to Crown corporations declined $0.7 billion. This decline was primarily due to the improved financial situation of enterprise Crown corporations in 1995-96.

Defence spending was down $0.8 billion, reflecting the impact of the 1994 and 1995 budget reductions.

Other program spending includes the costs of government administration and specific services delivered to the public, such as:

- health care to natives and veterans;
- research undertaken by government employees;
- the operation of airports and national parks;
- collection of taxes;
- the operation of federal correctional institutions and provision of police services; and
- the delivery of programs such as elderly benefits and unemployment insurance.

Spending in this area was down $2.4 billion, or 11.4 cent. This decline was attributable to the 1994 and 1995 budget actions affecting operating and capital spending by departments. In addition, the 1994-95 number included a one-time charge for the cost of reducing employment in the federal public service related to the downsizing measures announced in Program Review.

FINANCIAL REQUIREMENTS AND DEBT

Financial requirements measure the amount by which cash going out from the government exceeds cash coming in. Financial requirements are lower than the deficit, as they also include the net source of funds from non-budgetary transactions. These include transactions in loans, investments and advances, government employees' pension accounts, other specified accounts, and other financial assets and liabilities.

Non-budgetary transactions in 1995-96 resulted in a net source of funds amounting to $11.4 billion, down $0.2 billion from 1994-95.

As a result, financial requirements, excluding foreign exchange transactions, amounted to $17.2 billion, down $8.7 billion from 1994-95. The 1995-96 requirements are the lowest since 1981-82.

Total financial requirements also include the transactions of the Exchange Fund Account. The purpose of the Exchange Fund Account is to promote order and stability of the Canadian dollar in the foreign exchange market. It fulfills this function by buying foreign exchange (selling Canadian dollars) when there is upward pressure on the value of the Canadian dollar and selling foreign exchange (buying Canadian dollars) when there is downward pressure on the currency.

During 1995-96, there was a net requirement of funds amounting to $4.7 billion, up from $1.4 billion in 1994-95.

As a result, total financial requirements were $21.9 billion in 1995-96, down $5.4 billion from 1994-95.

To finance these requirements, the government borrows from the private sector and/or draws down its cash reserves. Total borrowings from the private sector (unmatured debt transactions) amounted to $28.5 billion in 1995-96, up $1.5 billion from last year. As a result, cash in the bank as of March 31, 1996 stood at $8.6 billion, up $6.7 billion from March 31, 1995.

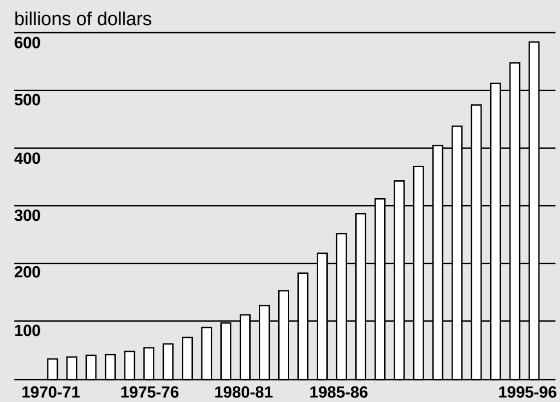
Interest-bearing debt, which includes unmatured debt and borrowings from pension and other accounts, amounted to $586.4 billion at March 31, 1996, up $36.2 billion from March 31, 1995. Of this amount, $16.8 billion was payable in foreign currencies, down slightly from the level in March 1995.

Foreign holdings of the Government of Canada's outstanding market debt are estimated at $117.3 billion at the end of March 1996. This represented 25.2 per cent of the government's total market debt, virtually unchanged from the previous year.

Table 5
Financial requirements and the debt

	1995-96	1994-95	1993-94
	(billions of dollars)		
Budgetary deficit	-28.6	-37.5	-42.0
Non-budgetary transactions	11.4	11.6	12.2
Financial requirements (excl. foreign exchange transactions)	-17.2	-25.8	-29.9
Foreign exchange account transactions	-4.7	-1.4	-2.1
Financial requirements	-21.9	-27.3	-32.0
Increase in unmatured debt			
Payable in Canadian currencies	28.7	20.8	26.0
Payable in foreign currencies	-0.1	6.3	5.3
Total	28.5	27.0	31.2
Change in cash balances	6.7	-0.2	-0.7
Cash in bank at year end	8.6	1.9	2.1

Interest-bearing debt



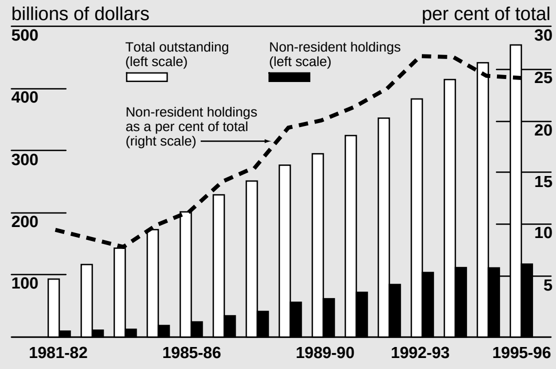
Source: *Public Accounts of Canada.*

Table 6

Outstanding debt at year end

	1995-96	1994-95	1993-94
	(billions of dollars)		
Interest-bearing debt			
Unmatured debt	469.5	441.0	414.0
Pension and other accounts	116.9	109.2	100.5
Total interest-bearing debt	586.4	550.2	514.5
Other liabilities	36.4	32.7	29.6
Total liabilities (Gross public debt)	622.8	582.9	544.1
Less: Financial assets	48.5	37.2	35.9
Accumulated deficit (Net public debt)	574.3	545.7	508.2

Foreign holdings of Government of Canada debt



Source: Statistics Canada.

THE "SCORECARD"

This section compares the actual outcome for selected economic indicators and for the financial results with the forecasts presented in the February 1995 and March 1996 budgets.

The government's deficit target for 1995-96, as presented in the February 1995 and March 1996 budgets, was $32.7 billion. The government's fiscal strategy is to set two-year rolling deficit targets, base these targets on the average of private sector economic forecasts available at that time. In addition, a prudence factor is applied to the interest rates in the average private sector forecast and the impacts are allowed to flow through to output and inflation. This procedure reflects the advice given at a December 1993 meeting with private sector economists and the recommendations of the House of Commons Standing Committee on Finance. The deficit targets also include a Contingency Reserve to cover risks arising from unpredictable events and unavoidable inaccuracies in the economic and fiscal models used to translate the economic assumptions into detailed budget forecasts. For 1995-96, the Contingency Reserve was set at $2.5 billion.

In the February 1995 budget, it was assumed that the pace of economic growth witnessed in 1994 would continue into the first half of 1995. However, growth was expected to slow in the second half of the year, due to the effects of high interest rates on interest-sensitive components of spending and a slow-down in exports due to slower U.S. growth. Economic growth for the year as a whole was projected at 3.8 per cent. Short-term interest rates were assumed to average 8.5 per cent and long-term rates 9.7 per cent.

The economic weakness expected in the budget outlook for 1995 came much sooner and was much more pronounced than expected. Real GDP advanced only 2.3 per cent, with both exports and domestic demand weakening considerably. As a result, nominal income – the applicable tax base for federal government budgetary revenues – was considerably lower. However, interest rates did not rise as much as expected in the 1995 budget. Financial market sentiment improved considerably over the spring and summer of 1995, due in part to the favourable reception given to the federal budget and the budgets of many provincial governments. Both short- and long-term interest rates were 150 basis points lower-than-assumed at the time of the 1995 budget.

The net effect of the economic changes on the financial outcome was positive. In comparison to the February 1995 budget projections, the lower deficit outcome reflects a number of factors, including:

- the use of "prudent" economic assumptions for planning purposes with the result that the $2.5 billion Contingency Reserve was not required; and
- much lower-than-expected public debt charges and lower program spending, which more than offset lower-than-expected budgetary revenues.

Budgetary revenues were $2.9 billion lower than forecast in the February 1995 budget. Personal income tax collections were $0.2 billion lower than forecast due to the lower-than-expected growth in labour income. Corporate income tax collections were up $0.5 billion, reflecting the strong growth in corporate profits during 1995-96. Unemployment insurance premiums were down $1.2 billion, primarily reflecting adjustments to recover overpayments to the Account in previous fiscal years. Goods and Services Tax collections were $1.0 billion lower, while excise taxes and duties were down $0.5 billion, primarily due to lower consumer demand. Non-tax revenues were $0.7 billion lower than forecast due to lower Exchange Fund revenues.

Total program spending was $2.0 billion lower than forecast in the February 1995 budget. Among the components, major transfers to persons were $1.0 billion lower than forecast, most of which was attributable to lower unemployment insurance benefits. Major transfers to other governments were up slightly. Other transfer payments were up $0.9 billion, reflecting reallocations from other departmental spending. Lower spending in the remaining components reflected lower liabilities at year end.

Public debt charges were $2.6 billion lower than forecast in the February 1995 budget, due to the lower outturn for interest rates.

In relation to the March 1996 budget, the lower deficit outcome resulted from the fact that the Contingency Reserve was not required and from lower-than-expected program spending.

Table 7

The scorecard

	Actual	1995 budget (forecast)	1996 budget (estimate)
		(per cent)	
Economic indicators			
Real GDP	2.3	3.8	2.2
Inflation			
CPI	2.1	1.8	2.2
GDP deflator	1.5	1.6	1.8
Nominal GDP	3.9	5.5	4.0
Interest rates			
91-day Treasury bill rate	7.0	8.5	7.0
10-year government bond rate	8.2	9.7	8.2
		(billions of dollars)	
Financial results			
Budgetary revenues			
Personal income tax	60.2	60.4	60.5
Corporate income tax	16.0	15.5	14.4
Unemployment insurance premium	18.5	19.7	18.5
Goods and Services Tax	16.4	17.4	17.2
Sales and excise taxes/duties	10.2	10.7	10.3
Other revenues	9.1	9.5	9.7
Total	*130.3*	*133.2*	*130.6*
Program spending			
Major transfers to persons	34.5	35.5	34.7
Major transfers to other levels of government	26.5	26.3	26.6
Other transfers	18.1	17.2	17.6
Crown corporations expenditures	4.3	4.5	4.4
Defence	9.9	10.3	10.3
Other departmental spending	18.6	20.1	20.1
Total	*112.0*	*114.0*	*113.7*
Public debt charges	46.9	49.5	47.0
Contingency reserve	0.0	2.5	2.5
Deficit	28.6	32.7	32.7
Non-budgetary transactions	11.4	7.8	12.7
Financial requirements (excl. foreign exchange transactions)	17.2	24.9	20.0

OPINION OF THE AUDITOR GENERAL ON THE CONDENSED FINANCIAL STATEMENTS OF THE GOVERNMENT OF CANADA

To the Minister of Finance

I have audited, in accordance with generally accepted auditing standards, the statement of assets and liabilities of the Government of Canada as at March 31, 1996 and the statements of revenues and expenditures, accumulated deficit, changes in financial position and transactions for the year then ended. In my report to the House of Commons dated July 22, 1996, I expressed an unqualified opinion on those financial statements. My audit report and the financial statements will be included in Volume I of the 1996 *Public Accounts of Canada* which are expected to be tabled in the House of Commons later this year.

In my opinion, the accompanying condensed financial statements of revenues and expenditures, assets and liabilities, and changes in financial position fairly summarize, in all material respects, the related information contained in the full financial statements from which they have been derived.

L. Denis Desautels, FCA
Auditor General of Canada

Ottawa, Canada
July 22, 1996

PREFACE TO THE CONDENSED FINANCIAL STATEMENTS OF THE GOVERNMENT OF CANADA

The fundamental purpose of these condensed financial statements is to provide an overview to Parliament, and thus to the public, to facilitate an understanding of the full nature and extent of the financial affairs and resources for which the government is responsible. Responsibility for the integrity and objectivity of these statements rests with the government.

The condensed financial statements reflect the financial position of the government at the end of the year, as well as its results of operations, deficit, financial requirements and changes in financial position for the year. These financial statements and the accompanying notes are extracted and summarized from the audited financial statements. The audited financial statements are included in Section 1 of Volume I of the 1996 *Public Accounts of Canada*, which are expected to be tabled in Parliament later this year. These condensed financial statements were prepared by the Government of Canada in accordance with the accounting policies set out in the accompanying notes.

Table 8

Government of Canada
Condensed statement of revenues and expenditures
for the year ended March 31, 1996

	1996	1995
	(millions of dollars)	
Revenues(1)		
Tax revenues		
Income tax	83,255	75,049
Excise taxes and duties	30,086	30,494
Unemployment insurance premiums	18,510	18,928
	131,851	*124,471*
Non-tax revenues	10,659	10,608
Total gross revenues	*142,510*	*135,079*
Amounts deducted to arrive at net revenues	12,209	11,756
Total net revenues	*130,301*	*123,323*
Expenditures(1)		
Transfer payments		
Old age security and related payments	20,430	20,143
Unemployment insurance benefits	13,476	14,815
Payments to other levels of government	25,298	25,510
Other transfer payments	27,761	29,735
	86,965	*90,203*
Crown corporations expenditures	6,040	5,741
Other program expenditures	31,217	34,551
Total gross program expenditures	124,222	130,495
Amounts deducted to arrive at net program expenditures	12,209	11,756
Total net program expenditures	112,013	118,739
Interest on debt	46,905	42,046
Total net expenditures	*158,918*	*160,785*
Deficit for the year	28,617	37,462
Accumulated deficit		
Beginning of year	545,672	508,210
End of year	574,289	545,672

(1) Detailed amounts on this statement are reported on a gross basis; see *Reporting of revenue and expenditure on a gross basis* (page 26), for explanation.

Table 9

Government of Canada
Condensed statement of assets and liabilities
as at March 31, 1996

	1996	1995
	(millions of dollars)	
Liabilities		
Current liabilities and allowances		
Accounts payable and accruals	26,679	23,221
Allowances for guarantees and employee benefits	9,730	9,450
	36,409	*32,671*
Interest-bearing debt		
Pension and other accounts		
Public sector pensions	107,882	101,033
Canada Pension Plan (net of securities)	3,636	3,406
Other	5,322	4,755
	116,840	*109,194*
Unmatured debt		
Marketable bonds	252,700	225,679
Treasury bills	166,100	164,450
Canada Savings Bonds	30,460	30,460
Bonds for Canada Pension Plan	3,478	3,488
Total payable in Canadian currency	452,738	424,077
Payable in foreign currencies	16,809	16,921
	469,547	*440,998*
Total interest-bearing debt	*586,387*	*550,192*
Total liabilities	*622,796*	*582,863*
Assets		
Current assets		
Cash	9,044	1,383
Accounts receivable (net of allowance for doubtful accounts)	5,972	4,353
	15,016	*5,736*
Foreign exchange accounts including gold	19,054	14,350
Loans, investments and advances		
Enterprise Crown corporations	14,663	18,218
Other	11,044	13,787
	25,707	*32,005*
Less: Allowance for valuation	11,270	14,900
	14,437	*17,105*
Total assets	*48,507*	*37,191*
Accumulated deficit	574,289	545,672

Government of Canada Notes to the Condensed Financial Statements

Introduction

These notes are a brief summary of the accounting policies followed by the Government of Canada and other explanatory material related to the condensed financial statements. For more detailed notes on accounting policies and for more extensive information on the financial position and results of operations of the government, the reader is referred to the audited financial statements in Section 1 of Volume I of the 1996 *Public Accounts of Canada.*

Significant accounting policies

Reporting entity

The Government of Canada as a reporting entity includes the financial activities of all departments, agencies, corporations and funds which are owned or controlled by the government and which are accountable to Parliament, except for the Canada Pension Plan and enterprise Crown corporations.

Table 10

Government of Canada
Condensed statement of changes in financial position
for the year ended March 31, 1996

	1996	1995
	(millions of dollars)	
Cash requirements for:		
Operating activities		
Deficit for the year	28,617	37,462
Less: Items not requiring cash	9,583	12,146
	19,034	*25,316*
Net payments from pension and other accounts	3,182	2,033
Net change in current assets and liabilities	(2,402)	(664)
Cash required for operating activities	*19,814*	*26,685*
Investing activities		
Net decrease in loans, investments and advances	(3,630)	(1,035)
Net increase in foreign exchange accounts	4,704	1,425
Cash required for investing activities	*1,074*	*390*
Total cash requirements	*20,888*	*27,075*
Financed by:		
Net increase (decrease) in borrowings		
Canadian currency	28,661	20,770
Foreign currencies	(112)	6,253
	28,549	*27,023*
Net change in cash	7,661	(52)
Cash at beginning of year	1,383	1,435
Cash at end of year	*9,044*	*1,383*

The Canada Pension Plan, which is under joint control of the government and participating provinces, is financed from contributions by employees, their employers, and self-employed persons, and interest earned on investments which are mainly in provincial government securities. Enterprise Crown corporations, which are reported as investments, are not dependent on the government for financing their activities.

Basis of accounting

In general, the government accounts for transactions on an accrual basis with two notable exceptions:

- Tax revenues and related refunds are generally accounted for on a cash basis (when taxes are collected and refunds are paid out respectively), except for certain significant refunds which are reported on an accrual basis.
- Capital assets and inventories are fully charged to expenditures at the time of acquisition or construction.

As a consequence, the only assets recorded on the Condensed Statement of Assets and Liabilities are financial assets, as they can provide resources to discharge liabilities or finance future operations. These assets include cash, gold, receivables, as well as loans, investments and advances. Assets are recorded at the lower of cost or net estimated realizable value, except for gold (1996 – 3.3 million ounces at $69.51 per ounce; 1995 – 3.9 million ounces at $76.42 per ounce), which is valued at its approximate cost in foreign currency terms.

Liabilities are generally recorded on an accrual basis. Public sector pension and severance liabilities are determined on an actuarial basis.

Allowances are established for outstanding loan guarantees, concessionary and sovereign loans, and other obligations. Unmatured debt is recorded at face value with foreign currency amounts translated to Canadian dollar equivalents using rates at March 31.

Reporting of revenues and expenditures on a gross basis

Detailed amounts on the Condensed Statement of Revenues and Expenditures are presented on a full (gross) disclosure basis only. Gross revenues include revenues of consolidated Crown corporations, and revenues of government departments which, on the net basis, are deducted from expenditures for budget and parliamentary authority purposes. Gross expenditures include expenditures determined through the tax system, such as child tax benefits payments and quarterly GST tax credits, that are deducted from revenues on the net basis. The Statement of Revenues and Expenditures in the audited financial statements in Section 1 of Volume I of the *Public Accounts of Canada* presents detailed amounts on both a gross and net basis.

Authorities for transactions

Authority of Parliament is required before revenue can be raised and moneys spent or borrowed by the government. Spending authorities on a net basis granted by Parliament were $163.1 billion ($164.6 billion in 1995), whereas $158.9 billion ($160.8 billion in 1995) was spent. Of the total borrowing authority of $28.9 billion ($34.3 billion in 1995), $28.7 billion ($26.9 billion in 1995) was used.

Public sector pensions

Separate funds are not set aside to provide for payment of pension benefits to government employees, members of Parliament, the Canadian Forces, the RCMP, and judges. Pension liabilities are estimated annually using the government's best estimates for demographic and economic assumptions affecting these pension obligations. Changes in assumptions can result in significantly higher or lower estimates of these liabilities.

Significant transactions

Some significant transactions were recorded as expenditures and liabilities of the government during the year. Transactions recorded include $0.7 billion ($2.3 billion in 1995) for the restructuring of the Public Service, of which $0.6 billion ($0.8 billion in 1995) was included as Public sector pensions. As well, $1.0 billion was recorded for commitments made to three of the Atlantic provinces to provide assistance to facilitate their participation in the proposed harmonized tax system.

Loans, investments and advances

In 1995-96, the government sold its total investment in the Canadian National Railway and a major portion of its investment in Petro-Canada. The investments recorded in these corporations were reduced by $5.4 billion during the year, and the related allowances for valuation by $2.5 billion. The net recorded gain from the two sales was $0.3 billion.

Contractual commitments

The nature of the government's activities requires negotiation of contracts that are significant in relation to its current financial position or that will materially affect the level of future expenditures. Contractual commitments pertain to transfer payment agreements, capital asset acquisitions, other purchases, operating and capital leases, funding of international organizations, and benefit plans for veterans. At March 31, 1996 major contractual commitments amounted to approximately $26.0 billion ($28.9 billion in 1995). Estimated annual payments related to these commitments for the next five years decrease from $6.5 billion in 1997 to $3.4 billion in 2001.

Insurance programs

Three enterprise Crown corporations – Canada Deposit Insurance Corporation, Canada Mortgage and Housing Corporation, and Export Development Corporation – operate insurance programs for the government. These programs are intended to be self-sustaining, but in the event that the corporations have insufficient funds, the government will have to provide financing. Insurance in force at March 31, 1996 amounted to approximately $454 billion ($435 billion in 1995). The government expects that it will incur no costs to cover the costs of any claims for these insurance programs.

Contingent liabilities

The contingent liabilities of the government are potential liabilities which may become actual liabilities when one or more future events occur or fail to occur. At such time they may become actual liabilities and if so they are recorded in the accounts of Canada. An exception is made for losses on loan guarantees, including those in respect of borrowings of enterprise Crown corporations, which are recorded as actual liabilities when it is likely that a future payment will be made and the amount of the loss can be reasonably determined.

Contingent liabilities result from the exercise of guarantees; environmental contingencies; callable share capital and lines of credit in international organizations; claims, and pending and threatened litigation related to aboriginal land claims and treaty obligations; and like items. At March 31, 1996, these contingent liabilities amounted to approximately $68.7 billion ($64.2 billion in 1995), of which $5.4 billion ($5.5 billion in 1995) related to loan guarantees and borrowings of enterprise Crown corporations recorded as liabilities in the financial statements.

Other sources of information

The Public Accounts of Canada

The Public Accounts of Canada, as required under Section 64(1) of the Financial Administration Act, are tabled in the fall of each year by the President of the Treasury Board. This report is presented in two volumes:

- Volume I contains the government's audited financial statements and supporting schedules and information;
- Volume II contains details of financial operations by Ministry (Part I) and additional information and analyses (Part II).

The Budget

The Budget that is introduced, usually in February, presents the government's overall fiscal plan, incorporating revenue projections and spending plans which combine to determine the resulting budgetary deficit. The Budget also introduces proposals for changes in taxation.

The Estimates

The Estimates are the detailed annual expenditure plans submitted to Parliament each spring. The estimates are presented in three parts:

- Part I presents an overview of the government expenditure plan;
- Part II outlines spending according to departments, agencies and programs;
- Part III provides additional detail on each department and its programs.

The Debt Operations Report

This annual document provides an overview of the federal government's borrowing operations. It outlines the key elements of current federal debt strategy and describes various strategic and operational aspects of the government's debt program and cash management activities over the past fiscal year.

The Fiscal Monitor

This monthly newsletter produced by the Department of Finance highlights the financial results of the government together with the reasons underlying major variances.