Annual Financial Report

of the Government of Canada

Fiscal Year 1998-99

Canada

Price: $16 (including GST)
(This price includes the *Fiscal Reference Tables*)

Available from the Finance Canada Distribution Centre
300 Laurier Avenue West, Ottawa K1A 0G5
Tel: (613) 943-8665
Fax: (613) 996-0901

Cette publication est également disponible en français.

Cat no. F1-25/1999E
ISBN 0-660-17880-X

ANNUAL FINANCIAL REPORT

of the Government of Canada

Fiscal Year 1998-99

For the fiscal year 1998-99, there was a budgetary surplus of $2.9 billion. Together with the $3.5-billion surplus recorded in 1997-98, this marks only the second surplus since 1969-70 and the first back-to-back surpluses since 1951-52. With these surpluses, the absolute stock of net public debt has declined by $6.4 billion in two years and net public debt as a percentage of the economy is on a permanent downward track. Market debt – the debt issued on credit markets – fell even faster than net public debt. Over the last two fiscal years, $16.4 billion of market debt has been retired.

This turnaround in federal government finances is a historic milestone and represents an achievement that all Canadians can truly be proud of, for without their efforts, it would not have been possible. This turnaround also underlines the soundness of the government's fiscal strategy – basing budget plans on prudent planning assumptions backed by a Contingency Reserve and adopting policies which have engendered economic growth and job creation. With the era of deficit financing now over, Canada is entering the new millennium with renewed financial credibility.

Department of Finance Canada | Ministère des Finances Canada

Actions to address the fiscal problem facing Canada were both balanced and measured. Even as the deficit was being eliminated, targeted investments were undertaken to enhance job creation and growth and address priorities in health care, knowledge and innovation. In the 1997 budget, the government announced the establishment of the Canada Foundation for Innovation, with an initial endowment of $800 million. In the 1998 budget, the Canadian Opportunities Strategy was launched. Central to that strategy was the establishment of the Canada Millennium Scholarship Foundation, with an endowment of $2.5 billion. Effective 1997-98, the cash floor under the Canada Health and Social Transfer (CHST) was increased from $11 billion to $12.5 billion. In the 1999 budget, a one-time supplement of $3.5 billion to the CHST was made from funds available in 1998-99. In addition, the 1998 and 1999 budgets began the process of providing affordable broad-based tax cuts to all Canadians. In the 1998 budget, personal income tax measures amounting to $1.1 billion were announced for 1998-99. The 1998 and 1999 budget tax measures will mean further savings of $16.5 billion for Canadians over the next three years. In addition, employment insurance premium rates for both 1998 and 1999 were cut, delivering savings of some $800 million in both 1998-99 and 1999-2000. These initiatives were financed within the available resources and not with borrowed money.

This is the sixth edition of the *Annual Financial Report*. Publication of the report responds to recommendations by the Auditor General and the House of Commons Standing Committee on Public Accounts. The government shares their view that providing Canadians with accurate, relevant, understandable and timely information on its financial activity enhances government accountability and enables Canadians to play a more active and effective role in guiding government decision-making. To make the report more useful and easier to understand, a survey form is attached to solicit users' views for further improvements.

The financial data in this report are based on the audited results, which will appear in more detail in the 1999 *Public Accounts of Canada*, scheduled for tabling in the House of Commons this fall. They cover the federal government's spending and revenue performance for the past fiscal year (April 1, 1998-March 31, 1999), and detail the factors affecting these results. In addition, the *Fiscal Reference Tables* have been updated to incorporate the results for 1998-99 and historical revisions to the *National Economic and Financial Accounts* published by Statistics Canada. These tables are an integral part of this report.

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

TABLE OF CONTENTS

REPORT HIGHLIGHTS

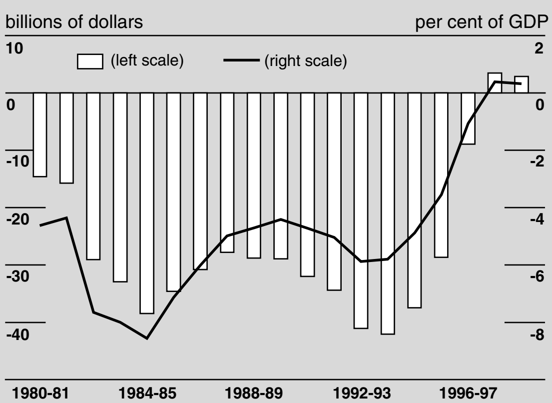
- Budgetary surplus of $2.9 billion in 1998-99, following a surplus of $3.5 billion in 1997-98: first back-to-back surpluses since 1951-52.
- Net public debt, at $576.8 billion, down $6.4 billion since 1996-97; net public debt-to-GDP ratio down to 64.4 per cent from a peak of 71.2 per cent in 1995-96.
- Market debt – the debt issued on credit markets – fell even faster than net public debt. Over the last two fiscal years, $16.4 billion of market debt has been retired.
- By accounting practices used in most other countries, a financial surplus for the third consecutive year was reported – the only G-7 country to do so.

The budgetary balance

In 1993-94, the federal deficit stood at $42 billion. The actions taken in the 1994, 1995 and 1996 budgets, coupled with sustained economic growth, resulted in the elimination of that deficit in just four years. In 1997-98, a budgetary surplus of $3.5 billion was recorded, the first surplus in 28 years. This has now been followed by a surplus of $2.9 billion in 1998-99.

This turnaround in the budgetary balance reflected the combined effects of lower program spending, primarily reflecting the expenditure reduction measures introduced since 1993, and higher revenues, primarily reflecting the growth in the economy. The contributions are best viewed in terms of their relationship to gross domestic product (GDP). Over the period 1993-94 to 1998-99, there was an improvement of 6.1 percentage points of GDP in the budgetary balance – from a deficit of 5.8 per cent of GDP to a surplus of 0.3 per cent. Over two-thirds of this improvement was attributable to the decline in program spending – from 16.6 per cent of GDP in 1993-94 to 12.4 per cent in 1998-99. Budgetary revenues increased by 1.4 percentage points of GDP – representing about 23 per cent of the overall improvement in the budgetary balance. Public debt charges declined by 0.6 percentage points, accounting for about 10 per cent of the improvement in the budgetary balance.

The budgetary balance



Sources: Public Accounts of Canada and Statistics Canada.

Net public debt

The 1998-99 surplus brought the federal government's net public debt – the accumulation of annual deficits and surpluses – down to $576.8 billion. As a share of GDP, the net public debt dropped to 64.4 per cent, down 6.8 percentage points from the peak of 71.2 per cent in 1995-96. This ratio is generally recognized as the most appropriate measure of the debt burden as it measures debt relative to the ability of the government and the country's taxpayers to finance it. This is the third

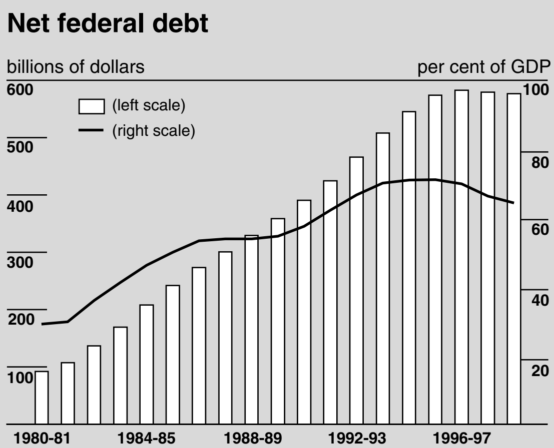
Table 1
Financial highlights

	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99
			(billions of dollars)			
Budgetary transactions						
Revenues	116.0	123.3	130.3	140.9	153.2	155.7
Program spending	-120.0	-118.7	-112.0	-104.8	-108.8	-111.4
Operating balance	-4.0	4.6	18.3	36.1	44.4	44.3
Public debt charges	-38.0	-42.0	-46.9	-45.0	-40.9	-41.4
Budgetary balance	-42.0	-37.5	-28.6	-8.9	3.5	2.9
Non-budgetary transactions	12.2	11.6	11.4	10.2	9.3	8.6
Financial requirements/surplus (excludes foreign exchange transactions)	-29.9	-25.8	-17.2	1.3	12.7	11.5
Foreign exchange transactions	-2.1	-1.4	-4.7	-7.8	-2.2	-5.7
Net financial balance	-32.0	-27.3	-21.9	-6.5	10.6	5.8
Net change in borrowings	31.2	27.0	28.5	7.3	-9.6	-6.9
Net change in cash balances	-0.7	-0.2	6.7	0.8	1.0	-1.1
Financial position						
Total liabilities	-546.4	-584.8	-624.7	-640.7	-638.5	-640.3
Total assets	38.2	39.1	50.4	57.5	58.8	63.5
Accumulated deficit (net public debt)	-508.2	-545.7	-574.3	-583.2	-579.7	-576.8
Financial results (% of GDP)						
Budgetary revenues	16.0	16.1	16.1	16.9	17.5	17.4
Program spending	16.6	15.5	13.9	12.6	12.4	12.4
Public debt charges	5.2	5.5	5.8	5.4	4.7	4.6
Budgetary balance	-5.8	-4.9	-3.5	-1.1	0.4	0.3
Net public debt	70.1	71.1	71.2	69.9	66.3	64.4

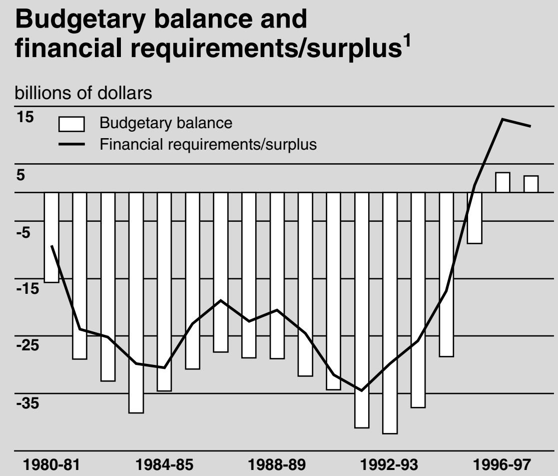
consecutive year in which the debt-to-GDP ratio has declined. The ratio is now back to where it was in the early 1990s, but still well above what it was in the 1970s. The net public debt at the end of 1998-99 was $18,923 for each Canadian, down from $19,184 a year earlier.

Net public debt consists of interest-bearing debt and other liabilities, net of financial assets. Interest-bearing debt, in turn, consists of unmatured, or market, debt and the government's obligations to internally held accounts – primarily the liabilities for the federal government employees' pension plans.

- In 1998-99, interest-bearing debt was $595.0 billion, up $0.2 billion from 1997-98.
- However, of this, market debt declined by $6.9 billion to $460.5 billion. This reflected a lower stock of Treasury bills (down $15.4 billion) and Canada Savings Bonds (down $2.1 billion), offset in part by higher marketable bonds (up $10.0 billion) and bonds for the Canada Pension Plan (up $0.6 billion).
- This decline in market debt was offset by an increase of $7.1 billion in liabilities to public sector pensions and other accounts.



Sources: Public Accounts of Canada and Statistics Canada.



[1]Excluding foreign exchange transactions.
Sources: Public Accounts of Canada and Statistics Canada.

The financial balance

Financial requirements/surplus measures the difference between cash coming into the government and cash going out. Most industrialized countries currently use a measure comparable to the financial requirements/surplus as their main budget measure.

- There was a financial surplus (excluding foreign exchange transactions) of $11.5 billion in 1998-99. This is the third consecutive year in which a financial surplus has been recorded – the only G-7 country to do so.

During the course of the fiscal year, there was a net requirement of $5.7 billion relating to foreign exchange transactions, up from a net requirement of $2.2 billion in 1997-98. Including these amounts, the financial surplus in total was $5.8 billion. This compares to a financial surplus of $10.6 billion in 1997-98.

BUDGETARY REVENUES

Table 2 on page 11 shows budgetary revenues on both a budget, or "net", basis as well as on a "gross" basis. The net figures reflect the way in which revenues and expenditures are presented to Parliament and in the government's annual budget. As such, there are a number of tax expenditures which are netted against revenues and a number of revenue items that are netted against spending.

Netted against revenues are:

- the Canada Child Tax Benefit;
- the quarterly goods and services tax (GST) credit; and
- repayments of Old Age Security benefits.

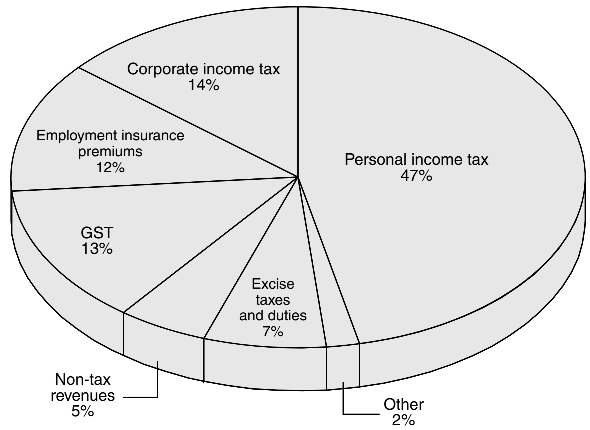
Netted against spending are:

- revenues of consolidated Crown corporations; and
- revenues levied by departments for specific services, such as the costs of policing services in provinces.

On a gross basis, the tax expenditures netted against revenues are included as part of spending, while the items netted against spending are included as part of revenues, thereby increasing both revenues and spending with no impact on the balance.

On a net basis, revenues amounted to $155.7 billion in 1998-99, an increase of $2.5 billion, or 1.6 per cent, from the 1997-98 level. The revenue ratio – net budgetary revenues as a percentage of GDP – represents an approximate measure of the overall "tax burden" in that it compares the total of all revenues collected to the size of the economy. However, as some important components of income subject to taxation are excluded from the Statistics Canada measure of GDP, such as capital gains and income from trusteed pension plans, this ratio overstates the tax burden. In addition, the sharp rise in capital gains and the growth in income from trusteed pension plans due to the aging of the population distort year-to-year changes in the ratio. Therefore, caution should be exercised in interpreting this ratio. The revenue ratio stood at 17.4 per cent in 1998-99, down slightly from 17.5 per cent in 1997-98. This decline reflects lower corporate income tax revenues and the impact of the tax relief measures announced in the 1998 budget, which restrained the growth in personal income tax revenues.

Composition of net revenues for 1998-99



Source: Public Accounts of Canada.

Net personal income tax revenues, the largest component of budgetary revenues, were up $1.7 billion, or 2.4 per cent, in 1998-99. This is in sharp contrast to the increase of 11.9 per cent reported in 1997-98. This slowdown in the rate of growth was attributable to the tax relief measures announced in previous budgets and prior-year adjustments.

- In the 1998 budget, the amount of income that low-income Canadians can receive on a tax-free basis was increased by $500. In addition, the general federal surtax was eliminated for Canadians earning up to about $50,000 and reduced for those earning between $50,000 and $65,000. It is estimated that these measures reduced tax revenues by $0.9 billion in 1998-99. There were a number of other tax expenditure measures (credit for interest on student loans, part-time education tax credit, caregiver credit, among others) which served to reduce taxes otherwise payable. In consultation with provincial governments, the Child Tax Benefit was restructured to create an enriched Canada Child Tax Benefit (CCTB). These changes came into effect July 1, 1998 and reduced personal income tax revenues by about $0.4 billion in 1998-99.

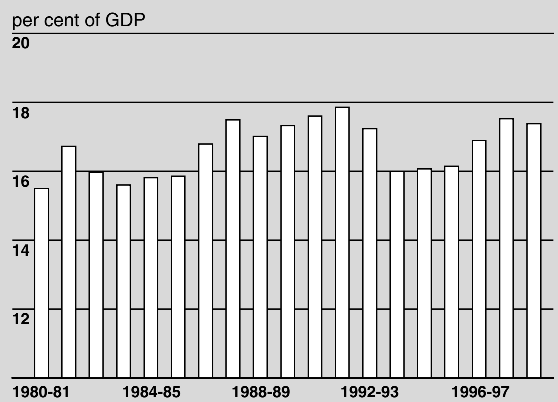
- Prior-year adjustments also affected the flow of personal income tax revenues in both 1997-98 and 1998-99. For example, refunds were up $1 billion in 1998-99, reflecting overpayment of taxes pertaining to the 1997 taxation year. In contrast, refunds were lower in 1997-98 than in 1996-97. Gross remittances received include not only federal personal income tax liabilities but also provincial income tax liabilities (as set out under the tax collection agreements with participating provinces) and employee and employer premium contributions for employment insurance and the Canada Pension Plan. On a monthly basis, deductions for these liabilities are based on estimates, with adjustments made once either preliminary or final data become available from Revenue Canada. In 1997-98, there were large transfers to personal income tax revenues, pertaining to overestimations of these deductions during the course of the fiscal year. The reverse occurred in 1998-99.
- According to Statistics Canada, personal income – a proxy for the applicable tax base for personal income tax revenues – advanced by 4 per cent in 1998, compared to an increase of 3.7 per cent in 1997. Although personal income excludes some important income components subject to taxation, such as capital gains and income from trusteed pension plans, the underlying growth in personal income tax revenues is broadly in line with the growth in personal income.

Corporate income tax revenues declined $0.9 billion, or 4.1 per cent, in 1998-99, as profits fell by 6 per cent in 1998. Other income tax revenues, which closely mirror the performance of corporate income tax revenues, were down $73 million, or 2.4 per cent.

Employment insurance premium revenues increased $0.6 billion, or 3 per cent, in 1998-99. However, this increase was entirely attributable to prior-year adjustments.

- As noted above, in 1997-98, there was a transfer from employment insurance premium revenues to personal income tax revenues, reflecting underpayments with respect to the 1996 taxation year.
- However, in 1998-99, there were net transfers from personal income tax revenues due to overpayments with respect to previous taxation years. The net impact of these adjustments was about $0.8 billion, implying a decline in underlying revenues in 1998-99.
- This decline was attributable to the reduction in premium rates. The employee premium rate (per $100 of insurable earnings) was reduced from $2.90 for 1997 to $2.70 for 1998 and to $2.55 for 1999 (with a corresponding decline in the employer rate). The net impact of these rate reductions was to lower revenues by about $1.5 billion.
- Dampening the effect of these rate reductions was an increase in the number of people employed.

The revenue ratio



Sources: Department of Finance and Statistics Canada.

Net excise taxes and duties increased $0.5 billion, or 1.7 per cent, down from a gain of 6.1 per cent recorded in 1997-98. There were significant variations among the various components.

- Net GST revenues were up 6.3 per cent. Excluding the quarterly GST credit, gross revenues were up 5.3 per cent, roughly in line with the growth in the applicable tax bases.
- Customs import duties declined 14.7 per cent, reflecting reductions in tariffs, as specified under international agreements.
- Other excise taxes and duties include customs import duties, excise taxes on motive fuels, excise taxes and duties primarily on tobacco and tobacco products, and the air transportation tax. They were down 3.2 per cent, due initially to the reduction in the air transportation tax effective January 1, 1998 and to its subsequent elimination effective November 1, 1998.

Non-tax revenues include return on investments and other non-tax revenues, such as net proceeds from the sale of assets, user charges, etc. Net non-tax revenues increased $0.7 billion, or 9.7 per cent, in 1998-99, primarily reflecting higher Bank of Canada profits and gains from the foreign exchange accounts.

Gross budgetary revenues in 1998-99 were $11.9 billion higher than net budgetary revenues, of which $5.7 billion was for the CCTB, $2.9 billion for the quarterly GST credit, $1.5 billion for revenues of consolidated Crown corporations and $2.3 billion for revenues levied by departments, which are credited back to the programs giving rise to these revenues. Old Age Security benefit repayments increased net revenues by $0.5 billion. The increase in the CCTB payments was attributable to the increase in benefits announced in the 1997 budget.

Table 2
Budgetary revenues

	1997-98	1998-99	Net change	
		($ millions)		(%)
Net income tax collections				
Personal income tax	70,787	72,488	1,701	2.4
Corporate income tax	22,496	21,575	-921	-4.1
Other	2,974	2,901	-73	-2.4
Total	96,257	96,964	707	0.7
Employment insurance premium revenues	18,802	19,363	561	3.0
Net excise taxes and duties				
Goods and services tax (GST)	19,461	20,684	1,223	6.3
Customs import duties	2,766	2,359	-407	-14.7
Other excise taxes/duties				
Energy taxes	4,638	4,716	78	1.7
Other	3,995	3,640	-355	-8.9
Total	8,633	8,356	-277	-3.2
Total	30,860	31,400	540	1.7
Net tax revenues	145,919	147,726	1,807	1.2
Net non-tax revenues				
Return on investments	4,427	4,991	564	12.7
Other non-tax revenues	2,816	2,954	138	4.9
Total	7,243	7,945	702	9.7
Net budgetary revenues	**153,162**	**155,671**	**2,509**	**1.6**
Adjustments				
Canada Child Tax Benefit	5,352	5,715	363	6.8
Old Age Security benefit repayment	-467	-496	-29	6.2
Quarterly GST credit	2,892	2,850	-42	-1.5
Revenues netted against expenditures	2,196	2,305	109	5.0
Revenues of consolidated Crown corporations	1,227	1,498	271	22.1
Net adjustment	11,200	11,872	672	6.0
Gross budgetary revenues	**164,362**	**167,543**	**3,181**	**1.9**

BUDGETARY EXPENDITURES

Table 3 on page 16 presents budgetary expenditures on both a gross and net basis. The differences are identical to those between gross and net budgetary revenues.

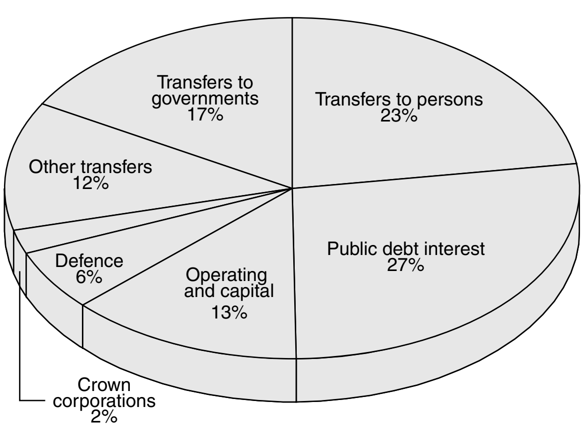
Net budgetary expenditures amounted to $152.8 billion in 1998-99, up $3.1 billion, or 2.1 per cent, from 1997-98. The expenditure ratio – net budgetary expenditures as a percentage of net budgetary revenues – stood at 98.1 per cent, up slightly from 1997-98. This implies that, in 1998-99, revenues exceeded total expenditures by 1.9 per cent. In 1993-94, the expenditure ratio stood at 136.2 per cent, which meant that an amount equivalent to 36.2 per cent of revenues had to be financed by borrowings.

Public debt charges increased by $0.5 billion, or 1.1 per cent, in 1998-99. Public debt charges are affected by interest rate developments as well as by the stock and composition of interest-bearing debt.

- The average effective interest rate on the government's interest-bearing debt (unmatured debt and pension liabilities) was 7.4 per cent in 1998-99, compared to 7.3 per cent in 1997-98. The average effective interest rate on unmatured debt was 6.7 per cent, while that on pension and other accounts was 9.8 per cent. Since 1990-91, the average effective interest rate on interest-bearing debt has declined by 3.5 percentage points, with virtually all of this attributable to lower average effective interest rates on unmatured debt – down 4.5 percentage points.
- The stock of interest-bearing debt increased slightly in 1998-99, from $594.8 billion to $595.0 billion: the stock of unmatured debt declined by $6.9 billion to $460.4 billion, while the liabilities to pension and other accounts increased by $7.1 billion to $134.6 billion. Since 1990-91, the share of unmatured debt has declined by about 2 percentage points with a corresponding increase in the liabilities for pension and other accounts. Within unmatured debt, the share of marketable bonds has increased by over 25 percentage points, while that for Treasury bills and Canada Savings Bonds has declined.

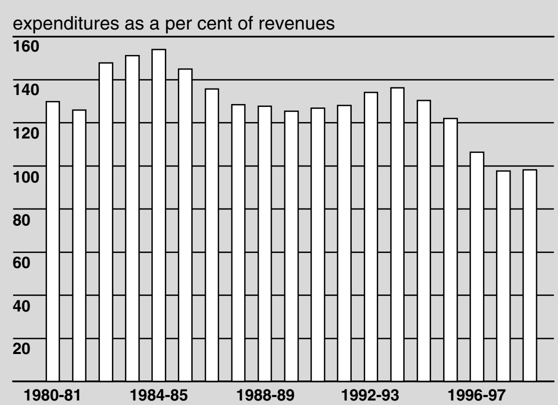
The interest ratio – public debt charges as a percentage of net budgetary revenues – declined only marginally from 26.7 per cent in 1997-98 to 26.6 per cent in 1998-99. This ratio means that, in 1998-99, the government spent about 27 cents of every revenue dollar for interest on the public debt. This is down from the peak of 36 cents in 1995-96. This is money that must be paid to

Composition of net expenditures for 1998-99

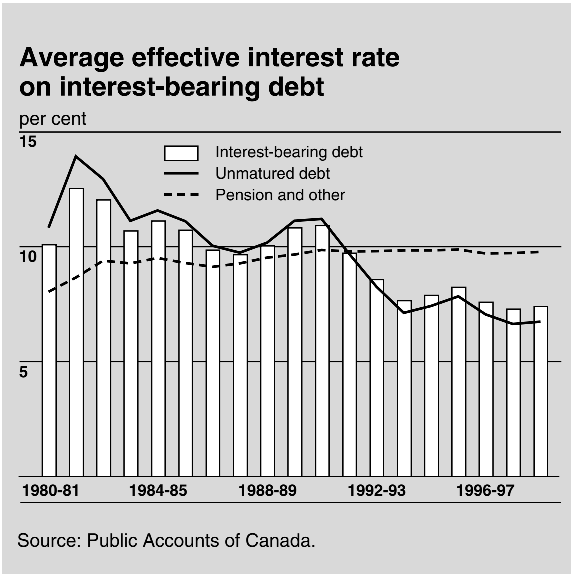


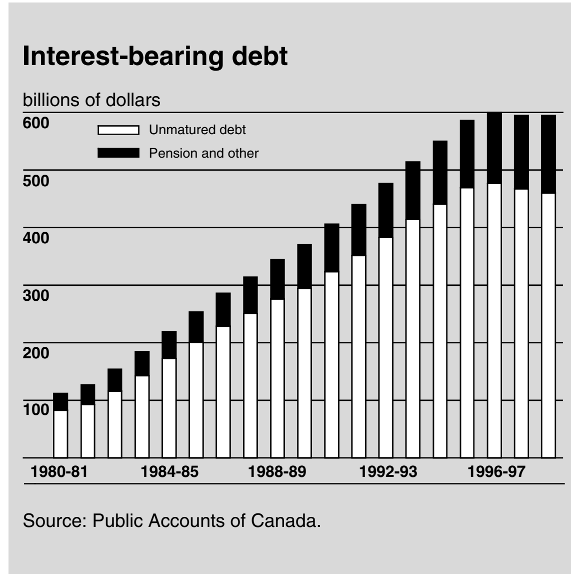
Source: Public Accounts of Canada.

The expenditure ratio



Source: Public Accounts of Canada and Statistics Canada.





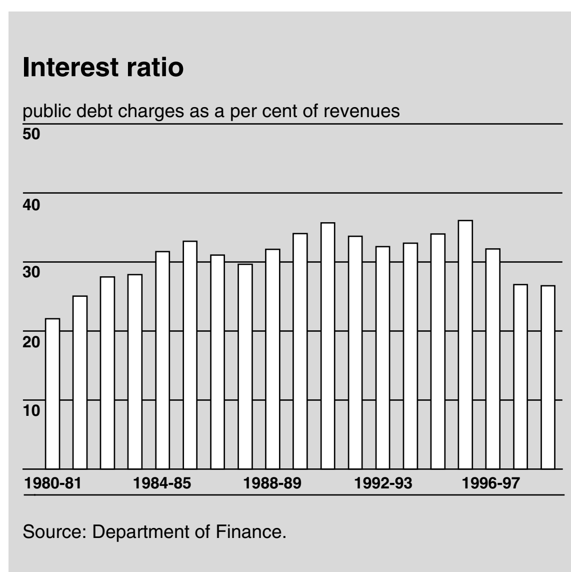
meet the government's obligations on its debt. The lower the ratio, the more flexibility the government has to address the key priorities of Canadians.

Net program spending – net budgetary expenditures less public debt charges – increased by $2.6 billion, or 2.4 per cent, in 1998-99. As was the case in 1997-98, a number of initiatives undertaken during the course of 1998-99 raised the overall level of program spending. These included the one-time cash supplement of $3.5 billion to the Canada Health and Social Transfer and incremental funding of $0.4 billion to the Canada Foundation for Innovation, the Canadian Institute for Health Information and the Canadian Health Services Research Foundation. Funding was also provided for the Canadian Fisheries Adjustment and Restructuring Program and the Agricultural Income Disaster Assistance Program (total of $1 billion). In addition, Equalization entitlements increased significantly ($1.6 billion), reflecting prior-year data revisions.

The program share – net program spending as a percentage of net revenues – amounted to 71.6 per cent, up slightly from 1997-98 but still well below previous levels.

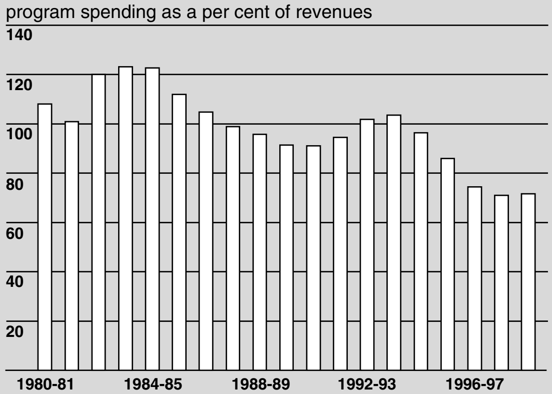
Within program spending, net major transfer payments to persons consist of elderly benefits and employment insurance benefits. This component increased by $0.6 billion, or 1.8 per cent, in 1998-99.

- Elderly benefits consist of Old Age Security payments, Guaranteed Income Supplement payments and spouse's allowance payments. Total benefits were up $0.6 billion in 1998-99, reflecting both higher average benefits and an increase in the number of recipients.



Program share

program spending as a per cent of revenues



Source: Department of Finance.

- Employment insurance benefits were virtually unchanged from 1997-98. Regular benefit payments were lower, reflecting the decline in the number of unemployed. However, this was offset by increased transfers to the provinces under the Labour Market Development Agreements.

Major transfer payments to other levels of government include the Canada Health and Social Transfer (CHST), fiscal arrangements (Equalization, transfers to the territories as well as a number of small transfer programs) and Alternative Payments for Standing Programs. Net cash transfers increased by $5.0 billion in 1998-99, or 24.5 per cent. Of this increase, $3.5 billion was attributable to the CHST cash supplement while the remainder was attributable to higher Equalization payments.

- On April 1, 1996, the CHST – a new block-funded transfer – replaced Established Programs Financing and the Canada Assistance Plan. Total CHST entitlements are paid in the form of tax point transfers and cash transfers. In the 1998 budget, CHST entitlements were forecast to be $26 billion for 1998-99. The budget also set a floor on the cash portion of the transfer at $12.5 billion for the years 1997-98 to 2002-03. Without this floor, the cash entitlement would have fallen below $12.5 billion in both 1997-98 and 1998-99.
- In the 1999 budget, the government announced a special payment of $3.5 billion to be paid to a third-party trust to be drawn by the provinces and territories over a period not to exceed three years, in a pattern which best meets the needs of their health care systems. This supplement was charged to the 1998-99 fiscal year, in accordance with objective accounting standards.
- Equalization is the largest of the transfers under fiscal arrangements. Under the Equalization program, the federal government transfers funds to the less prosperous provinces so that they can provide reasonably comparable levels of public services at reasonably comparable levels of taxation. Tax data for 1997 indicated much stronger revenue gains in the non-Equalization-receiving provinces than in the Equalization-receiving provinces, thereby resulting in higher Equalization entitlements.
- The Alternative Payments for Standing Programs represent recoveries of federal tax point abatements under contracting-out arrangements. These arrangements allowed provinces to assume the administrative and financial authority for certain federal-provincial programs. In turn, the federal government provided provinces with tax points, the value of which are netted against total entitlements, and accordingly recovered from cash transfers. These recoveries reflect the growth in the value of the tax points.

Net direct program spending – total program spending less major transfers to persons and other levels of government – consists of subsidies and other transfer payments, expenditures related to Crown corporations, defence spending, and operating and capital expenditures of non-defence departments and agencies.

- Spending in this component amounted to $51.2 billion in 1998-99, down $3.0 billion, or 5.5 per cent, from 1997-98. This decline was attributable to the recording of a number of one-time liabilities in 1997-98 amounting to $5.5 billion: liabilities for the Canada Millennium Scholarship Foundation ($2.5 billion), compensation for hepatitis C victims ($0.8 billion), the Aboriginal healing strategy ($350 million) and the change in accounting policy relating to assistance to international financial institutions ($1.8 billion).

- Excluding the impact of these liabilities, direct program spending increased by $2.5 billion, or 5.1 per cent. This increase was entirely attributable to the initiatives announced in the 1998 and 1999 budgets ($1.9 billion) and the economic adjustment programs for farmers and fishers ($1 billion).

Within net direct program spending:

- Subsidies and other transfer payments declined by $3.7 billion, with the decline attributable to the special factors noted above ($5.5 billion). Partially offsetting the impact of these liabilities were:
  - booking of the 1998-99 liabilities associated with the Agricultural Income Disaster Assistance Program;
  - payments under the Canadian Fisheries Adjustment and Restructuring Program;
  - initiatives under the Canadian Opportunities Strategy, as announced in both the 1998 and 1999 budgets, including the introduction of the Canada Education Savings Grant and the Canada Jobs Fund, renewal of the Youth Employment Strategy, increased funding for the granting councils and the Canada Study Grants program, and an additional investment in the Canada Foundation for Innovation; and
  - other initiatives announced in the 1998 and 1999 budgets, including funding for *Gathering Strength* (the government's response to the Royal Commission on Aboriginal Peoples), for the Canada Television and Cable Production Fund, and for furthering international co-operation, among others.

- Expenditures related to Crown corporations were up $0.9 billion. This component includes appropriations to consolidated Crown corporations (those Crown corporations that rely on government funding as their principal source of revenue) and the annual profit and losses for enterprise Crown corporations. The increase was largely attributable to changes in the allowance for loan guarantees and borrowings of enterprise Crown corporations. In contrast, appropriations for consolidated Crown corporations were virtually unchanged from 1997-98.

- Operating and capital expenditures include the costs of defence, government administration and delivery of specific services to the public, such as:
  - health care to Aboriginals and veterans;
  - research undertaken by government departments;
  - food inspection;
  - Coast Guard and air and sea rescue;
  - operation of national parks and historic sites;
  - collection of taxes;
  - operation of federal correctional institutions and provision of police services; and
  - administration of programs.

Spending in this component declined $0.2 billion, or 0.6 per cent, from 1997-98.

Consistent with the difference between gross and net budgetary revenues, gross budgetary expenditures were $11.9 billion higher than net budgetary expenditures. The differences are described on page 10.

Table 3
Budgetary expenditures

	1997-98	1998-99	Net change	
		($ millions)		(%)
Net major transfers to persons				
Elderly benefits	22,225	22,781	556	2.5
Employment insurance benefits	11,842	11,884	42	0.4
Total	34,067	34,665	598	1.8
Major transfers to other levels of government				
Canada Health and Social Transfer (CHST)	12,612	12,528	-84	-0.7
CHST cash supplement		3,500	3,500	
Fiscal arrangements	10,000	11,645	1,645	16.5
Alternative Payments for Standing Programs	-2,108	-2,150	-42	-2.0
Total	20,504	25,523	5,019	24.5
Net direct program spending				
Subsidies and other transfers				
Agriculture and Agri-food	817	1,194	377	46.1
Foreign Affairs and International Trade	2,084	2,065	-19	-0.9
Health Canada	902	1,180	278	30.8
Human Resources Development	2,076	2,429	353	17.0
Indian Affairs and Northern Development	3,978	4,101	121	3.1
Industry/regional agencies	2,177	2,282	105	4.8
Veterans Affairs	1,374	1,377	3	0.2
One-time liabilities	5,450		-5,450	
Other	3,618	4,107	489	13.5
Total	22,476	18,735	-3,741	-16.6
Crown corporations				
Canada Mortgage and Housing Corporation	1,863	1,865	2	0.1
Canadian Broadcasting Corporation	806	912	106	13.2
Other	-121	720	841	n/a
Total	2,548	3,497	949	37.2
Operating and capital expenditures				
Defence	8,879	8,781	-98	-1.1
All other departments	20,279	20,192	-87	-0.4
Total	29,158	28,973	-185	-0.6
Net direct program spending	54,182	51,205	-2,977	-5.5
Net program spending	**108,753**	**111,393**	**2,640**	**2.4**
Public debt charges	40,931	41,394	463	1.1
Net budgetary expenditures	**149,684**	**152,787**	**3,103**	**2.1**
Adjustments				
Canada Child Tax Benefit	5,352	5,715	363	6.8
Old Age Security benefit repayment	-467	-496	-29	-6.2
Quarterly goods and services tax credit	2,892	2,850	-42	-1.5
Revenues netted against expenditures	2,196	2,305	109	5.0
Revenues of consolidated Crown corporations	1,227	1,498	271	22.1
Net adjustment	11,200	11,872	672	6.0
Gross budgetary expenditures	**160,884**	**164,659**	**3,775**	**2.3**

n/a.: not applicable

The Budgetary Balance, Financial Requirements/Surplus and Debt

The budgetary balance is presented on a modified accrual basis of accounting, recording government liabilities when they are incurred, regardless of when the cash payment is made. The budgetary balance covers only those activities over which the government has legislative control.

In contrast, financial requirements/surplus measures the difference between cash coming in to the government and cash going out. It differs from the budgetary balance in that it includes transactions in loans, investments and advances, federal employees' pension accounts, other specified purpose accounts, and changes in other financial assets and liabilities. These activities are included as part of non-budgetary transactions. The conversion from accrual to cash accounting is also reflected in non-budgetary transactions.

Non-budgetary transactions in 1998-99 resulted in a net source of funds amounting to \$8.6 billion, down \$0.7 billion from 1997-98. Among the major components:

- Loans, investments and advances were down \$1.5 billion, primarily reflecting the impact of the change in accounting in 1997-98 for assistance to international financial institutions.
- Pensions and other accounts were up \$3.2 billion. Of this amount, \$1.2 billion was attributable to plan enhancements to the various public sector pension plans as specified in the *Budget Implementation Act, 1999*. The amendments improved pension entitlements primarily by calculating pension benefits using the average of the best five consecutive years of earnings rather than the best six consecutive years. These changes were part of the overall reform of the public sector pension plans, as announced by the President of the Treasury Board in February 1999. The costs of this reform were charged to pension expenditures in 1998-99.
- Other transactions were down \$2.3 billion. In the 1998 budget, a number of one-time initiatives were announced and charged to program spending in 1997-98. However, as no cash payments with respect to these initiatives were made in 1997-98, an offsetting adjustment was made in other transactions. Cash payments with respect to these initiatives were made in 1998-99, which dampened the effect of the initiatives announced in the 1999 budget, for which no cash payments were made in 1998-99.

With a budgetary surplus of \$2.9 billion and a net source of funds from non-budgetary transactions of \$8.6 billion, there was a financial surplus, excluding foreign exchange transactions, of \$11.5 billion in 1998-99, down slightly from the financial surplus of \$12.7 billion in 1997-98. This marks the third consecutive year in which a financial surplus was recorded.

Foreign exchange transactions represent all transactions in international reserves held in 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. The buying of Canadian dollars represents a source of funds from exchange fund transactions, while the selling of Canadian dollars represents a requirement. Changes in foreign currency liabilities, which are undertaken to change the level of Canada's foreign exchange reserves, also impact on foreign exchange transactions. During 1998-99, foreign exchange transactions resulted in a net requirement of funds amounting to \$5.7 billion, compared to a net requirement of \$2.2 billion in 1997-98.

Table 4
Budgetary balance and financial requirements/surplus

	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99
			(billions of dollars)			
Budgetary balance	-42.0	-37.5	-28.6	-8.9	3.5	2.9
Non-budgetary transactions						
Loans, investments and advances	0.6	0.3	2.7	0.3	2.0	0.5
Pensions and other accounts						
Public sector pensions	6.2	6.9	6.8	6.3	3.3	5.0
Canada Pension Plan	-0.1	0.7	0.2	0.1	0.5	1.2
Other	0.2	1.0	0.6	0.5	0.1	0.9
Total	6.2	8.7	7.6	6.9	3.8	7.0
Other transactions	5.4	2.6	1.1	3.0	3.4	1.1
Total	12.2	11.6	11.4	10.2	9.3	8.6
Financial requirements/surplus (excluding foreign exchange transactions)	-29.8	-25.9	-17.2	1.3	12.7	11.5
Foreign exchange transactions	-2.1	-1.4	-4.7	-7.8	-2.2	-5.7
Net financial balance	-32.0	-27.3	-21.9	-6.5	10.6	5.8
Net change in borrowings	31.2	27.0	28.5	7.3	-9.6	-6.9
Change in cash balances	-0.7	-0.2	6.7	0.8	1.0	-1.1
Cash in bank (March 31)	2.1	1.9	8.6	9.4	10.4	9.3

As a result, there was a net financial surplus – the budgetary surplus plus non-budgetary and foreign exchange transactions – of $5.8 billion in 1998-99, compared to a net financial surplus of $10.6 billion in 1997-98.

With this net financial surplus and a reduction in its cash balances of $1.1 billion, the government was able to retire $6.9 billion of its market debt. Cash balances at March 31, 1999 stood at $9.3 billion.

Total liabilities consist of interest-bearing debt and other liabilities. Interest-bearing debt includes unmatured debt and liabilities for pension and other accounts. At March 31, 1999, interest-bearing debt amounted to $595.0 billion, up slightly from a year earlier. Other liabilities, which include accounts payable and accrued liabilities, increased by $1.6 billion. As a result, total liabilities, or gross debt, stood at $640.3 billion.

Financial assets consist of cash and accounts receivable, foreign exchange accounts and loans, investments and advances. Capital assets, inventories and net receivables for tax revenues are not included. Capital assets and inventories are fully charged to expenditures at the time of acquisition or construction while tax revenues are reported on a cash basis. Financial assets totalled $63.5 billion at March 31, 1999, up $4.7 billion from March 31, 1998, attributable to increased assets in the foreign exchange accounts as the government continues to increase foreign exchange reserves to be more in line with other comparable countries.

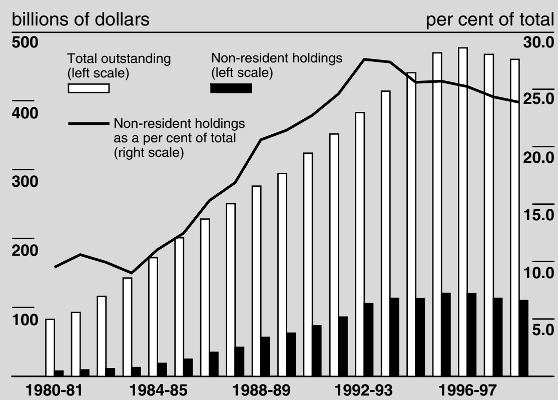
Table 5
Outstanding debt at year-end

	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99
			(billions of dollars)			
Interest-bearing debt						
Unmatured debt	414.0	441.0	469.5	476.9	467.3	460.4
Pension and other accounts	100.5	109.2	116.9	123.7	127.5	134.6
Total	514.5	550.2	586.4	600.6	594.8	595.0
Other liabilities	31.9	34.6	38.3	40.1	43.7	45.3
Total liabilities (gross debt)	546.4	584.8	624.7	640.7	638.5	640.3
Financial assets	38.2	39.1	50.4	57.5	58.8	63.5
Accumulated deficit (net public debt)	508.2	545.7	574.3	583.2	579.7	576.8

As a result, the accumulated deficit, or net public debt, stood at $576.8 billion at March 31, 1999, down $2.9 billion from March 31, 1998 and $6.4 billion below the peak of $583.2 billion at March 31, 1997.

Foreign holdings of the Government of Canada's outstanding market debt are estimated at $107.5 billion at the end of March 1999. This represented 23.3 per cent of the government's total market debt – the lowest ratio since 1990-91.

Foreign holdings of Government of Canada debt



Source: Bank of Canada.

The "Scorecard"

This section compares the outcome for selected economic indicators for 1998, and for the financial results for fiscal year 1998-99, with the forecasts presented in the February 1998 and 1999 budgets.

The government targeted a balanced budget for 1998-99 in both the 1998 and 1999 budgets. Under the Debt Repayment Plan, the fiscal target for each year is based on:

- prudent economic planning assumptions – the average of private sector economic forecasts available at that time adjusted to include an additional element of prudence; and
- the inclusion of an annual 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 1998-99, the Contingency Reserve was set at $3.0 billion.

1998 budget

Economic growth for 1998 was significantly weaker than assumed at the time of the 1998 budget, primarily reflecting the impact of the Asian financial crises. In contrast, interest rates turned out to be lower than those used for budget planning purposes.

Based on sensitivity analysis, the change in nominal income should have resulted in a deterioration in the revenue outcome for 1998-99, compared to the 1998 budget projections. However, positive revenue developments in the final quarter of 1997-98 – the results of which only became available after the tabling of the 1998 budget – carried over in 1998-99. As a result, budgetary revenues were $4.7 billion higher than forecast in the 1998 budget, with all major components up except excise taxes and duties. Public debt charges were $2.1 billion lower than projected in the 1998 budget, attributable in part to the lower-than-assumed outcome for interest rates and the lower stock of market debt.

The net impact of the higher revenues and lower public debt charges resulted in an improvement in the budgetary balance of $6.8 billion.

However, program spending was $6.9 billion higher than projected at the time of the 1998 budget. This was attributable to initiatives announced since the 1998 budget, which totalled $5.2 billion, and the impact of prior-year adjustments, which increased Equalization entitlements by $2.4 billion. In contrast, major transfers to persons were lower, primarily reflecting the impact of the lower-than-expected number of unemployed on employment insurance benefits.

The net impact of these developments was a requirement of $0.1 billion. As the balanced budget target for 1998-99 included a Contingency Reserve of $3 billion, there was a surplus of $2.9 billion. This surplus was applied to reducing the public debt, as specified under the Debt Repayment Plan.

Non-budgetary transactions were $2.6 billion higher than assumed in the 1998 budget. As a result, the financial surplus, excluding foreign exchange transactions, was $5.5 billion higher than projected in the 1998 budget.

1999 budget

Budgetary revenues for 1998-99 were $0.8 billion lower than projected in the 1999 budget, primarily due to transfers from personal income tax revenues to the Provincial Tax Collection Account, for underpayments with respect to both the 1997 and 1998 taxation years. Program spending was $0.7 billion lower, primarily due to lower direct program spending.

Non-budgetary transactions were $2.9 billion lower than assumed in the 1999 budget. As a result, the financial surplus, excluding foreign exchange transactions, was unchanged from the 1999 budget projection.

Table 6
The "scorecard": comparison of outcomes to 1998 and 1999 budget estimates

	Outcome: Difference from	
	1998 budget	1999 budget
Economic indicators (1998)		
Nominal GDP (percentage points)	-1.6	0.0
Interest rates		
91-day Treasury bill rate (basis points)	-68	-8
10-year government bond rate (%)	-110	0
Financial results (1998-99)	(billions of dollars)	
Budgetary revenues		
Personal income tax	1.5	-1.2
Corporate income tax	1.1	-0.4
Other income tax	0.6	0.0
Employment insurance premium revenues	0.8	0.2
Excise taxes and duties	-0.6	0.0
Non-tax revenues	1.2	0.4
Total	4.7	-0.8
Program spending		
Major transfers to persons		
Elderly benefits	-0.1	0.0
Employment insurance benefits	-0.7	-0.2
Major transfers to other levels of government		
Canada Health and Social Transfer	3.6	0.1
Fiscal arrangements	2.4	0.0
Direct program spending	1.5	-0.7
Total	6.9	-0.7
Public debt charges	-2.1	0.0
Net impact on budgetary balance	**-0.1**	**-0.1**
Contingency Reserve	-3.0	-3.0
Budgetary outcome	**2.9**	**2.9**
Non-budgetary transactions	2.6	-2.9
Financial requirements/surplus (excluding foreign exchange transactions)	5.5	0.0

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

To the Minister of Finance:

The accompanying condensed statements of revenues, expenditures and accumulated deficit, assets and liabilities and changes in financial position are derived from the complete financial statements of the Government of Canada as at March 31, 1999 and for the year then ended on which I expressed an opinion without reservation in my report dated July 26, 1999. This opinion also referred to my qualified opinion on the March 31, 1998 complete financial statements. The fair summarization of the complete financial statements is the responsibility of the Government. My responsibility is to report on the condensed financial statements.

In my opinion, the accompanying condensed financial statements fairly summarize, in all material respects, the related complete financial statements in accordance with the criteria established by The Canadian Institute of Chartered Accountants.

Since these are condensed financial statements, readers are cautioned that these statements may not be appropriate for their purposes. For more information on the Government's financial position, results of operations and changes in financial position, reference should be made to the related complete financial statements to be included in Volume I of the 1999 *Public Accounts of Canada*, expected to be tabled in the House of Commons later this year.

L. Denis Desautels, FCA
Auditor General of Canada

Ottawa, Canada
July 26, 1999

CONDENSED FINANCIAL STATEMENTS OF THE GOVERNMENT OF CANADA

The fundamental purpose of these condensed financial statements is to provide an overview of the financial affairs of the government and the resources for which it is responsible under authority granted by Parliament. Responsibility for the integrity and objectivity of these statements rests with the government.

These financial statements are extracted and condensed from the audited financial statements included in Section 1 of Volume I of the 1999 *Public Accounts of Canada*, which are expected to be tabled in Parliament later this year.

As these condensed financial statements are, by their nature, summarized, they do not include all disclosure required for financial reporting by governments in Canada. Readers interested in the disclosure of more detailed data should refer to the audited financial statements in the Public Accounts.

Table 7

Government of Canada
Condensed statement of revenues, expenditures and accumulated deficit for the year ended March 31, 1999

	1999	1998
	(millions of dollars)	
Revenues		
Tax revenues		
Income tax	102,183	101,142
Excise taxes and duties	34,249	33,752
Employment insurance premiums	19,363	18,802
	155,795	153,696
Non-tax revenues	11,748	10,666
Total gross revenues	***167,543***	***164,362***
Amounts deducted to arrive at net revenues	11,872	11,200
Total net revenues	***155,671***	***153,162***
Expenditures		
Transfer payments		
Old Age Security and related payments	22,285	21,758
Other levels of government	25,523	20,504
Employment insurance benefits	11,884	11,842
Other transfer payments	27,300	28,909
	86,992	83,013
Crown corporation expenditures	4,995	3,775
Other program expenditures	31,278	31,353
Total gross program expenditures	***123,265***	***118,141***
Amounts deducted to arrive at net program expenditures	11,872	11,200
Total net program expenditures	***111,393***	***106,941***
Interest on debt	41,394	40,931
Total net expenditures	***152,787***	***147,872***
Surplus for the year before change in accounting policy	**2,884**	**5,290**
Change in accounting policy		(1,812)
Surplus for the year	**2,884**	**3,478**
Accumulated deficit at beginning of year	579,708	583,186
Accumulated deficit at end of year	**576,824**	**579,708**

Table 8

Government of Canada
Condensed statement of assets and liabilities
as at March 31, 1999

	1999	1998
	(millions of dollars)	
Liabilities		
Payables, accruals and allowances		
Accounts payable and accruals	34,300	32,783
Allowances for guarantees and employee benefits	11,016	10,917
	45,316	43,700
Interest-bearing debt		
Unmatured debt		
Marketable bonds	295,752	294,583
Treasury bills	96,950	112,300
Canada Savings Bonds	27,662	29,769
Bonds for Canada Pension Plan	4,063	3,456
Total payable in Canadian currency	424,427	440,108
Payable in foreign currencies	36,000	27,183
	460,427	467,291
Pension and other accounts		
Public sector pensions	122,407	117,457
Canada Pension Plan (net of securities)	5,427	4,205
Other	6,724	5,872
	134,558	127,534
Total interest-bearing debt	594,985	594,825
Total liabilities	***640,301***	***638,525***
Assets		
Cash and accounts receivable		
Cash	10,693	11,691
Accounts receivable	4,580	4,122
	15,273	15,813
Foreign exchange accounts	34,668	28,968
Loans, investments and advances		
Enterprise Crown corporations and other government business enterprises	11,052	12,601
National governments and international organizations	7,555	6,869
Other	4,341	3,832
	22,948	23,302
Less allowance for valuation	9,412	9,266
	13,536	14,036
Total assets	***63,477***	***58,817***
Accumulated deficit	**576,824**	**579,708**

Table 9

Government of Canada
Condensed statement of changes in financial position
for the year ended March 31, 1999

	1999	1998
	(millions of dollars)	
Cash provided by operating activities		
Surplus for the year	2,884	3,478
Add expenditures not requiring cash	11,466	13,867
	14,350	17,345
Net payments from pension and other accounts	(3,531)	(5,110)
Net change in receivables, payables and accruals	181	(470)
	11,000	11,765
Cash provided by investing activities		
Net decrease in loans, investments and advances	566	1,467
Cash provided by foreign exchange activities		
Net increase in foreign currency borrowings	8,817	4,167
Less net increase in foreign exchange accounts	5,700	2,155
	3,117	2,012
Net cash generated before financing activities	***14,683***	***15,244***
Cash used for financing activities		
Net decrease in Canadian currency borrowings	15,681	13,728
Net increase (decrease) in cash	**(998)**	**1,516**
Cash at beginning of year	11,691	10,175
Cash at end of year	***10,693***	***11,691***

Government of Canada
Notes to the Condensed Financial Statements

Significant accounting policies

The Government of Canada reporting entity includes all departments, agencies, corporations and funds which are owned or controlled by the government and which are accountable to Parliament. The financial activities of all these entities are consolidated in these statements, except for enterprise Crown corporations and other government business enterprises, which are not dependent on the government for financing their activities. These corporations are reported as investments at their original cost adjusted by an allowance for valuation to reflect their annual profits or losses. The Canada Pension Plan is excluded from the reporting entity, as it is under the joint control of the government and participating provinces.

The government basically accounts for transactions on an accrual basis. Two notable exceptions are tax revenues and related refunds, which are generally accounted for on a cash basis; and capital assets, which 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. Assets are recorded at the lower of cost or net realizable value. Liabilities are recorded on an accrual basis with public sector pension and severance liabilities being determined on an actuarial basis. Valuation allowances are established for loan guarantees, concessionary and sovereign loans, and other obligations.

Some amounts in these statements are based on estimates and assumptions made by the government. By their nature, such estimates are subject to measurement uncertainty, although all of them are believed to be reasonable.

Comparative figures for 1998 are reclassified to conform to the current year's presentation, except for the one-time impact of the change made in 1998 of $1.8 billion in the accounting policy for assistance to international financial institutions.

Reporting of revenues and expenditures on a gross basis

Detailed amounts on the Condensed Statement of Revenues, Expenditures and Accumulated Deficit are presented on a full (gross) disclosure basis only. Gross revenues include revenues of consolidated Crown corporations, and revenues of government departments, agencies and funds 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 and quarterly goods and services tax credits, that are deducted from revenues on the net basis.

Contractual commitments

Contractual commitments that will materially affect the level of future expenditures include transfer payment agreements, benefit plans for veterans and others, capital asset acquisitions and other purchases, operating and capital leases, and funding of international organizations. At March 31, 1999 contractual commitments amounted to approximately $30.9 billion ($29.4 billion in 1998).

Contingent liabilities

Contingent or potential liabilities that may become actual liabilities in future years include: guarantees by the government; callable share capital in international organizations; claims and pending and threatened litigation; and environmental contingencies. Contingent liabilities related to guarantees by the government and international organizations amount to $62 billion. The total amount claimed against the government for other claims and pending and threatened litigation but not assessed is not determinable. Of these other claims, over $200 billion relates to Aboriginal and comprehensive land claims. The government is confident that the ultimate settlement for these contingent liabilities will be for amounts significantly lower than those being disclosed.

Insurance in force relating to self-sustaining insurance programs operated for the government by three enterprise Crown corporations amounted to approximately $501 billion ($485 billion in 1998). The government expects that it will not incur any costs to cover the claims for these programs.

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; and
- Volume II contains details of financial operations by Ministry (Part I) and additional information and analyses (Part II).

The Budget

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

The Estimates

Each year, the government prepares Estimates in support of its request to Parliament for authority to spend public monies. This request is formalized through the tabling of appropriation bills in Parliament. The Estimates are tabled in the House of Commons by the President of the Treasury Board.

The Debt Management 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.