The Fiscal Monitor

A Publication of the Department of Finance

Highlights of financial results for December 1996

Surplus of $2.2 billion reported in December 1996

A surplus of $2.2 billion was reported in December 1996, compared to a surplus of $0.1 billion in December 1995.

- Over half the increase in the surplus was attributable to timing factors, primarily affecting revenues, resulting in an overstatement of financial improvement in December 1996. This will be unwound over the balance of the 1996-97 fiscal year.

Deficit for April 1996 to December 1996 down by $13.2 billion

Over the nine-month period (April to December), the deficit stood at $5.9 billion, down $13.2 billion from the same period in 1995-96.

- Budgetary revenues were up $7.3 billion or 7.7 per cent, on a year-over-year basis. A significant part of this improvement was due to special factors which overstate the underlying trend in budgetary revenues.
- Program spending was down $4.5 billion or 5.8 per cent, primarily reflecting the impact of the restraint measures introduced in the 1994 and 1995 budgets.
- Public debt charges were down by $1.4 billion or 4.0 per cent. This reflected declines in interest rates, especially short-term rates.

Deficit for 1996-97 expected to be at least $5.3 billion under target

Timing factors with respect to the receipt of revenues and the manner by which certain restraint measures are being implemented overstate the actual extent of improvement in the deficit. As a result, the deficit over the remaining three months of 1996-97 and in the end-of-year accounting period is expected to be higher than over the same period last year.

As indicated in the 1997 budget, the deficit for the year as a whole is now estimated at no more than $19.0 billion – at least $5.3 billion below target. The target for 1996-97 was based on prudent planning assumptions, backed by a $2.5 billion Contingency Reserve. The latter can only be used to cover risks arising from unpredictable events; it cannot be used to finance new policy initiatives. Credible fiscal restraint by the federal and provincial governments and continued low inflation have provided the necessary conditions for interest rates to come down to levels much lower than assumed at the time of the 1996 budget. As a result, public debt charges are expected to be $2.3 billion lower than projected in the March 1996 budget. This, in combination with strict control over program spending, has meant that the Contingency Reserve will not be required for 1996-97 – the third consecutive year in which this has occurred.

Table 1

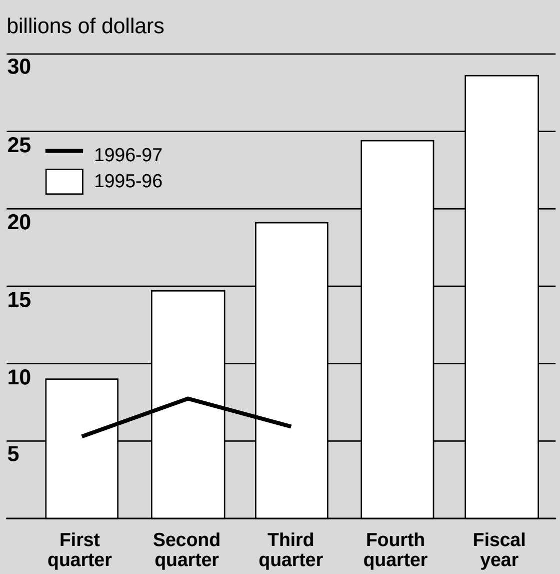
Summary statement of transactions

	December		April to December	
	1995	1996	1995-96	1996-97
	(millions of dollars)			
Budgetary transactions				
Revenues	12,946	14,173	94,562	101,830
Program spending	-8,764	-8,344	-78,457	-73,961
Operating surplus	4,182	5,829	16,105	27,869
Public debt charges	-4,034	-3,638	-35,216	-33,795
Deficit/surplus	148	2,191	-19,111	-5,926
Non-budgetary transactions	-1,063	-1,369	3,758	2,994
Financial requirements/source (excluding foreign exchange transactions)	-915	822	-15,353	-2,932
Foreign exchange transactions	1,457	1,573	1,288	-2,206
Total financial requirements/source	542	2,395	-14,065	-5,138
Unmatured debt transactions	-1,333	-914	19,555	1,751

Note: Positive numbers indicate net source of funds. Negative numbers indicate net requirement for funds.

The federal deficit 1995-96 and 1996-97

Year to date



Budgetary revenues up

On a year-over-year basis, budgetary revenues over the April 1996 to December 1996 period increased by $7.3 billion (7.7 per cent). However, as explained below, about 60 per cent of this increase was attributable to special factors, which overstate the underlying trend in budgetary revenues and the impact on the deficit outcome for the year as a whole.

Personal income tax collections were up 7 per cent, or $3.2 billion. Over half this increase relates to higher taxes paid on filing, net of refunds, and quarterly installment payments – which were up about 20 per cent. In contrast, deductions from employment income, up about 2 per cent from last year, closely mirror the developments in employment and earnings. Taxes paid on filing in the current fiscal year pertain to developments affecting the 1995 taxation year. The sharp increase in quarterly installment payments was largely due to more taxpayers being required to make installments on income not subject to withholding in 1996 than in 1995. Again, this is largely based on 1995 taxation year liabilities and could result in lower collections when individuals file their 1996 tax returns.

Table 2

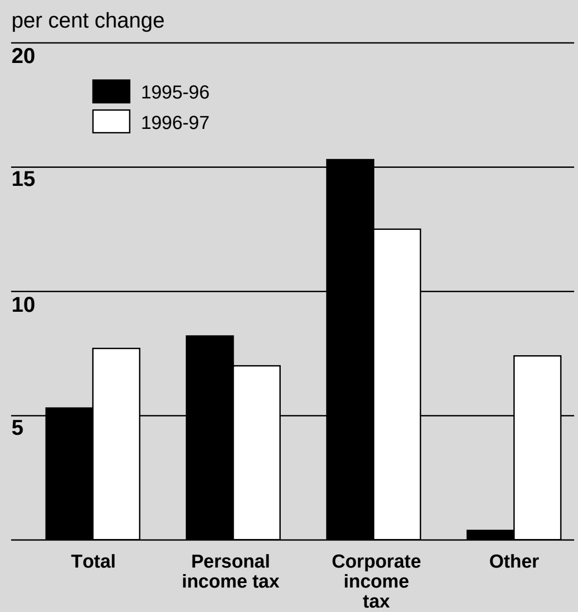
Budgetary revenues

	December		April to December		
	1995	1996	1995-96	1996-97	Per cent change
	(millions of dollars)				(%)
Income taxes					
Personal income tax	6,681	7,146	46,465	49,713	7.0
Corporate income tax	1,411	1,478	8,760	9,859	12.5
Other	148	253	1,404	1,728	23.1
Total income tax	8,240	8,877	56,629	61,300	8.2
Employment insurance contributions	1,340	1,554	14,320	14,105	-1.5
Excise taxes and duties					
Goods and services tax	1,463	2,113	11,643	12,360	6.2
Customs import duties	261	211	2,179	1,874	-14.0
Other excise taxes/duties	679	604	5,300	5,960	12.5
Total excise taxes and duties	2,403	2,928	19,122	20,194	5.6
Total tax revenue	11,983	13,359	90,071	95,599	6.1
Non-tax revenue	963	814	4,491	6,231	38.7
Total budgetary revenues	12,946	14,173	94,562	101,830	7.7

Corporate income tax collections are running well above last year's level. However, most of this increase reflects timing factors relating to the monthly tax remittance procedures for corporations. Corporations are required to file monthly installments, based on either last year's tax liability or their current year's estimated tax liability. Corporations have 60 days after their year end to file their tax return, with any amounts outstanding. As a result, over 30 per cent of corporate income tax collections are received in the months of February and March. Monthly installments during 1995-96 were based on 1994 tax liabilities. But liabilities for taxation year 1995 were substantially higher than those in 1994, with the result that installments during 1995-96 significantly understated the tax liability for the year as a whole. Collections in the settlement period (February and March) of 1995-96 were up 34 per cent over the previous year's settlement period. During the current fiscal year, installment payments are estimated to be more in line with final tax liabilities, as profits in 1996 are up only slightly from 1995. Therefore, the settlement period collections in the current fiscal year are not expected to be as large as those experienced in 1995-96.

Budgetary revenues
1995-96 and 1996-97

April to December
Year-over-year growth



The decline in employment insurance premiums was largely due to lower premium rates and the lowering of the applicable earnings base on which premiums are calculated.

Total excise taxes and duties were up $1.1 billion, or 5.6 per cent:

- Half this increase was due to the reclassification of the air transport tax from an offset to program spending to budgetary revenues, effective April 1, 1996. Although this reclassification affects both revenues and program spending, the budgetary deficit is unaffected by this change.
- Net goods and services tax (GST) collections were up 6.2 per cent, or $0.7 billion, on a year-over-year basis. Over half this increase occurred in April 1996, reflecting abnormally low collections in April 1995, rather than strength in collections in April 1996. Timing factors also account for some remaining increase, as collections in December 1995 were affected by the slippage of some revenues into January 1996. Finally, refunds were abnormally low in December 1996. Given the growth in gross collections, refunds should be higher in future months, thereby dampening net collections accordingly. Excluding the impact of these factors, net collections to date would be little changed from last year.
- Customs import duties declined 14.0 per cent, in part reflecting reductions in tariffs under the Canada-United States Free Trade Agreement.
- Excluding the air transport tax, other excise taxes and duties were up only 2.5 per cent.

The increase in non-tax revenues is more than accounted for by the inclusion of the second tranche of seignorage gains related to the introduction of the $2 coin (the first tranche was included in the final quarter of 1995-96) and the proceeds from the sale of the air navigation system.

Budgetary expenditures down

Over the period April 1996 to December 1996, total budgetary expenditures, which include both public debt charges and program spending, were down 5.2 per cent, or $5.9 billion. This decline was due to both lower public debt charges and program spending.

Public debt charges were down $1.4 billion or 4.0 per cent. This decline reflected lower interest rates, especially short-term rates. Fiscal restraint by federal and provincial governments and continued low inflation have provided the necessary conditions for interest rates to come down substantially.

Program spending declined by $4.5 billion, or 5.7 per cent, in the April 1996 to December 1996 period, compared to the same period last year. This decline primarily reflects the impact of the 1994 and 1995 budget measures to reduce and restructure federal government spending, affecting all major components of program spending. However, there are a number of other factors which affect the year-over-year decline to date.

This is especially applicable with respect to the decline in transfers to other levels of government. In the February 1994 budget, provincial entitlements under the Canada Assistance Program (CAP) for 1995-96 were frozen at their 1994-95 levels. As a result, monthly CAP payments during 1995-96 were concentrated in the first nine months of the year as payments were made until the provincial ceilings were reached. Effective 1996-97, as announced in the 1995 budget, CAP and Established Programs Financing (EPF) were replaced by a new block grant called the Canada Health and Social Transfer (CHST), with the cash portion paid in equal monthly installments. As a result, the year-over-year changes are affected by not only the restraint measures but also the manner in which transfers to the provinces are being made on a monthly basis. All the expected decline in CHST transfers for the fiscal year as a

Budgetary expenditures
1995-96 and 1996-97

April to December
Year-over-year growth

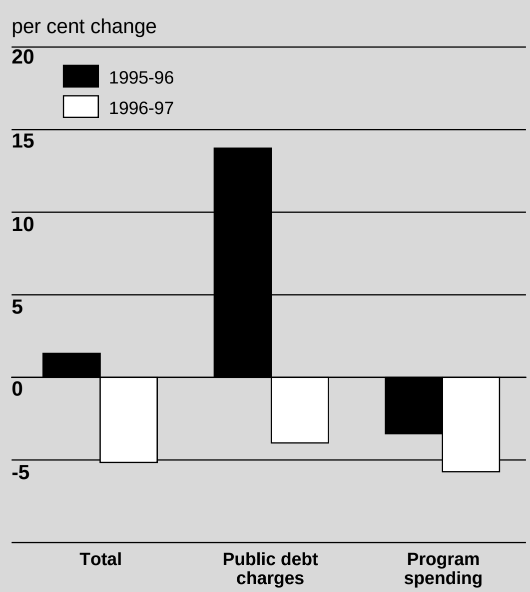


Table 3

Budgetary expenditures

	December		April to December		
	1995	1996	1995-96	1996-97	Per cent change
	(millions of dollars)				(%)
Transfer payments to:					
Persons					
Elderly benefits	1,773	1,809	15,703	16,136	2.8
Employment insurance benefits	1,141	932	9,167	8,597	-6.2
Veterans’ pensions/allowances	109	112	1,039	1,017	-2.1
Total	3,023	2,853	25,909	25,750	-0.6
Other levels of government					
Canada Health and Social Transfer	1,341	1,267	14,889	11,325	-23.9
Fiscal transfers	804	725	7,568	7,362	-2.7
Alternative payments for standing programs	-163	-166	-1,467	-1,513	3.1
Total	1,982	1,826	20,990	17,174	-18.2
Other					
Agricultural subsidies	109	100	330	561	70.0
Indian and Inuit programs	273	289	2,739	2,766	1.0
Regional development	54	73	322	300	-6.8
Science and technology	179	181	908	768	-15.4
International assistance	114	143	1,091	1,108	1.6
Other	467	466	3,679	3,275	-11.0
Total	1,196	1,252	9,069	8,778	-3.2
Total transfers	6,201	5,931	55,968	51,702	-7.6
Payments to Crown corporations					
Canadian Broadcasting Corporation	77	58	857	707	-17.5
Canada Mortgage and Housing Corporation	201	173	1,393	1,359	-2.4
Other	123	134	1,095	949	-13.4
Total	401	365	3,345	3,014	-9.9
Operating and capital expenditures					
Defence	747	810	6,931	6,453	-6.9
All other departmental expenditures	1,415	1,238	12,213	12,792	4.7
Total	2,162	2,048	19,144	19,245	0.5
Total program expenditures	8,764	8,344	78,457	73,961	-5.7
Public debt charges	4,034	3,638	35,216	33,795	-4.0
Total budgetary expenditures	12,798	11,982	113,673	107,756	-5.2

Table 4

The deficit and financial requirements

	December		April to December	
	1995	1996	1995-96	1996-97
	(millions of dollars)			
Deficit/surplus	148	2,191	-19,111	-5,926
Loans, investments and advances				
Crown corporations	382	176	3,010	872
Other	1	-7	-215	-411
Total	383	169	2,795	461
Specified purpose accounts				
Canada Pension Plan Account	-366	-428	-160	-413
Superannuation accounts	2,440	2,635	6,222	6,596
Other	-31	49	127	205
Total	2,043	2,256	6,189	6,388
Other transactions	-3,489	-3,794	-5,226	-3,855
Total non-budgetary transactions	-1,063	-1,369	3,758	2,994
Financial requirements (excluding foreign exchange transactions)	-915	822	-15,353	-2,932

Table 5

Financial requirements, foreign exchange and unmatured debt transactions

	December		April to December	
	1995	1996	1995-96	1996-97
	(millions of dollars)			
Financial requirements (-) / source (+) (excluding foreign exchange)	-915	822	-15,353	-2,932
Foreign exchange transactions				
Net international reserves	1,457	1,573	1,288	-2,206
Total financial requirements/source	542	2,395	-14,065	-5,138
Unmatured debt transactions				
Marketable bonds	2,450	6,106	27,556	28,103
Canada Savings Bonds	-171	-273	972	2,962
Treasury bills	-3,800	-6,800	-4,350	-30,900
Other	-14	-60	-4,342	1,929
Subtotal	-1,535	-1,027	19,836	2,094
Less:				
Government’s holding of unmatured debt	202	113	-281	-343
Total unmatured debt transactions payable in Canadian dollars	-1,333	-914	19,555	1,751
Change in cash balance	-791	1,481	5,490	-3,387

Table 6

Cash, unmatured debt and debt balances: at December 31

	1995	1996
	(millions of dollars)	
Cash balances at end of period		
In Canadian dollars	6,405	5,151
In foreign currencies	981	4
Total cash balance	7,386	5,155
Unmatured debt balance		
Payable in Canadian dollars		
Marketable bonds	250,080	278,125
Canada Savings Bonds	32,359	34,390
Treasury bills	160,100	135,200
Other	4,078	3,785
Subtotal	446,617	451,500
Less: Government's holdings of unmatured debt	1,275	1,376
Total	445,342	450,124
Payable in foreign currencies		
Marketable bonds	11,097	12,257
Notes and loans	0	2,079
Canada bills	4,115	6,839
Subtotal	15,212	21,175
Less: Government's holdings of unmatured debt	0	0
Total unmatured debt	460,554	471,299

whole has already been recorded in the financial results to date. CHST transfers over the balance of the fiscal year are expected to be in line with what was paid last year.

The increase in all other departmental expenditures was entirely due to the reclassification of the air transport tax. In 1995-96, this tax was netted against such spending, whereas in 1996-97 it is classified as part of budgetary revenues. Adjusting for this reclassification, this component would register a decline on a year-over-year basis.

Among the other major components of program spending, transfers to persons were down 0.6 per cent in the nine months of 1996-97, as higher elderly benefit payments, due to increases in the elderly population and average benefits, were more than offset by lower employment insurance benefits and veterans' pensions and allowances. Other transfer payments and payments to Crown corporations and defence were also lower, reflecting the impact of expenditure restraint.

Financial requirements lower

Financial requirements measure the amount by which cash going out from the government exceeds cash coming in. Financial requirements – for the fiscal year as a whole – are lower than the deficit, as they also include non-budgetary transactions. The latter includes transactions in loans, investments and advances, government employees' pension accounts, other specified accounts, and other financial assets and liabilities.

Non-budgetary transactions in the April 1996 to December 1996 period resulted in a net source of funds amounting to $3.0 billion, compared to a net source of $3.8 billion recorded in the corresponding period of 1995-96.

As a result, financial requirements, excluding foreign exchange transactions, amounted to $3.0 billion in the first nine months of 1996-97, down $12.4 billion from that recorded in the same period of 1995-96.

The purpose of the Exchange Fund Account is to promote order and stability 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.

In the first nine months of 1996-97, foreign exchange transactions resulted in a net requirement of $2.2 billion, compared to a net source for funds amounting to $1.3 billion in the comparable period last year.

As a result, total financial requirements, including foreign exchange transactions, were $5.1 billion to date in 1996-97, down $8.9 billion from the net requirement in the same period last year.

To finance these requirements, the government borrows from the private credit markets and/or draws down its cash reserves. In the first nine months of 1996-97, the government's cash requirements were met through a drawing-down of its cash balances ($3.4 billion) and borrowings from the private credit markets (unmatured debt transactions) of $1.8 billion. In the first nine months of 1995-96, net new borrowings amounted to $19.6 billion.

The Debt Servicing and Reduction Account

In June 1991, legislation to establish the Debt Servicing and Reduction Account (DSRA) received Royal Assent. As a result, effective April 1, 1991, all GST revenue net of the applicable input tax credits, rebates and the low-income credit, along with the net proceeds from the sale of Crown corporations and gifts to the Crown identified for debt reduction, must go directly to the DSRA. The funds in this account can only be used to pay the cost of servicing the public debt and ultimately to reduce the debt. The account is audited on an annual basis by the Auditor General of Canada.

Table 7

Debt Servicing and Reduction Account

	1991-92	1992-93	1993-94	1994-95	1995-96
			(millions of dollars)		
Gross GST collected	29,564	30,516	32,652	36,715	38,048
Less:					
Refunds and rebates	11,330	12,138	14,271	17,112	18,874
Quarterly low-income tax credit	2,262	2,503	2,685	2,816	2,799
Net GST	15,168	14,868	15,696	16,787	16,374
GST penalties and interest received	19	71	90	129	135
Gains from wind-up of interest in Crown corporations/disposal of shares in Crown corporations	2	110			325
Gifts to the Crown	0.4	0.1	0.2	0.5	0.3
Proceeds to the DSRA	15,190	15,050	15,786	16,916	16,835

Figures for 1991-92, 1992-93, 1993-94, 1994-95 and 1995-96 are from the *Public Accounts of Canada.*

Note: Numbers in this newsletter may not add due to rounding.

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