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The Borrowing Authority Act and measures of federal debt

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The Parliamentary Budget Officer (PBO) supports Parliament by providing analysis, including analysis of macro-economic and fiscal policy, for the purposes of raising the quality of parliamentary debate and promoting greater budget transparency and accountability.

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Table of Contents

Executive Summary

Recent changes to the *Financial Administration Act* require the Government of Canada to seek parliamentary approval to borrow in debt markets. The Government has done so with the *Borrowing Authority Act*, which came into force on 23 November 2017. While parliamentary approval of increases in annual borrowing limits was required prior to 2007, the *Borrowing Authority Act* has three components which are new to the federal fiscal framework:

- It sets a maximum amount on the total stock of market debt of the Government of Canada
- It sets a maximum amount on borrowing by agent enterprise Crown corporations
- It requires the Government to report to Parliament on the status of borrowing with respect to the maximum amount within three years of the Act coming into force, regardless of whether the limit will need to be increased.

Parliamentarians were consequently presented with a new debt aggregate on which to vote, which was previously unpublished: *government and agent Crown corporation market debt*. As discussed in the Government's Debt Management Strategy for 2018-19, this debt is expected to reach $1,066 billion in 2018-19.

This report was prepared to address two areas of confusion that have arisen in committees and debates following Budget 2018:

1. How was this new debt aggregate calculated?
2. How should it be used to scrutinize government borrowing?

The maximum borrowing amount of $1,168 billion was calculated as the sum of three components:

1. Total cumulative past market debt of the Government of Canada and forecast amounts to be issued in the three fiscal years 2017-18 to 2019-20. This includes borrowing on behalf of consolidated Crown corporations, as well as third-party borrowing by those corporations. This component was $794 billion, or 68 per cent of the maximum borrowing amount.
2. Total cumulative past borrowings by agent enterprise Crown corporations and forecast amounts for the three fiscal years 2017-18 to 2019-20. These corporations sell goods and services to parties outside government in a business model that is sustainable without parliamentary appropriations, but whose legislation deems them to be agents of Her Majesty (meaning that the government is legally liable to repay their debt in the event of default). This component was $319 billion, or 27 per cent of the maximum.
3. A 5% contingency amount equal to $56 billion.

This measure of debt is appropriate for the Borrowing Authority Act as a measure of market borrowing for which the Government of Canada is ultimately legally liable. However, any one debt measure will not give a full picture of the government's finances. For example, market debt does not capture important considerations, such as:

- Obligations to public service pension and benefit plans
- The contribution of liquid financial assets to the government's financial position
- The pressure and relief of demographics on the future revenues and expenses of current policy commitments
- The size of the economy and its capacity to service public debt through taxes.

Conventional measures of debt with which parliamentarians are familiar and that appear in the Government's consolidated financial statements are more suited to this task.

For example, *total liabilities* captures the accrued obligations of the government for public service pension and benefit plans.

Net debt captures both pension and benefit obligations and the contribution of liquid financial assets to the government's financial position.

Finally, PBO's preferred measure for assessing the government's overall fiscal sustainability—the fiscal gap—addresses all of these considerations. The fiscal gap measures the change in revenues, program spending, or combination of both, that is required to stabilize a government's net debt-to-GDP ratio at its current level, considering policy commitments and demographic trends. PBO will continue to estimate and publish the fiscal gap in our annual Fiscal Sustainability Report as the key measure of the sustainability of government finances.

Summary Table 1 Summary table of debt measures

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2018-19*
Government and agent Crown corporation market debt	873	912	894	903	936	972	1,066
Total liabilities	969	1,016	1,002	1,024	1,060	1,097	1,162
Net debt	652	678	682	687	694	714	758
Fiscal gap = 1.2% of GDP	The federal government could permanently increase spending or reduce taxes by 1.2 per cent of GDP ($24.5 billion) while returning the net debt-to-GDP ratio to its current level of 33.2 per cent over the long term.						

* Budget 2018 projections (Government and agent Crown corporation market debt is available only for 2018-19)

The Borrowing Authority Act and measures of federal debt

What is the Borrowing Authority Act?

Over 2016 and 2017, the Government of Canada amended the *Financial Administration Act* to introduce a new borrowing approval framework.[1] The changes require the Minister of Finance to seek the approval of the Parliament of Canada to borrow on behalf of the Government.

Before 2007, the Government required parliamentary approval to increase its annual incremental borrowing in capital markets if it was expected to be higher than the previous year.[2] *Budget Implementation Act, 2007* eliminated this requirement in favour of approval by only the Governor in Council.

To fulfil the requirement for parliamentary approval in the new framework, the Government introduced the *Borrowing Authority Act*, which received assent on 22 June 2017 and came into force on 23 November 2017. The *Borrowing Authority Act* sets the maximum amount of outstanding Government of Canada and agent enterprise Crown corporation market debt at $1,168 billion.[3]

The *Borrowing Authority Act* introduces three notable innovations to financial procedures:

- It is the first framework to authorize a maximum total stock of projected market debt of the Government of Canada—that is, the cumulative sum of historical and forecast securities issues
- It is the first framework to authorize a maximum amount of borrowings by agent enterprise Crown corporations
- It is the first framework to require the Government to report to Parliament on the status of borrowing with respect to the maximum amount within three years of the act coming into force, regardless of whether the limit will need to be increased.

Is this a debt ceiling?

Not as the term is commonly understood. While the *Borrowing Authority Act* sets a maximum borrowing amount, it contains provisions that permit the Governor in Council to unilaterally approve borrowing to refinance existing debt, to address unanticipated contingent liabilities, or to respond to unforeseen circumstances such as a disaster or economic crisis. These provisions, along with the requirement in a parliamentary democracy for the government to maintain the confidence of the House, are unlikely to lead to fiscal cliff episodes like those in the United States.[4]

What is the measure of debt on which parliamentarians vote?

For purposes of the *Borrowing Authority Act*, two debt aggregates are combined: 1) market debt of the Government of Canada, and 2) borrowings of enterprise Crown corporations designated as agents of Her Majesty.

This is a measure of debt that has not previously been published in the consolidated financial statements of the Government of Canada (though its components are presented in the Public Accounts of Canada). Official background documents refer to this as *Government and agent Crown corporations market debt*.

The maximum projected amount of this borrowing for 2017-18 to 2019-20 was arrived at according to the following formula (in billions):

Total cumulative past issues of **market debt of the Government of Canada** expected by the end of 2016-17 at the time the Act was prepared*	$691
	+
Total cumulative past **borrowings of enterprise Crown corporations designated as agents of Her Majesty** expected by the end of 2016-17 at the time the Act was prepared*	276
	+
Expected additional borrowing by the Government of Canada over 2017-18, 2018-19 and 2019-20	103
	+
Expected additional borrowing by agent enterprise Crown corporations over 2017-18, 2018-19, and 2019-20	43
	+
5% contingency amount	56
Borrowing Authority 2017-18 through 2019-20	$1,168

* These items were estimated at the time the *Borrowing Authority Act* was tabled. Actual amounts have since been published. Market debt of the Government of Canada was $695 billion and borrowings of enterprise Crown corporations were $277 billion at the end of 2016-17. The borrowing authority was therefore underestimated by roughly $5 billion.

Market debt of the Government of Canada is presented in the Public Accounts of Canada and the annual Debt Management Report. It consists of marketable bonds, treasury bills, retail debt, Canada bills and medium-term notes issued to supply funds to federal departments, as well as consolidated agent and non-agent Crown corporations (defined in the appendix).

Borrowings of enterprise Crown corporations designated as agents of Her Majesty consist of a range of securities including bonds and medium-term notes. Borrowings do not appear directly in the government's consolidated financial statements under public sector accounting guidelines because, as the liabilities of enterprise Crown corporations, they are expected to repay the debts themselves through their principal activity of selling goods and services to parties outside government, with a business model that is sustainable without parliamentary appropriations (though they may nonetheless receive them).[5]

How should this measure of debt be interpreted?

The borrowings of agent enterprise Crown corporations are expected to be repaid by the corporations themselves through their market activity and they are therefore not included in the government's consolidated financial statements. However, as agents of the Crown, the Government would be liable to repay their debt in the event of default. Therefore, for purposes of the *Borrowing Authority Act*, **government and agent Crown corporation market debt may be interpreted as an aggregate measure of debt for which the government could be legally held accountable.**

Government and agent Crown corporation market debt may be interpreted as an aggregate measure of debt for which the government could be legally held accountable

This measure is sensible as an aggregate level of borrowing from market lenders to be approved by Parliament for purposes of transparency and accountability.

Parliamentarians should be aware, however, that the Government may also be financially exposed to borrowings of non-agent enterprise Crown corporations that are excluded from the borrowing limit. As non-agents, there is no legal liability to repay their borrowing in event of default; however, in practice there could be a moral liability, or courts could deem the Government to be liable under a common-law principal-agent relationship. Borrowing by non-agent enterprise Crown corporations was $343 million at the end of 2016-17.

Outside of a transparency and contingency risk-evaluation framework, the inclusion of the borrowings of enterprise Crown corporations in debt aggregates is of limited use for assessing the federal government's finances. Borrowing activities of enterprise Crown corporations are largely to fund the purchase of relatively secure and liquid assets. For example, the Canada Mortgage and Housing Corporation sells Canada Mortgage Bonds through the Canada Housing Trust and uses the proceeds to buy mortgage-backed securities, transforming them into a more practical product for investors.

Which indicators should be used to assess government borrowing?

Any one measure will not give a complete picture of the government's finances. PBO uses a broad range of indicators to assess the government's financial position (balance sheet) and the fiscal sustainability of policy.

Assessing the government's financial position

The broadest measure of the federal government's financial obligations under current public-sector accounting practices is *total liabilities*. This includes the government's obligations to external creditors, as well as accrued obligations such as pension and benefit plans for federal public servants.[6] Total liabilities exceeded $1.0 trillion in 2012-13 and the Government expects it to rise to $1.2 trillion by the end of 2018-19.

When the government borrows, it does so to fund not only operating expenses, but also to invest in financial and fixed capital assets. To evaluate the government's financial position, Parliamentarians may also wish to consider these assets as follows:

- Deducting financial assets from total liabilities gives *net debt*, which shows the government's position if it were forced to liquidate its financial portfolio, for example by a sovereign debt crisis. The Government expects net debt to be $758 billion at the end of 2018-19.
- Deducting the value of physical assets such as buildings, land, and equipment from net debt gives *accumulated deficit*. Accumulated deficit also appears in the budget as *federal debt*. Accumulated deficit is the broadest sense of the government's net worth. The Government expects the accumulated deficit to be $670 billion at the end of 2018-19.

A complete balance sheet evaluation would consider these debt measures in relation to the size of the economy, as well as a broad array of other market risk indicators, such as:

- Rollover risk (a government's ability to issue new bonds to pay the principal of old bonds as it comes due)
- The share of non-resident debt holders
- The share of debt denominated in foreign currency
- Inflation conditions and the coordination of fiscal policy with monetary policy
- International economic and financial conditions.

Assessing the government's fiscal sustainability

To address the broader question of the sustainability of the trajectory of the government's balance sheet under current policy commitments, PBO uses the *fiscal gap*. The fiscal gap measures the change in revenues, program spending, or combination of both, that is required to stabilize a government's debt-to-GDP ratio at its current level over the long term. PBO will continue to estimate and publish the fiscal gap in its annual Fiscal Sustainability Report as the key summary measure of the sustainability of the government's finances.

The fiscal gap is based on a government's net debt (which accounts for its holding of financial assets) as well as a government's ability to sustainably service its liabilities (by considering debt and carrying costs in relation to the size of the economy). The fiscal gap also incorporates the discounted value of projected flows of future revenues and program expenses that result from the long-term consequences of public policy commitments. This allows the sustainability of government finances to be considered against demographics and other structural cost pressures and reliefs.

In Fiscal Sustainability Report 2017, PBO estimated that federal fiscal policy is sustainable and that the Government could permanently increase spending or reduce taxes by 1.2 per cent of GDP ($24.5 billion) while returning the net debt-to-GDP ratio to its current level of 33.2 per cent over the long term.[7]

Table 1 compares the recent history of these measures to *government and agent Crown corporation debt* from the *Borrowing Authority Act*, which is expected to be $1,066 billion at the end of 2018-19.

Table 1 Key measures to assess government borrowing

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2018-19*
Measures of debt in the consolidated financial statements of the Government of Canada							
Total liabilities	969	1,016	1,002	1,024	1,060	1,097	1,162
Net debt	652	678	682	687	694	714	758
Accumulated deficit / Federal debt	584	609	612	612	616	632	670
Measures of debt for the Borrowing Authority Act							
Government and agent Crown corporation market debt	873	912	894	903	936	972	1,066
Of which:							
Market debt of the Government of Canada**	631	668	649	650	670	695	755
Agent enterprise Crown corporation borrowing	242	244	245	253	266	277	311
Measure of fiscal sustainability estimated by PBO							
Fiscal gap = 1.2% of GDP	The federal government could permanently increase spending or reduce taxes by 1.2 per cent of GDP ($24.5 billion) while returning the net debt-to-GDP ratio to its current level of 33.2 per cent over the long term.						

* Budget 2018 projections (Government and agent Crown corporation market debt is available only for 2018-19)

** Includes consolidated agent and non-agent Crown corporations

How will PBO account for the Borrowing Authority Act?

The *Borrowing Authority Act* is unlikely to be a binding constraint on federal borrowing. PBO will nonetheless include an independent projection of the maximum stock of outstanding market debt of the Government of Canada and borrowings of agent enterprise Crown corporations in future Economic and Fiscal Outlooks beginning in fall 2018. The analysis will include a discussion of the probability that the Government must return to Parliament to seek renewed approval of a higher maximum amount of borrowing before the end of the current 3-year reporting period.

Appendix: Classifying Crown corporations for the Borrowing Authority Act

Crown corporations operate at arm's length to the government (that is, they are administered independently from ministerial decisions, generally by a board of directors) but may ultimately be legally and financially accountable to government. The degree of accountability determines whether the corporation's liabilities fall under the *Borrowing Authority Act*. The range of accountability can be classified along two dimensions:

1. Are their private borrowings and total liabilities consolidated or not consolidated with the government's financial statements?
2. Do they operate according to an agent or non-agent relationship? That is, is the government legally liable and financially exposed to the corporation's actions, particularly its liabilities in the event of default?

These two dimensions result in four categories, described below. The liabilities of the first two of these are included in the market debt of the Government of Canada and have fallen under past *Borrowing Authority Acts*. The new *Borrowing Authority Act* extends parliamentary approval to the third category. The liabilities of the fourth category remain outside the scope of parliamentary approval. Examples of each are provided, but these lists should not be considered complete or definitive, as several (such as the Bank of Canada and CMHC) have mixed characteristics that depend on the corporation's business activity under consideration.

Included in the maximum level of borrowing in the Borrowing Authority Act

1. Consolidated agent Crown corporations. The government is legally liable for their actions, and the corporations' liabilities are ultimately the liabilities of the government. They can either receive financing from the government (which borrows on their behalf) or issue securities in their own name. Currently only three such corporations borrow in private markets: the Canadian Broadcasting Corporation, the Canadian Dairy Commission, and the Federal Bridge Corporation Limited. Consolidated agent Grown corporations are not financially viable without government appropriations. The assets and liabilities on their balance sheets are converted to the same public-sector accounting basis as the federal government and appear within market debt of the Government of Canada in the Public Accounts of Canada and the consolidated financial statements of the Government of Canada.

Examples: *Atomic Energy of Canada Limited, Canadian Air Transport Security Authority, Canadian Broadcasting Corporation, Canadian Commercial Corporation, Canadian Dairy Commission, Canada Development Investment Corporation, Canadian Museum for Human Rights, Canadian Museum of History, Canadian Museum of Immigration at Pier 21, Canadian Museum of Nature, Canadian Race Relations Foundation, Destination Canada, Defence Construction (1951) Limited, The Federal Bridge Corporation Limited, National Capital Commission, National Gallery of Canada, National Museum of Science and Technology, Telefilm Canada, The Jacques Cartier and Champlain Bridges Inc.*

2. Consolidated non-agent Crown corporations. The government is not legally liable for the corporation's actions and is not financially exposed to the corporation's market borrowing unless it is explicitly directed by the Crown, or if a court deems there to be a common-law principal-agent relationship. In practice, though not legally liable, the government may nonetheless assume the corporation's liabilities in the event of default. Consolidated non-agent Crown corporations are not financially viable without government appropriations. Currently no consolidated non-agent Crown corporations borrow in their own name; all receive loans directly from the Government of Canada. Regardless of legal liability, all borrowings of consolidated non-agent Crown corporations appear within market debt of the Government of Canada in the Public Accounts and the consolidated financial statements of the Government of Canada.

Examples: *Canada Council for the Arts, PPP Canada Inc., International Development Research Centre, Marine Atlantic Inc, National Arts Centre Corporation, Standards Council of Canada, St. Lawrence Seaway Management Corporation, VIA Rail Canada Inc., Windsor-Detroit Bridge Authority.*

3. Agent enterprise Crown corporations. The corporation's principal activity is the sale of goods and services to parties outside government, and its business model is sustainable without parliamentary appropriations (though they may nonetheless receive them). The total liabilities of agent enterprise Crown corporations do not appear in the market debt of the Government of Canada, nor the consolidated financial statements of the Government of Canada.[8] However, as agents of the Crown, the government is ultimately legally liable for their actions and for their liabilities.

Examples: *Business Development Bank of Canada, Canada Deposit Insurance Corporation, Canada Mortgage and Housing Corporation, Canada Post Corporation, Export Development Canada, Farm Credit Canada, Freshwater Fish Marketing Corporation, Royal Canadian Mint.*

Excluded from the maximum level of borrowing in the Borrowing Authority Act

4. Non-agent enterprise Crown corporations and other business enterprises. Defined similarly to agent-enterprise Crown corporations, but the government is not legally or financially liable for their borrowing (unless directed by the Crown or deemed an agent by the courts).

Examples: *Atlantic Pilotage Authority, Bank of Canada, Canada Lands Company Limited, Halifax Port Authority, Pacific Pilotage Authority, Prince Rupert Port Authority, Quebec Port Authority, Ridley Terminals Inc., Sept-Iles Port Authority, Toronto Port Authority, Vancouver Fraser Port Authority, Other Canada Port Authorities.*

Notes

1. The legislative provisions were introduced sequentially in *Budget Implementation Act 2016,* No. 1 and *Budget Implementation Act 2017, No. 1*. The motivation for the changes was provided in the Minister of Finance's mandate letter dated 12 November 2015, available at: https://pm.gc.ca/eng/minister-finance-mandate-letter.
2. The previous annual acts were also titled *Borrowing Authority Act*. The last *Borrowing Authority Act* under the previous framework was in 1996-97. No acts were tabled from 1997-98 to 2006-07 because the government ran surpluses each year.
3. The language of Budget 2018, background documentation, committee testimony, and the *Borrowing Authority Act* uses several terms for this measure of debt, including "government and Crown corporation market debt", "government and agent corporations market debt", or "government and agent Crown corporations" (all omitting enterprise). While this ensures all forms of agent Crown corporations are legally bound by the Act, PBO believes that referring instead to "Government of Canada and agent enterprise Crown corporation market debt" in discussions provides greater clarity and consistency with the presentation of the Public Accounts of Canada and the calculation of the $1,168 billion maximum amount. The total liabilities of consolidated agent and non-agent Crown corporations (that is, non-enterprise agents of Her Majesty in right of Canada) are already included in the market debt of the consolidated financial statements of the Government of Canada.
4. The *Borrowing Authority Act* may be considered a money bill, and as such would be a vote of confidence. Failure to pass the Act could result in the dissolution of government and an election.
5. The Government's net investments in enterprise Crown corporations are recorded under the modified equity method of accounting.
6. Adjusting total liabilities to remove *accounts payable and accrued liabilities* (12.8% of total liabilities on average over the last 10 years) gives *interest-bearing debt*. Interest-bearing debt includes only that portion of total liabilities that incurs debt charges, which may be market interest payments or deemed interest charges.
7. PBO's preferred calculation of the fiscal gap is over a 75-year horizon (though others are estimated and provided). PBO also estimates provincial fiscal gaps, which could present additional financial exposure for the Government of Canada if their debt burdens were unsustainable. Federal and provincial fiscal gaps, as well as a more detailed definition and methodology backgrounder are published in PBO's Fiscal Sustainability Report 2017, available here: http://www.pbo-dpb.gc.ca/web/default/files/Documents/Reports/2017/FSR%20Oct%202017/FSR_2017_FINAL_EN.pdf.
8. While the total liabilities of agent enterprise Crown corporations do not appear in the consolidated financial statements of the Government of Canada, the Government's net investments in them are recorded under the modified equity method of accounting.