Beyond the ABC of Quebec Public Accounting

- Elements specific to the Quebec fiscal situation added a level of complexity in understanding its financial framework;
- Transfers to the Generations Fund entail two distinct surplus concepts: accounting and within the mean of the balanced budget act;
- The Stabilization Reserve is not a liquidity reserve but a factor of debt reduction;
- Prudential liquidities exist, are significant, and are held within the Sinking Fund related to borrowings.

Fiscal frameworks generally have a similar structure. They are based on laws regarding the presentation of fiscal material and follow for the most part the Canadian public sector accounting standards. However, some particularities exist. In the case of the Quebec government, the existence of the Generations Fund, as well as the accumulation of large surpluses in recent years have added some level of complexity from an accounting standpoint when it comes to analyzing the province's fiscal situation. In this report, we shed light on the following key elements of the financial framework: the stabilization reserve, the liquidity provisions and the debt concepts.

The Generations Fund alters the statement of operations

The basic consolidated fiscal framework (statement of operations) usually consists of the difference between revenues and expenditures, including interest on debt, which yields the budgetary balance. Within the meaning of its public accounts, Quebec is no different than other provinces. However, since the establishment of the Generations Fund in 2006, the province reports its official budgetary balance after transfers to the Fund, which have become substantial throughout the years (Table 1)[1]. For FY 2019-20, the government projects a $4.1B *accounting surplus* (0.9% of GDP). This is the budgetary balance (surplus) concept that's usually used when comparing provinces. However, after the $2.7B dedicated transfer to the Generations Fund, the surplus becomes $1.4B (0.3% of GDP). The latter is the surplus within the meaning of the *Balanced Budget Act* and presented as official by the government of Quebec. Over the projection horizon, *accounting surpluses* are projected to average $3.3B and a balanced budget is expected after transfers to the Fund.

Table 1: Quebec Consolidated financial framework, 2018-19 to 2023-24

$Billion	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Total consolidated revenue	114.7	117.4	119.9	123.5	127.1	130.7
Portfolio expenditure	-97.7	-105.4	-108.5	-111.4	-114.8	-118.3
Debt Service	-8.7	-7.7	-8.5	-8.8	-8.8	-8.5
Total consolidated expenditure	-106.5	-113.2	-117.0	-120.3	-123.5	-126.8
Contingency Reserve	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Surplus	8.3	4.1	2.8	3.2	3.5	3.8
Deposits of dedicated revenues in the Generations Funds	-3.5	-2.7	-2.7	-3.1	-3.4	-3.7
Budgetary balance	4.8	1.4	0.1	0.1	0.1	0.1

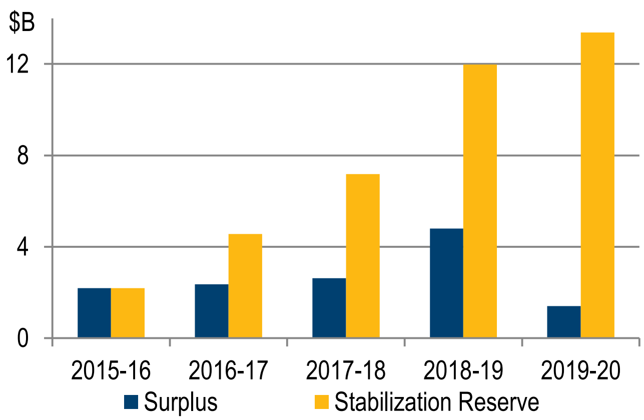
Source: Quebec Fall Update 2019.

[1] For more details on the Generations Fund, see Section E.22 of the Fall Update.

The stabilization reserve is not a cash reserve

According to the most recent public accounts, Quebec registered a fourth consecutive budgetary surplus in FY 2018-19 ($4.8B, 1.1% of GDP), after the $3.5B transfer to the Generations Fund. Those four annual surpluses added up to a sizeable $12.0B (11.4% of revenues) and were accumulated into a stabilization reserve (Chart 1). Importantly, the stabilization reserve is not held in cash and short-term investments *i.e.* it is not a liquidity reserve. Technically, the annual surplus is dedicated to reduce the gross debt and was therefore used to repay $12.0B in recently matured debt.[2] As a consequence, net debt, which subtracts financial assets from gross debt, is also reduced by the same amount (Table 2).[3] That is an important distinction since net debt is the most widely used concept in public finances to compare jurisdictional indebtedness and therefore assess credit risk. However, in the event of an economic slowdown, Quebec would still incur an *accounting* deficit and borrow more-than-currently expected on financial markets to cover the revenue shortfall, therefore increasing its debt outstanding. At the same time, the Quebec government would use the reserve to preserve a budget balance *within the mean of the Balanced Budget Act.* From that perspective, the Stabilization Reserve should be seen as a factor of debt reduction, leaving some fiscal room to increase spending and therefore borrowing during a recession.

Chart 1: Accumulated Surplus go into the Reserve



Note: Surplus within the mean of the *Balanced Budget Act*.
Source: Quebec Government.

[2] For more details on the Stabilization Reserve, see Section D.16 of the Fall Update.

[3] From an accounting standpoint, the creation of the Stabilization Reserve required the government to adjust upward its accumulated deficit by the amount of the accumulated surplus since FY 2015-16 (see Table 2). It is not done in the Public Accounts. This has led to a discrepancy between *debt representing accumulated deficits* shown in budget documents and in public accounts. In the Fall Update, the government mentioned its intention to modify the definition of debt representing accumulated deficits in budget documents. Going forward, it will reflect the public account concept (without adding the Stabilization Reserve). Hence, in Budget 2020, *debt representing accumulated deficits* should be $13.4B lower, all else equal. It will represent 21.3% of GDP versus 24.3% presented with the previous concept.

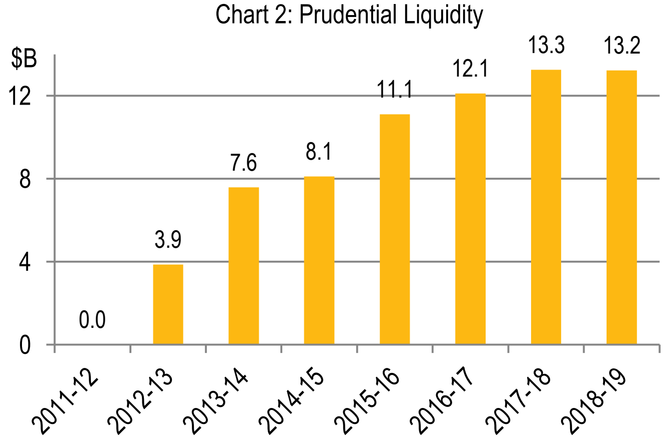
Table 2: Measures of Quebec Debt ($B)	2017-18	2018-19	2019-20
Gross Debt	201.1	199.1	201.3
% of GDP	*48.2*	*45.8*	*44.6*
less: financial assets	24.5	26.5	28.8
Net Debt	176.5	172.6	172.5
% of GDP	*42.3*	*39.7*	*38.2*
less: non-financial assets	69.1	72.1	76.1
Plus: Stabilization Reserve	7.2	12.0	13.4
Debt Representing Accumulated Deficits	114.6	112.4	109.8
% of GDP	*27.5*	*25.9*	*24.3*

Source: Quebec Fall Update 2019.

Liquidities exist

As mentioned above, the Stabilization Reserve is not a liquidity buffer. However, the government does indeed hold a liquidity buffer within its sinking funds related to borrowings. The strategy is for the government to borrow on a relatively long-term horizon and to invest the proceeds in short-term highly secured and liquid assets. According to the public accounts, the book value of these prudential assets stood at $13.2B as of March 31st 2019 (chart 2). Those assets are preserved to honor the government's financial obligations in the event of major financial disruption restraining access to market funding. They are not to be confused with the annual $100M contingency reserve or the $200M contingency fund reserve embedded in the fiscal framework and dedicated to meet an unexpected increase in expenditures.

Chart 2: Prudential Liquidity



Note : Prudential liquidity started to be held in the sinking fund in FY 2012-13.
Source: Public Accounts of the Government of Quebec.

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