THE QUÉBEC GOVERNMENT'S DEBT

Finances Québec

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INTRODUCTION

In recent years, the subject of the government's debt has become more prominent in discussions on public finances. People are concerned by the size of the debt and its growth.

In 2006, the government created the Generations Fund with the objective of reducing the ratio of debt to GDP to 25% by 2025-2026. This objective is written into the *Act to reduce the debt and establish the Generations Fund*.

Along with the work done by the Task Force on Government Accounting, the ministère des Finances has examined the concepts of debt used by various governments in Canada and by the credit rating agencies. This document sets out the results of this analysis.

The document also shows the impact of the reform of government accounting on the debt indicators.

1. THE QUÉBEC GOVERNMENT'S DEBT

This section discusses the various concepts of debt that the government uses.

At present, the ministère des Finances presents information according to four debt concepts. They are the government's total debt, the net debt, the debt representing accumulated deficits and the debt of Québec's public sector. These concepts are defined in Appendix 1.

1.1 The government's total debt

For many years, the "total debt" has been the primary indicator used by the Québec government to measure indebtedness. This concept has been used in the budget papers since the mid-1980s. This concept of debt was also used to set the debt reduction targets in the *Act to reduce the debt and establish the Generations Fund.*

The total debt of the Québec government includes the direct debt and the net retirement plans liability, from which the balance of the Generations Fund is subtracted.

TABLE 1

Total debt of the Québec government as at March 31, 2007[1]
(millions of dollars)

Direct debt	**90 340**
Plus: Net retirement plans liability	32 677
Less: Generations Fund	– 576
TOTAL DEBT	**122 441**

1 Real data before the accounting reform.

Before taking the items of the accounting reform into account, the government's total debt amounted to $122.4 billion as at March 31, 2007. It represented 43.3% of gross domestic product (GDP), compared with 52.2% as at March 31, 1998. According to the objectives written into the *Act to reduce the debt and establish the Generations Fund*, this ratio must reach 25% of GDP by March 31, 2026.

The change in total debt reflects all the financial requirements the government must satisfy each fiscal year. For this reason, the total debt can rise even if the government balances its budget year after year, since it must borrow to acquire fixed assets (e.g.: roads, buildings, land, etc.) and make investments in government corporations. Appendix 2 shows the major growth factors of the total debt since the end of the 1990s.

It is worthwhile explaining each component of the government's total debt.

1.1.1 The direct debt

The direct debt corresponds to the debt that has been contracted on financial markets. It consists of the debt issued for the purposes of the Consolidated Revenue Fund and those of the consolidated organizations.

Consolidated organizations are organizations whose results (revenue, expenditure, assets and liabilities) are consolidated line by line with those of the government. The main consolidated organizations are the Road Network Preservation and Improvement Fund, the Société immobilière du Québec, Investissement-Québec, the Agence métropolitaine de transport and the Société du Palais des congrès de Montréal. As at March 31, 2007, the debt of these organizations accounted for more than 80% of all the debt of organizations consolidated line by line.

TABLE 2

Direct debt as at March 31, 2007[1]
(millions of dollars)

Issued for the purposes of the Consolidated Revenue Fund	77 914
Issued for the purposes of the consolidated organizations	12 426
DIRECT DEBT	**90 340**

1 Real data before the accounting reform.

1.1.2 The net retirement plans liability

The net retirement plans liability is calculated by subtracting the balance of the Retirement Plans Sinking Fund (RPSF) from the gross liability for the retirement plans.

The gross liability for the retirement plans represents the present value of the retirement benefits the government will pay to public and parapublic sector employees, taking into account the conditions of their plans and their years of service. This gross liability stood at $59.7 billion as at March 31, 2007.

The government created the RPSF in 1993. It is an asset that will be used to pay the retirement benefits of public and parapublic sector employees. As at March 31, 2007, the balance of the RPSF stood at $27.0 billion.

Accordingly, the net retirement plans liability was $32.7 billion as at March 31, 2007. Appendix 3 provides further information on the retirement plans.

TABLE 3

Net retirement plans liability as at March 31, 2007[1]
(millions of dollars)

Gross retirement plans liability:		
– Government and Public Employees Retirement Plan (RREGOP)	30 512	
– Pension Plan of Management Personnel (PPMP)	6 636	
– Other plans	22 573	**59 721**
Less: Retirement Plans Sinking Fund		– 27 044
NET RETIREMENT PLANS LIABILITY		**32 677**

1 Real data before the accounting reform.

1.1.3 The Generations Fund

In 2006, the government adopted a strategy to reduce the debt by setting up the Generations Fund. The amounts paid into the Fund will be used exclusively to repay the debt.

As at March 31, 2007, the balance of the Generations Fund, before the accounting reform, stood at $576 million.

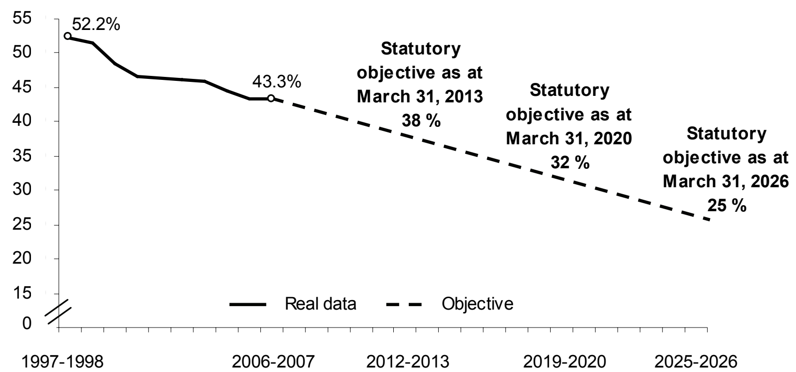
The Generations Fund enables the government to reduce its debt burden more quickly

The Generations Fund was created in June 2006 to accumulate amounts that will be dedicated exclusively to retiring the debt. The Fund derives its revenue from a number of sources. The largest are water-power royalties and a portion of the additional profits Hydro-Québec will earn on its exports of electricity.

Including the stipulated contributions, the balance of the Generations Fund will approach $2 billion by March 31, 2009 and reach $42 billion by March 31, 2026. These funds are managed by the Caisse de dépôt et placement du Québec according to a diversified investment policy set by the Minister of Finance.

By law, the government's total debt must amount to 38% of GDP as at March 31, 2013, 32% of GDP as at March 31, 2020 and 25% of GDP as at March 31, 2026.

Total debt of the government[1]
(as a percentage of GDP)



1 Total debt for the purposes of the *Act to reduce the debt and establish the Generations Fund*.

1.2 The net debt

In addition to the total debt, the Québec government presents information on the net debt in the budget papers and the public accounts.

The net debt is equal to the government's liabilities less its financial assets. It represents the debt that was used to fund investments in fixed assets and the budgetary deficits. It is obtained by subtracting the government's financial assets, net of other liabilities, from the total debt.

As at March 31, 2007, the net debt stood at $103.5 billion.

1.3 The debt representing accumulated deficits

The debt representing accumulated deficits represents the difference between the government's liabilities and all its assets, both financial and non-financial. It corresponds to the total of all the budgetary deficits and surpluses accumulated in the past by the Québec government.

TABLE 4

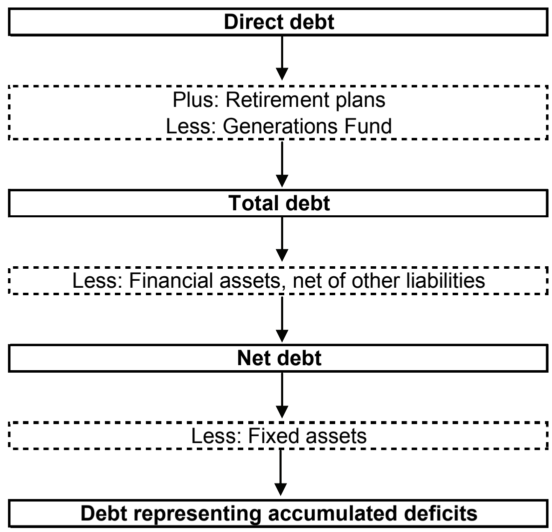
Québec's debt as at March 31, 2007[1]
(millions of dollars)

Direct debt	**90 340**
Plus: Net retirement plans liability	32 677
Less: Generations Fund	– 576
Total debt	**122 441**
Less: Financial assets, net of other liabilities	– 18 934
Net debt	**103 507**
Less: Fixed assets	– 14 077
DEBT REPRESENTING ACCUMULATED DEFICITS	**89 430**

1 Real data before the accounting reform.

As at March 31, 2007, the debt representing accumulated deficits was $89.4 billion.

Concepts of debt used by the Québec government



1.4 The debt of Québec's public sector

The Québec government uses the concept of "long-term public sector debt" to represent the total of all the debts of organizations of Québec's public sector. The long-term debt of the public sector is presented according to borrowers on financial markets and includes:

- the government's total debt;
- the debt of the health and social services and the education networks;
- the debt of Hydro-Québec;
- the debt of other government enterprises;
- the debt of the municipalities and municipal bodies including, the Société québécoise d'assainissement des eaux.

The debt of Québec's public sector as at March 31, 2007 was $191.7 billion, or 67.8% of GDP.

TABLE 5

Long-term debt of Québec's public sector as at March 31, 2007
(millions of dollars)

Total debt of the government[1]	122 441
Health and social services and education networks[2]	14 138
Hydro-Québec	32 674
Other government enterprises	3 564
Municipalities and municipal bodies[3]	18 931
TOTAL	**191 748**
As a percentage of GDP	**67.8**

1 Real data before the accounting reform.
2 Includes the long-term debt of Financement-Québec and the long-term debt of entities of the networks contracted in their own name.
3 Includes the debt of the Société québécoise d'assainissement des eaux.

This debt has been used in particular to fund public infrastructures such as roads, schools, hospitals, hydro-electric dams and water treatment plants.

Information provided to regulatory authorities and data on Québec's debt

To borrow on foreign financial markets, the Québec government must satisfy the requirements of the regulatory authorities of those markets. Accordingly, Québec must file a variety of information with the Securities and Exchange Commission (SEC) in the United States, the Financial Services Authority (FSA) in the United Kingdom, the Australian Stock Exchange and the regulatory authority of Japan.

Each year, Québec files an information document (form 18-K) with the SEC that contains all the information required under the *Securities Act of 1933*. The annual filing of form 18-K avoids having to file a prospectus for each borrowing, which would entail additional time and costs. The information in form 18-K must reflect the borrower's financial position as fairly as possible. This requirement provides investors with the relevant information to make informed investment decisions.

Concerning the debt, the SEC legislation requires the inclusion of the "funded debt", i.e. the debt with a term exceeding one year that was contracted on financial markets, and the "floating debt", i.e. the short-term debt that is continually rolled over to fund operations. Québec also provides information concerning the liability for the retirement plans of the public and parapublic sectors.

The information on the public sector debt in form 18-K is divided into four categories:

- the debt contracted by the government to meet its financial requirements, fund government enterprises and the Société québécoise d'assainissement des eaux;
- the debt of public sector entities (Hydro-Québec, Financement-Québec and the Commission municipale du Québec) for which the government guarantees the payment of the interest and repayment of the principal in the event of the entity's default of payment;
- the debt of the municipalities;
- the debt of other institutions of the public sector issued in their own name (education institutions, health and social services institutions and other government enterprises).

Moreover, Québec provides other regulatory authorities around the world with the same information supplied to the SEC.

The data on the debt shown in the Québec government's budget papers reflect the requirements of the SEC for the purposes of the presentation of information in the annual form 18-K and those of the other regulatory authorities with which the government must file information.

2. Concepts of debt used by other governments and by the credit rating agencies

It is worthwhile comparing the concepts of debt used by the Québec government with those used by other governments in Canada and the credit rating agencies.

2.1 Concepts of debt used by the federal and provincial governments in Canada

An analysis of the budget papers of the federal and provincial governments shows that each government generally uses one of the four concepts of debt described in the preceding section as a measure of indebtedness. Briefly, these concepts are:

- **Direct debt:** represents only the borrowings made by governments on financial markets.
- **Total debt:** the government's net obligations for its employees' retirement plans are added to the direct debt.
- **Net debt:** the government's financial assets, net of other liabilities, are subtracted from the total debt.
- **Debt representing accumulated deficits:** the net debt is reduced by the value of the government's fixed assets.

The analysis shows that the concepts of debt used to assess the financial position vary widely from province to province. Québec is the only one to use the concept of total debt in its budget papers. The preferred concept of debt in British Columbia and Saskatchewan is direct debt. Alberta, New Brunswick, Newfoundland and Labrador, Manitoba and Nova Scotia use the concept of net debt. Prince Edward Island's recent budget papers make no reference to its debt.

Three governments use the concept of debt representing accumulated deficits as a measure of indebtedness in their budget papers. They are the federal government and the governments of Ontario and Alberta.

Governments that use the concept of debt representing accumulated deficits

Federal government

"The federal debt-to-GDP ratio (accumulated deficit) stood at 35.1 per cent in 2005-06, down significantly from its peak of 68.4 per cent in 1995-96. Taking into account the projected debt reduction, the ratio is expected to fall to 29.7 per cent by 2008-09." (2007-08 Budget Plan, p. 277)

"For 2006-07, the Government is planning to reduce the federal debt by $9.2 billion. Combined with last year's $13.2-billion surplus, federal debt will have been reduced by $22.4 billion over two years." (2007-08 Budget Plan, p. 270)

"The Government is planning on annual debt reduction of at least $3 billion in 2007-08 and 2008-09, and remains on target to lower the federal debt-to-GDP (gross domestic product) ratio to 25 per cent by 2012-13." (2007-08 Budget Plan, p. 270)

Ontario

"Consistent with the *Fiscal Transparency and Accountability Act, 2004*, the Provincial debt is defined as accumulated deficit, which is the sum of all past Provincial surpluses and deficits. The expansion of the Province's financial reporting to include hospitals, school boards and colleges also means that, beginning in 2005-06, the surpluses or deficits of these organizations are now reflected in the Province's debt-to-GDP ratio." (2007-08 Budget Plan, p. 155)

"In line with the improvements in the medium-term fiscal outlook, the Province's debt-to-GDP ratio is projected to improve from 25.2 per cent in 2003-04 to 17.4 per cent by 2009-10." (2007-08 Budget Plan, p. 155)

Alberta

There is no reference to the debt in the budget papers. However, two charts are shown to illustrate the change in the level of Alberta's debt representing accumulated deficits and the ratio of the net debt as a percentage of GDP for Alberta and the other provinces. (Fiscal Plan 2007-08, p. 129)

The following table shows, for the federal government and all the provinces, debt figures according to the four concepts described earlier. The figures in the boxes relate to the concept used by each government in its budget papers to measure its indebtedness. In light of this information, it is clear that there is no specific rule setting the concept of debt to use as a measure of indebtedness.

TABLE 6

Debt as at March 31, 2007 according to various concepts
(millions of dollars)

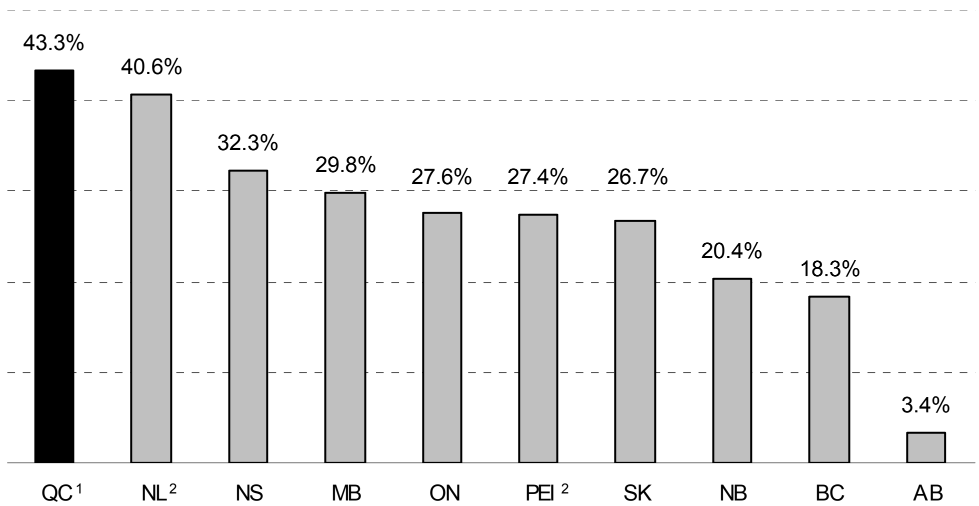
	QC[1]	Fed.	ON	BC	AB	NB	NL[2]	MB	SK	NS	PEI[2]
Direct debt	**90 340**	**414 192**	**156 993**	**32 940**	**2 634**	**5 305**	**6 529**	**9 918**	**7 585**	**10 107**	**1 108**
Retirement plans	32 677	134 726	– 2 997	2	5 593	– 126	2 201	3 460	4 684	216	21
Generations Fund	– 576	0	0	0	0	0	0	0	0	0	0
Total debt[3]	**122 441**	**548 918**	**153 996**	**32 942**	**8 227**	**5 179**	**8 730**	**13 378**	**12 269**	**10 323**	**1 129**
Less:											
Financial assets[4]	– 18 934	– 25 013	– 12 896	– 9 709	– 42 360	1 399	2 954	– 2 975	– 4 951	2 034	193
Net debt[5]	**103 507**	**523 905**	**141 100**	**23 233**	**– 34 133**	**6 578**	**11 684**	**10 403**	**7 318**	**12 357**	**1 322**
Less:											
Fixed assets	– 14 077	– 56 637	– 34 324	– 27 569	– 12 429	– 5 076	– 2 289	– 4 561	– 4 235	– 3 751	– 547
Debt representing accumulated deficits[5]	**89 430**	**467 268**	**106 776**	**– 4 336**	**– 46 562**	**1 502**	**9 395**	**5 842**	**3 083**	**8 606**	**775**

Note: The boxes indicate the concept of debt used in the budget papers.
1 Real data before the accounting reform.
2 Since the 2006-2007 public accounts were not yet published, the debt level is that as at March 31, 2006.
3 Most governments do not show the total debt in their budget papers. However, the components of the total debt, i.e. the direct debt and the liability for the retirement plans, are shown in their public accounts.
4 Financial assets, net of other liabilities.
5 A negative sign means that the government is in a net asset or accumulated surplus position.
Sources: Ministère des Finances du Québec and public accounts of governments.

On the basis of the concept of total debt, Québec is the most indebted government in Canada (43.3% of GDP as at March 31, 2007).

CHART 1

Total debt as at March 31, 2007
(as a percentage of GDP)



1 Total debt before the accounting reform.
2 Since the 2006-2007 public accounts were not yet published, the debt level is that as at March 31, 2006.
Sources: Ministère des Finances du Québec, public accounts of governments and Statistics Canada.

2.2 Concepts of debt used by the credit rating agencies

Five agencies assess Québec's credit rating. They are:

- Fitch Ratings;
- Dominion Bond Rating Service (DBRS);
- Standard & Poor's;
- Moody's;
- Japan Credit Rating Agency (JCR).

The credit rating agencies have developed their own concepts of debt to compare various governments among themselves, one of their basic objectives when setting a credit rating.

To that end, the credit rating agencies generally ignore financial assets (other than those dedicated, for instance, to the retirement plans) and fixed assets of governments. Rather, they use concepts such as the direct and guaranteed debt and the commitments under the retirement plans (Moody's) or the debt supported by tax revenues (DBRS). In Québec's case, these concepts of debt result in levels that are less than or equal to the long-term debt of the public sector published by the government.

TABLE 7

Concepts of debt used for Québec by the credit rating agencies[1]
(millions of dollars and as a percentage of GDP, as at March 31, 2007)

Source	Concept	$ million	% of GDP
2007-2008 Budget Plan	Long-term public sector debt	191 720	67.5
Fitch Ratings	Long-term public sector debt	191 720	67.5
DBRS	Total tax-supported debt	158 693	55.8
Standard & Poor's	Net financial liabilities	144 232	50.8
Moody's	Direct and guaranteed debt plus commitments under the retirement plans	131 585	46.3
Japan Credit Rating Agency	Total debt	122 413	43.1

1 Data from the 2007-2008 Budget tabled May 24, 2007.

In general, the credit rating agencies take the public sector debt as a basis and make adjustments to adapt it to their concept and compare it to other governments in Canada and elsewhere in the world. For instance, the main adjustment made by DBRS, Standard & Poor's and Moody's is to exclude the debt of Hydro-Québec in their concept of debt for Québec. The reason for this adjustment is that Hydro-Québec is a commercial enterprise whose revenues are more than sufficient to service its debt.

Concepts of debt used by the credit rating agencies

Fitch Ratings

Fitch uses the long-term public sector debt as shown in the government's budget papers.

Dominion Bond Rating Service

The concept of debt used by DBRS is debt supported by tax revenues.

This concept starts with the government's total debt, to which the agency adds the debt of the health and social services and the education networks, the long-term debt of the Corporation d'hébergement du Québec, the debt of the municipalities and certain other amounts owed.

Standard & Poor's

The concept of debt used by Standard & Poor's is the net financial liabilities.

This concept begins with the government's total debt, to which the agency adds the debt of public sector entities for which the government subsidizes the debt service by means of transfers for the repayment of the principal on borrowings and the payment of interest. These transfers are shown in the government's program spending under subsidized debt service. The entities receiving such transfers are the entities of the health and social services and the education networks, the Corporation d'hébergement du Québec and the municipalities.

Moody's

The concept used by Moody's is the direct debt, the guaranteed debt and commitments under the retirement plans of Québec.

This concept includes the direct and guaranteed debt less the Generations Fund, borrowings made by the government to meet the financing requirements of the Société québécoise d'assainissement des eaux and of certain government enterprises, the guaranteed debt and the government's commitments under the retirement plans. The guaranteed debt corresponds to borrowings made by public sector entities in their own name and guaranteed by the government in the event they are in default of payment.

Japan Credit Rating Agency

JCR uses the government's total debt as shown in the government's budget papers.

3. PRESENTATION OF INFORMATION ON THE DEBT

Along with the work carried out by the Task Force on Government Accounting, the ministère des Finances examined the concept of debt to be used to assess the government's indebtedness.

The concept of debt that seems most relevant is the "debt representing accumulated deficits". This concept is also used by the federal government and the governments of Ontario and Alberta.

The other information on the debt will continue to be published, in particular the concept of "total debt" used for the purposes of reporting on whether the targets stipulated in the *Act to reduce the debt and establish the Generations Fund* have been achieved.

The concept of debt representing accumulated deficits used by the Québec government has many advantages.

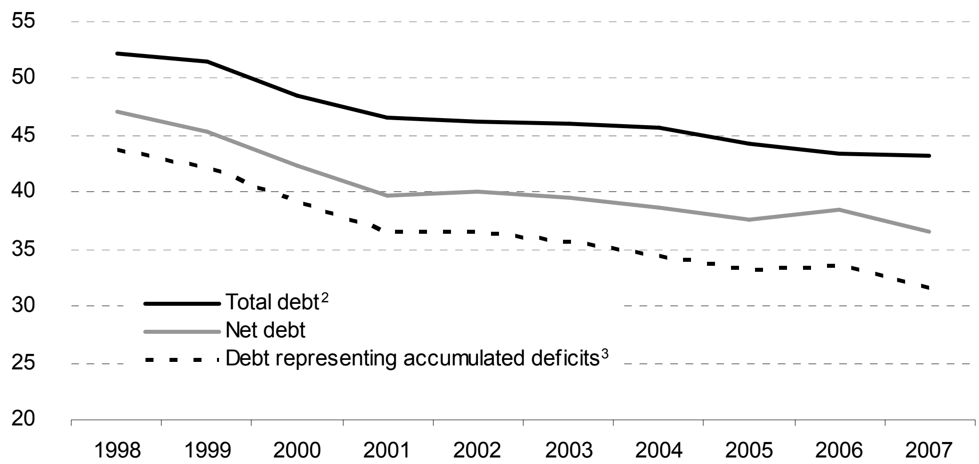
- **Transparency:** it is an indicator that fairly represents the government's real financial position, since it covers all its assets and liabilities.
- **Simplicity:** this concept corresponds to the total of the deficits and surpluses accumulated in the past by the Québec government. It makes it possible to measure the debt that was not used as consideration to finance assets.
- **Comparability:** the indicators of Québec's indebtedness (debt as a proportion of GDP, debt in dollars per capita, etc.) will now be directly comparable with those published by the federal government and the governments of Ontario and Alberta, since the concept of debt used by Québec is also used by these governments to measure their indebtedness.

3.1 The debt representing accumulated deficits

The debt representing accumulated deficits is not a new concept for the Québec government. It has been part of the published budget information for many years.

CHART 2

Québec's debt as at March 31[1]
(as a percentage of GDP)



1 Real data before the accounting reform.
2 Total debt for the purposes of the *Act to reduce the debt and establish the Generations Fund*.
3 Before allocation of the amount placed in the reserve and after inclusion of the net results of the Generations Fund.

As the above chart 2 shows, this change in concept in no way affects the trend of the debt burden in Québec. Regardless of which concept is used, Québec's debt burden as a percentage of GDP has been falling since 1997-1998.

On the basis of this concept, Québec's debt stood at $89.4 billion as at March 31, 2007, representing 31.6% of GDP.

3.2 Impact of the accounting reform on the debt

The government is changing its accounting practices to, in particular, include the entities of the health and social services and the education networks in its reporting entity. Detailed explanations of this reform are given in the *2006-2007 Public Accounts (vol. 1)* and in the *Fall 2007 Update on Québec's Economic and Financial Situation*. The accounting reform prompts the ministère des Finances to make changes to the data on the debt.

The following table shows the impact of the December 2007 accounting reform on the data on the debt according to each concept of debt used by the government.

TABLE 8

Québec's debt as at March 31, 2007
(millions of dollars)

	Before reform	Impact of the accounting reform[1]	After reform
Direct debt	90 340		90 340
Plus: Net retirement plans liability	32 677	167	32 844
Less: Generations Fund	– 576	– 8	– 584
Total debt for the purposes of the *Act to reduce the debt and establish the Generations Fund*	**122 441**	**159**	**122 600**
Plus: Debt of entities consolidated line by line		15 723	15 723
Debt of the SQAE		2 522	2 522
Future social benefits		752	752
Gross debt	**122 441**	**19 156**	**141 597**
Less: Financial assets, net of other liabilities	– 18 934	– 472	– 19 406
Net debt	**103 507**	**18 684**	**122 191**
Less: Fixed assets	– 14 077	– 2 310	– 16 387
Net investment in the health and social services and the education networks:			
– Loans made to the networks by FQ and the CHQ		– 13 322	– 13 322
– Accumulated deficits of the networks		3 439	3 439
Inventories and prepaid expenses		– 162	– 162
DEBT REPRESENTING ACCUMULATED DEFICITS[2]	**89 430**	**6 329**	**95 759**
As a percentage of GDP	**31.6**	**2.3**	**33.9**

SQAE: Société québécoise d'assainissement des eaux.
FQ: Financement-Québec.
CHQ: Corporation d'hébergement du Québec.
1 The impact of the accounting reform on the debt is described at the end of this section.
2 Before allocation of the amount placed in the reserve and after inclusion of the net results of the Generations Fund.

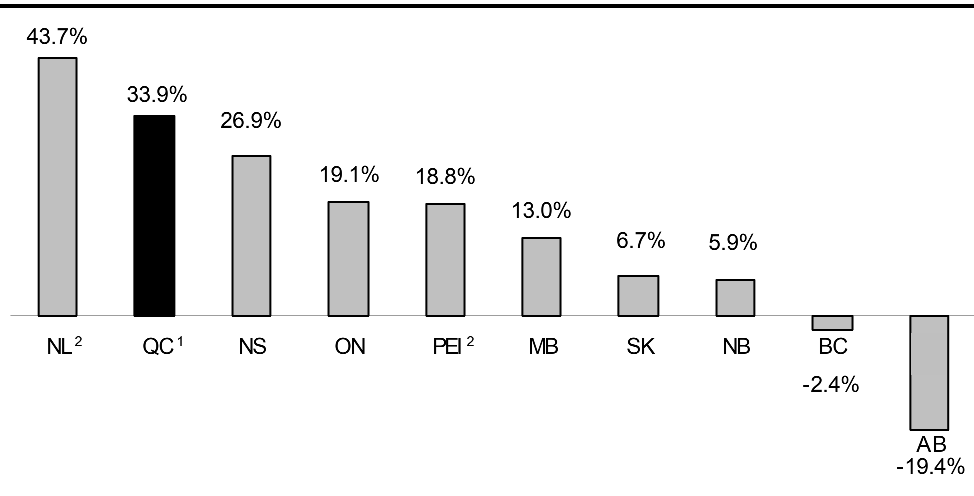
Accordingly, after the accounting reform, the debt representing accumulated deficits amounts to $95.8 billion as at March 31, 2007. It represents 33.9% of GDP and $12 516 per capita.

The concept of total debt is maintained for the purposes of the *Act to reduce the debt and establish the Generations Fund*. Moreover, the concept of gross debt is introduced. It corresponds to the total debt for the purposes of the *Act to reduce the debt and establish the Generations Fund*, to which is added the debt of the entities consolidated further to the accounting reform, as well as the value of the net liability on account of future social benefits previously shown under accounts payable. The gross debt reflects all the government's financial requirements that give rise to borrowings on financial markets. These requirements arise essentially from budget deficits and investments in government corporations and in fixed assets. As at March 31, 2007, the gross debt stood at $141.6 billion.

Subtracting the value of financial assets, net of other liabilities, from the gross debt gives the net debt, which amounted to $122.2 billion as at March 31, 2007. And subtracting the value of fixed assets, the net investment in the networks and the value of inventories and prepaid expenses from the net debt gives the debt representing accumulated deficits.

CHART 3

Debt representing accumulated deficits as at March 31, 2007
(as a percentage of GDP)



1 The debt representing accumulated deficits after the accounting reform. Before allocation of the amount placed in the reserve and after inclusion of the net results of the Generations Fund.
2 Since the 2006-2007 public accounts were not yet published, the debt level is that as at March 31, 2006.
Sources: Ministère des Finances du Québec, public accounts of governments and Statistics Canada.

On the basis of the concept of debt representing accumulated deficits, Québec is the second most indebted province after Newfoundland and Labrador.

Impact of the accounting reform on the debt

The changes made to the accounting method for the Retirement Plans Sinking Fund (RPSF) and the Generations Fund increase the total debt for the purposes of the *Act to reduce the debt and establish the Generations Fund* by $159 million as at March 31, 2007. This impact also extends to the gross debt, the net debt and the debt representing accumulated deficits.

Some items that previously were shown under "other liabilities" of the government are now shown in the gross debt. They are the debt of the Société québécoise d'assainissement des eaux (SQAE) and the future social benefits of government employees (sick leave, vacations and survivor pension plan). As at March 31, 2007, the debt of the SQAE amounted to $2 522 million and future social benefits, $752 million. The reclassification of these items does not increase the debt representing accumulated deficits.

Moreover, inventories and prepaid expenses, previously recorded in the government's expenditures, are now included in non-financial assets, just like fixed assets. The value of inventories and prepaid expenses is $162 million as at March 31, 2007.

The inclusion of the debt of certain organizations whose results are now consolidated line by line causes the gross debt to rise. This is the case of Financement-Québec (FQ), the Corporation d'hébergement du Québec (CHQ), part of the activities of the Société de l'assurance automobile du Québec, the Société de développement de la Baie James and the Société des établissements de plein air du Québec. The debt of these organizations stood at $15 723 million as at March 31, 2007. It is important to point out that the debt of these entities was previously included in the debt of Québec's public sector as a whole. It is now included in the government's debt. Lastly, after the inclusion of the fixed assets of these organizations and the loans made by FQ and the CHQ to the networks to fund their fixed assets, line-by-line consolidation of these organizations reduces the debt representing accumulated deficits by $52 million.

Lastly, under the reform, the development agencies of local health and social services networks, public health establishments, school boards, colleges and the Université du Québec and its constituents are included in the government reporting entity. The inclusion of the accumulated deficits of these entities of the networks affects only the debt representing accumulated deficits. The impact is $3 439 million as at March 31, 2007.

Taken as a whole, the components of the accounting reform increase the debt representing accumulated deficits by $6 329 million as at March 31, 2007.

Impact on the total debt for the purposes of the *Act to reduce the debt and establish the Generations Fund* and on the gross debt
(millions of dollars)

		March 31, 2007
Total debt before the reform		122 441
Impact of the reform:		
– Retirement Plans Sinking Fund		167
– Generations Fund		– 8
Total debt for the purposes of the *Act to reduce the debt and establish the Generations Fund* after the reform		122 600
Impact of the reform:		
– Debt of entities consolidated line by line:		
Financement-Québec	12 073	
Corporation d'hébergement du Québec	3 496	
Other entities	154	15 723
– Debt of the Société québécoise d'assainissement des eaux		2 522
– Future social benefits		752
GROSS DEBT		141 597

Impact of the accounting reform on the debt (continued)

Impact on the debt representing accumulated deficits
(millions of dollars)

		March 31, 2007
Debt representing accumulated deficits before the reform		89 430
Impact of the reform:		
– Retirement Plans Sinking Fund		167
– Generations Fund		– 8
– Entities consolidated line by line:		
Debt	15 723	
Financial assets, net of other liabilities	– 167	
Fixed assets	– 2 286	
Loans made to the networks by FQ and the CHQ	– 13 322	– 52
– Accrual accounting for tax revenues		1 626
– Transfers		418
– Loans at advantageous conditions		331
– Allowance for losses on guaranteed financial initiatives		– 126
– Future social benefits		21
– Currency futures contracts		741
– Inventories and prepaid expenses		– 162
– Other		– 66
– Accumulated deficits of the entities of the networks:		
Health and social services network	2 306	
Education network	1 133	3 439
DEBT REPRESENTING ACCUMULATED DEFICITS AFTER THE REFORM		95 759

Moreover, this accounting reform results in an increase in the debt of Québec's public sector of $2.3 billion. This impact is attributable mainly to the reclassification of future social benefits of government employees in the gross debt ($752 million), that were previously shown under "other liabilities" and the inclusion, in the gross debt of the short-term borrowings of the CHQ ($1 415 million).

As at March 31, 2007, after the reform, the debt of Québec's public sector amounts to $194.1 billion, or 68.6% of GDP.

TABLE 9

Long-term debt of Québec's public sector as at March 31, 2007
(millions of dollars)

	Before the reform	Impact of the accounting reform	After the reform
Gross debt	122 441	19 156	141 597
Health and social services and education networks	14 138	– 12 115	2 023
Hydro-Québec	32 674	—	32 674
Other government enterprises	3 564	– 2 170	1 394
Municipalities and municipal bodies	18 931	– 2 522	16 409
TOTAL	**191 748**	**2 349**	**194 097**
As a % of GDP	**67.8**	**0.8**	**68.6**

CONCLUSION

Along with the work carried out by the Task Force on Government Accounting, the ministère des Finances has re-examined the concept of debt to be used in its budget papers. The concept of debt that seems most appropriate for measuring indebtedness is that of “debt representing accumulated deficits”. This concept is also used by the federal government and the governments of Ontario and Alberta.

The debt representing accumulated deficits has been part of the information published by the Québec government in its budget papers for many years, although it was not used for the purposes of analyzing the financial position.

The concept of debt representing accumulated deficits offers the advantages of simplicity and transparency. In addition, this concept facilitates comparison of Québec’s indebtedness indicators with those of other governments.

The concept of “total debt” will continue to be monitored and shown in the budget papers for the purposes of the *Act to reduce the debt and establish the Generations Fund*. This Act stipulates that the rate of the total debt as a percentage of GDP must reach 25% by March 31, 2026. There is no change to this objective.

APPENDIX 1: GLOSSARY

Direct debt

The direct debt corresponds to the debt that has been contracted on financial markets. It consists of the direct debt of the Consolidated Revenue Fund and debt of the consolidated organizations.

Total debt for the purposes of the *Act to reduce the debt and establish the Generations Fund*

The total debt for the purposes of the *Act to reduce the debt and establish the Generations Fund* includes the direct debt and the net retirement plans liability, from which the balance of the Generations Fund is subtracted.

The Retirement Plans Sinking Fund (RPSF) is an asset constituted by the government to pay the benefits of public and parapublic sector employees. This asset is subtracted from the gross liability for the retirement plans to give the net retirement plans liability.

Note that the debt of organizations whose status is changed in the December 2007 accounting reform and future social benefits are not considered in the concept of total debt for the purposes of the *Act to reduce the debt and establish the Generations Fund*.

Gross debt

The gross debt corresponds to the total of the direct debt and the net retirement plans liability, to which future social benefits are added. The balance of the Generations Fund is subtracted from this amount.

Net debt

The concept of net debt corresponds to the debt that was used to fund fixed assets and the accumulated deficits. It is obtained by subtracting all the government's liabilities from its financial assets.

Debt representing accumulated deficits

The debt representing accumulated deficits corresponds to the total of all the deficits and surpluses accumulated in the past by the Québec government. It is obtained by subtracting non financial assets from the net debt.

Debt of the public sector

The debt of the public sector corresponds to the total of all the long-term debts of organizations in Québec's public sector.

Guaranteed debt

The guaranteed debt corresponds to the debt of certain public sector entities contracted on financial markets in their own name and for which the government guarantees repayment of the principal of the borrowings and the interest in case such entities default on their payment.

Borrowings made in advance

Borrowings made by the Consolidated Revenue Fund during a fiscal year that will be used to meet the financial requirements of the next fiscal year.

APPENDIX 2: GROWTH FACTORS OF THE TOTAL DEBT

The government's total debt (before reform) has increased by $24 056 million since the end of the 1990s, rising from $98 385 million as at March 31, 1998 to $122 441 million as at March 31, 2007.

Main factors responsible for the growth in total government debt
(millions of dollars)

	Debt, beginning of year	Budgetary deficit (surplus)	Investments, loans and advances	Net capital expenditures[1]	Other factors[2]	Generations Fund	Debt, end of year[3]	As a % of GDP
1998-1999	98 385	– 126	1 402	217	1 235		101 113	51.5
1999-2000	101 113	– 7	2 006	359	– 1 351		102 120	48.4
2000-2001	102 120	– 427	1 632	473	1 050		104 848	46.6
2001-2002	104 848	– 22	1 142	995	212		107 175	46.3
2002-2003	107 175	728	1 651	1 482	306		111 342	46.1
2003-2004	111 342	358	1 125	1 019	881		114 725	45.8
2004-2005	114 725	664	979	1 083	– 855		116 596	44.4
2005-2006	116 596	– 37	1 182	1 166	– 605		118 302	43.4
2006-2007	118 302	– 20	1 977	1 117	1 641	– 576	122 441	43.3
TOTAL		**1 111**	**13 096**	**7 911**	**2 514**	**– 576**		

Note: Real data before the accounting reform.
1 Investments in fixed assets made during the year less the annual depreciation expense.
2 Includes in particular the change in "other accounts", such as accounts receivable and accounts payable, as well as exchange losses (gains) following the re-valuation as at March 31 of the debt in foreign currencies.
3 Excluding borrowings made in advance.

This increase is attributable mainly to investments by the government in:

- government corporations of $13 096 million, 54.4% of the increase;
- fixed assets (essentially roads) of $7 911 million, 32.9% of the increase.

Moreover, during this period, deficits totalling $1 111 million were incurred because of exceptional losses at the Société générale de financement du Québec (SGF) of $697 million ($339 million in 2002-2003 and $358 million in 2003-2004) and the recognition of an allowance in 2004-2005 for the pay equity payment ($673 million). These deficits caused the debt to rise.

❑ Investments in government corporations

Each year, the government allows public enterprises to keep part of their earnings so that they can fund productive investments.

- In the case of Hydro-Québec, the government receives 50% of the corporation's profits as dividends; the government allows it to keep the other half of its profits to fund its investments in fixed assets, for instance, the construction of dams.
- The profits the government leaves with Hydro-Québec therefore constitute an investment by the government in this corporation. It is not a current expenditure.
- The result is an increase in the government's financial requirements and therefore its debt.

This practice was implemented in the 1986 accounting reform further to requests from the Auditor General.

- It is fully consistent with generally accepted accounting principles (GAAP).

These investments contribute to Québec's economic growth and benefit society as a whole.

❑ Investments in fixed assets

The same holds true for investments the government makes each year in its infrastructures (roads, buildings, land, etc.) and that require borrowings.

At the time they are made, these investments are carried to the government's balance sheet. Subsequently, they are gradually charged to expenditure based on their useful life (depreciation expense).

This practice is strictly consistent with GAAP.

Overall, the debt since March 31, 1998 has been incurred to finance assets.

APPENDIX 3: RETIREMENT PLANS

The Québec government participates financially in the retirement plans of its employees. As at December 31, 2006, these plans had 521 863 participants and 243 807 people receiving benefits.

Retirement plans for public and parapublic sector employees as at December 31, 2006

	Active participants	People receiving benefits
Government and Public Employees Retirement Plan (RREGOP)	485 000	146 953
Pension Plan of Management Personnel (PPMP)	26 150	17 595
Other plans:		
Teachers Pension Plan (TPP) and Pension Plan of Certain Teachers (PPCT)[1]	825	49 037
Civil Service Superannuation Plan (CSSP)[1]	950	23 974
Superannuation Plan for the Members of the Sûreté du Québec (SPMSQ)	5 200	4 269
Pension Plan of Peace Officers in Correctional Services (PPPOCS)	3 100	1 268
Pension Plan of the Judges of the Court of Québec (PPJCQ)	270	314
Pension Plan for Federal Employees Transferred to Employment with the Gouvernement du Québec (PPFEQ)	245	100
Pension Plan of the Members of the National Assembly (PPMNA)	123	297
Total other plans	10 713	79 259
TOTAL	**521 863**	**243 807**

1 Since July 1, 1973, these plans have stopped accepting new participants.
Source: Commission administrative des régimes de retraite et d'assurances.

These are defined benefit pension plans, meaning they guarantee a level of income to participants at time of retirement. Benefits are calculated on the basis of participants' average income for the best paid years (generally five) and their number of years of service. The retirement pension represents 2% of the employee's average income per year of service, to a maximum of 70%. Benefits are partially indexed to inflation.

The Commission administrative des régimes de retraite et d'assurances (CARRA) administers the retirement plans. The government disbursed $3 533 million in 2006-2007 to cover its share of benefits paid to its retired employees.

❑ The retirement plans liability

The government presents in its financial statements the present value of the retirement benefits it will pay to its employees, taking into account the conditions of their retirement plans and their years of service. This value is called the retirement plans liability.

The actuarial valuations of the liability of the various retirement plans are carried out by the CARRA, following the rules of the Canadian Institute of Actuaries (CIA) and the Canadian Institute of Chartered Accountants (CICA) for the public sector.

The liability for the government's retirement plans was $59 721 million as at March 31, 2007. This amount is recognized in full in the government's total debt.

❑ The annual expenditure for the retirement plans

As an employer, the government records its expenditure regarding the retirement plans each year.

In 2006-2007, this expenditure amounted to $1 875 million. It has two components:

— the net cost of vested benefits, i.e. the present value of retirement benefits that employees have accumulated for work done during the year, amounting to $1 493 million;

— the amortization of adjustments to the government's actuarial obligations arising from updating actuarial valuations, for a cost of $382 million in 2006-2007.

Expenditure for the retirement plans
(millions of dollars)

	2006-2007
Net cost of vested benefits	1 493
Amortization of adjustments stemming from actuarial valuations	382
EXPENDITURE FOR THE RETIREMENT PLANS	**1 875**

The Retirement Plans Sinking Fund

The Retirement Plans Sinking Fund (RPSF) was set up in 1993. It is an asset that will be used to pay the retirement benefits of public and parapublic sector employees.

As at March 31, 2007, the value of the RPSF stood at $26 877 million (after the changes made to the accounting for the RPSF as part of this accounting reform).

❑ Deposits to the RPSF have no impact on the total debt

To make deposits to the RPSF, the government issues bonds on financial markets. However, deposits to the RPSF do not affect the government's total debt.

The amount of the borrowings carried out to make the deposits increases the direct debt. However, the deposits to the RPSF reduce, simultaneously and for the same amount, the net retirement plans liability. Therefore, the net impact on the total debt is nil.

Illustration of the impact on the government's total debt of borrowing $1 billion on financial markets for deposit to the RPSF[1]
(millions of dollars)

		Before deposit	After deposit	Change
(A)	Direct debt	89 340	90 340	1 000
	Retirement plans liability	59 721	59 721	0
	Less: RPSF	– 25 877	– 26 877	– 1 000
(B)	Net retirement plans liability	33 844	32 844	– 1 000
(C)	Total debt before the Generations Fund (C=A+B)	123 184	123 184	0
(D)	Less: Generations Fund	– 584	– 584	0
(E)	**TOTAL DEBT FOR THE PURPOSES OF THE *ACT TO REDUCE THE DEBT AND ESTABLISH THE GENERATIONS FUND* (E=C+D)**	**122 600**	**122 600**	**0**

1 Illustration based on real data as at March 31, 2007 after the accounting reform.

❑ A reduction in debt service

Deposits to the RPSF cause the government's debt service to decrease. The rates of return obtained on funds managed by the Caisse de dépôt et placement du Québec are generally higher than the interest rates on Québec government bonds issued to fund deposits to the RPSF. Accordingly, the revenue of the RPSF, which is recorded as a decrease in the government's debt service, is generally higher than the additional interest expense arising from the new borrowings. The result is a net reduction in the government's debt service.

❑ A flexible deposit policy

In December 1999, as part of the agreement for the renewal of the collective agreements of state employees, the government set as an objective that the amounts accumulated in the RPSF be equal, in 2020, to 70% of its actuarial obligations for the retirement plans of public and parapublic sector employees.

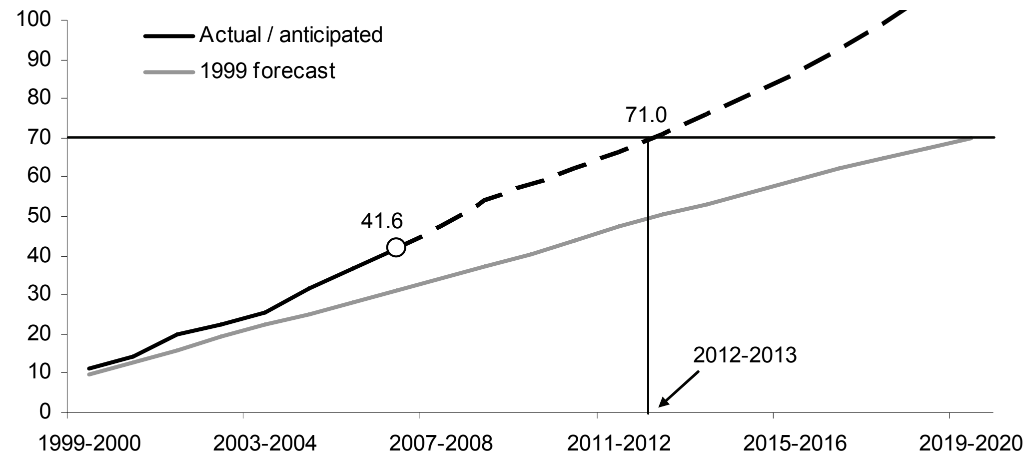
However, the government has the flexibility it needs in applying this policy. Deposits are made to the RPSF only when conditions on financial markets are favourable, in particular regarding interest rates and market receptivity to bond issues.

❑ The results of deposits made so far

As at March 31, 2007, the assets of the RPSF stood at $26 877 million and are now equivalent to almost 42% of the government's actuarial obligations for the retirement plans of public and parapublic sector employees.

As a result of the expected deposits and returns over the next few years, the 70% target should be achieved seven years earlier than forecast, i.e. in 2012-2013, which is a definite improvement compared to the objective set in December 1999. Indeed, the RPSF should represent 100% of actuarial obligations in 2020.

The RPSF as a proportion of the government's actuarial obligations for the retirement plans of public and parapublic sector employees
(percent)



❑ Investment policy

The RPSF's assets are managed by the Caisse de dépôt et placement du Québec according to an investment policy set by the Minister of Finance.

This policy stipulates a diversified investment portfolio that includes, in particular, fixed-income securities (e.g.: bonds), investments in equity markets and investments in other categories (e.g.: real estate, private placements, infrastructures).