

# SOUND PUBLIC FINANCES TO PROTECT OUR VALUES

A RETURN  
TO BALANCED  
BUDGETS  
BY 2013-2014

**2010** Budget  
**11**

Pre-budget  
consultations



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**2010-2011 Budget - Pre-budget consultations**  
**SOUND PUBLIC FINANCES TO PROTECT OUR VALUES**  
**A RETURN TO BALANCED BUDGETS BY 2013-2014**

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## INTRODUCTION

Over the past year, most major advanced economies have experienced the worst recession since the Great Depression. In Québec, as in Canada, the economic downturn was not as deep as in previous recessions. Accordingly, the decline in real GDP should be less severe in Québec in 2009 than in the large advanced economies. It should amount to 1.5% in Québec compared with 2.3% in Canada and 2.6% in the United States.

Québec has fared better largely because of the measures put in place by the government. Another contributing factor is the good performance of the housing market and the importance of the aerospace industry, which was not hit as hard as the automobile industry.

Québec's economy should resume growing, though at a modest rate, in the fall of 2009. In 2010, real GDP growth should average 1.7%. Economic recovery should gather pace as of 2011. However, the forecast recovery over the coming years will only partially compensate for the loss of output caused by the recession, mainly the American market, our largest trading partner, will recover more slowly than in the past.

The government's budgetary situation has not escaped the repercussions of the recession. Since late 2008, the government has had to deal with a substantial drop in revenue, attributable to the decline in economic activity and the additional cost of expenditures arising from support measures for the economy and employment announced in its action plan.

Accordingly, as the fall 2009 *Update on Québec's Economic and Financial Situation* has confirmed, the deficits expected for 2009-2010 and 2010-2011 have been adjusted upward to \$4.7 billion in each of these two years. In this regard, the government's strategy is to:

- adjust the forecast deficits for 2009-2010 and 2010-2011 upward in order not to hamper economic recovery;
- implement the measures needed to achieve the initial targets stipulated in the Plan to return to balanced budgets starting in 2011-2012 and thus eliminate the deficit by 2013-2014.

The deficits for the next five years are now estimated at \$13.2 billion, taking the Plan to return to balanced budgets into account, which is \$1.7 billion more than forecast last March. This adjustment is attributable to the rise in the deficits in 2009-2010 and 2010-2011.

In this document, the government is reiterating its determination to implement its Plan to return to balanced budgets once the economic recovery is well under way. This document:

- presents the government's five-year economic and budget forecasts;
- provides an overview of the challenging budgetary situation facing us over the coming years;
- confirms the government's commitment to initiate the measures needed to reduce the deficit in 2010-2011, as stipulated in the Plan to return to balanced budgets, in particular by:
  - reducing the increase in program spending by \$869 million to limit its growth rate to 3.2%;
  - providing Revenu Québec with additional resources to intensify measures to counter tax evasion and avoidance as stipulated in the plan;
- initiates the pre-budget consultations aimed at involving the public in the choices that must be made and the ways to achieve our economic and budgetary objectives.

Restoring fiscal balance is not an end in itself, but rather an unavoidable passage to protect and maintain the quality of public services for the generations that benefit from them now and those to come.

A return to balanced budgets also implies difficult choices that concern us all. The measures identified in this document are designed to continue the process begun in the last budget. A process that calls on all Quebecers and is consistent with the government's commitment to begin preparing Québec's future today.

# 1. QUÉBEC'S ECONOMIC AND FINANCIAL SITUATION

## 1.1 Economic outlook for 2009-2013<sup>1</sup>

The decline in international economic activity in the winter of 2009 was more significant than forecast in the budget, chiefly because of the deteriorating situation in the United States, Europe and Japan. That resulted in a downward adjustment to global real GDP for 2009. Still, within the last few months, signs of improvement in economic activity have emerged in many regions of the world, pointing to a gradual recovery in the global economy starting in the fall of 2009.

In Québec, with an expected decline in real GDP of 1.5% in 2009, the current recession will be more severe than anticipated, since an economic contraction of 1.2% had been forecast in the budget. Still, unlike the situation in the United States and in most large industrialized countries, the current recession in Québec will be less severe than the two previous ones, when real GDP fell 3.6% in 1982 and 2.7% in 1991. Québec was better able to resist international turmoil because of massive public investments, the good performance of the housing market and the importance of the aerospace industry, which fared better than the automobile industry.

Real GDP growth should average 1.7% in 2010, thanks in particular to the recovery in personal spending, non-residential investment and exports to the United States.

Economic growth should accelerate subsequently and average 2.5% per year from 2011 to 2013. However, real GDP growth over the coming years will not be enough to offset the loss of output caused by the recession, mainly because of a slower recovery in the American economy than had been the case in the past.

Furthermore, after gaining 2.2% in 2008, nominal GDP, on which growth in government revenue depends, will decline by 0.6% in 2009. Next year, the expected economic recovery will result in an increase of 3.8% in Québec's nominal GDP. For the three years after that, nominal GDP should increase by an average of 4.4% per year.

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1 For a more detailed explanation of economic developments in 2009 and 2010, see section 1, "Economic outlook" of the *Update on Québec's Economic and Financial Situation*, fall 2009.

The section on Québec's medium-term economic outlook, given in an appendix, provides a more detailed look at how Québec's economy is expected to perform over the next five years.

- It should be noted that the forecasts of the ministère des Finances du Québec take into account the Plan to return to balanced budgets which stipulates the elimination of deficits by 2013-2014.

TABLE 1

**Economic outlook for Québec – 2008-2013**

(percentage change)

	Real GDP				Nominal GDP			
	2008	2009	2010	Average 2011-2013	2008	2009	2010	Average 2011-2013
Update – Fall 2009	1.0	– 1.5	1.7	2.5	2.2	– 0.6	3.8	4.4
2009-2010 Budget	0.8	– 1.2	1.9	2.5	2.4	– 0.1	3.9	4.5

Source: Ministère des Finances du Québec.



## 1.2 The impact of the recession on the government's budgetary situation

The global financial crisis and the recession caused the government's budgetary situation to deteriorate significantly.

Furthermore, the negative adjustment to the outlook for 2009 and 2010 creates additional pressure on public finances that will require stepping up the effort needed to return to balanced budgets.

### □ The government's budgetary forecasts affected by the recession

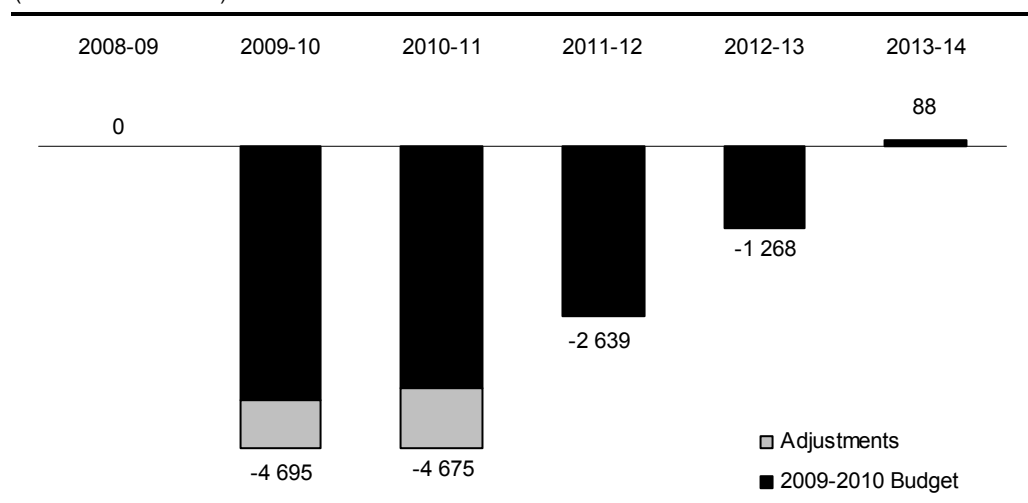
After taking into account the adjustments to economic growth released in the *Update on Québec's Economic and Financial Situation*, the government's budgetary forecasts now show that the expected deficits are adjusted upward by \$749 million for 2009-2010, \$915 million for 2010-2011, and by some \$1.3 billion for each of the subsequent three years.

— Given this situation, the government is adjusting the deficits to \$4.7 billion in 2009-2010 and 2010-2011 and intends to identify further necessary measures to maintain the initial deficit targets stipulated in the March 2009 budget for 2011-2012 to 2013-2014. Accordingly, the shortfall for the next five years will reach \$13.2 billion, after implementation of the Plan to return to balanced budgets, i.e. \$1.7 billion more than forecast last March.

CHART 1

### Budgetary balance after the Plan to return to balanced budgets

(millions of dollars)



■ **Additional restraint measures to meet the statutory requirements**

It should be borne in mind that Bill 40 (S.Q. 2009, c. 38), recently passed by the National Assembly, stipulates that in 2009-2010 and 2010-2011, the government may run deficits that are justified by the economic situation. Nonetheless, as of 2011-2012, the government will have to identify the measures necessary to meet the declining deficit objectives set to gradually return to balanced budgets by 2013-2014.

- Taking into account the update to the five-year budgetary forecasts, the additional measures that need to be identified to eliminate the deficit by 2013-2014 now stand at \$5.1 billion, an increase of \$1.3 billion over the \$3.8 billion forecast in the last budget.

## ❑ Four factors that account for the deficits

Compared to the 2008-2009 Budget, i.e. even before the recession started, four major factors account for the revenue shortfall in the coming years:

- a growth outlook far below expectation, leading to a drop in the government's revenue of some \$3 billion in 2009-2010 and 2010-2011;
- program spending raised to \$60 billion for 2009-2010, i.e. \$1.1 billion more than forecast;
- financing of economic support measures amounting to \$976 million in 2009-2010 and \$757 million in 2010-2011;
- unilateral changes by the federal government to the equalization program in the fall of 2008.

Lastly, the deficit expected in 2010-2011 is mitigated by the implementation of \$1.1 billion in restraint measures, as stipulated in the Plan to return to balanced budgets tabled with the last budget.

TABLE 2

### Adjustments to the budgetary balance since the 2008-2009 Budget

(millions of dollars)

	2009-2010 <sup>P</sup>	2010-2011 <sup>P</sup>
<b>BUDGETARY BALANCE IN THE 2008-2009 BUDGET</b>	<b>0</b>	<b>- 143</b>
<b>Decline in revenue</b>		
Economic slowdown	- 2 853	- 2 735
Hydro-Québec	—	- 300
Equalization:		
– Changes by the federal government in the fall of 2008	- 75	- 695
– <i>Update on Québec's Economic and Financial Situation</i> – fall 2009	—	- 225
	<b>- 2 928</b>	<b>- 3 955</b>
<b>Rise in spending</b>		
Increase in the program spending objective	- 1 051	- 1 171
Economic support measures <sup>1</sup>	- 976	- 757
Reduction in debt service	865	218
	<b>- 1 162</b>	<b>- 1 710</b>
Stabilization reserve	- 14	—
Provision for revenue shortfalls	- 300	—
Impact of the Plan to return to balanced budgets	—	1 065
Other factors	- 291	68
<b>BUDGETARY BALANCE – FALL 2009</b>	<b>- 4 695</b>	<b>- 4 675</b>

P: Projections.

1 Including tax expenditures.

## 1.3 The government's strategy

Given this exceptional situation, the government acted immediately to deal with the recession and emerge from it as quickly as possible. Its strategy is based on two components:

- first, support the economy and foster recovery;
- then, once the recovery is well under way and is sustainable, return to balanced budgets.

### □ First, get through the crisis

From the onset of the recession, the government acted quickly and vigorously to support the economy and employment.

In this regard, the measures announced over the past year will inject almost \$15.5 billion into the economy in 2009 and 2010. Essentially, the government has acted in five major areas:

- additional immediate actions to support businesses and workers;
- investments in public infrastructure;
- support for households, especially families and seniors;
- corporate tax reduction to stimulate investment;
- preparing Québec for economic recovery.

## ■ Government support among the most substantial anywhere

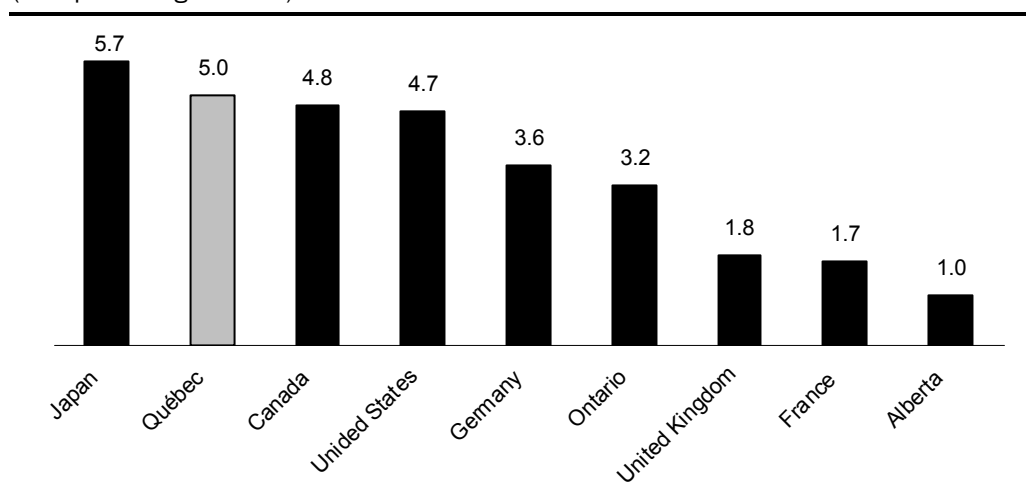
The impact of the government's action to support the economy and prepare for recovery puts Québec among the jurisdictions that have deployed the most substantial efforts to get through the recession.

Accordingly, for 2009 and 2010, the additional cash resources injected into the economy represent:

- in Québec, \$15.5 billion from the Québec government, i.e. 5.0% of GDP;
- in Canada, \$74.2 billion from the federal government, i.e. 4.8% of GDP;
- in Ontario, \$18.3 billion from the provincial government, i.e. 3.2% of GDP;
- in the United States, US\$675.0 billion from the federal government, i.e. 4.7% of GDP.

CHART 2

### Government action for economic recovery (as a percentage of GDP)



Sources: Sources: Ministère des Finances du Québec, Department of Finance Canada, Congressional Budget Office and U.S. Treasury.

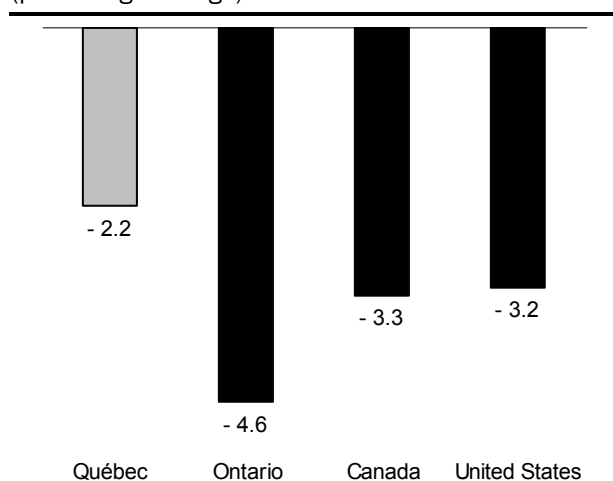
## ■ Convincing results

The measures put into place by the government to get through and emerge from the crisis quickly have produced results. They have helped reduce the impact of the global recession on our economy, and have limited job losses.

- In 2009, the 2.2% contraction of Québec's economy is less severe than elsewhere. In fact, the decline reached 3.3% in Canada and 3.2% in the United States.
- As for employment, the labour market has also been hit less hard than in other jurisdictions, especially in Ontario where the unemployment rate is now higher than in Québec. The 1.6% decline in employment over the past year has pushed the unemployment rate to 8.8% in Québec, compared with 9.2% in the neighbouring province.

CHART 3

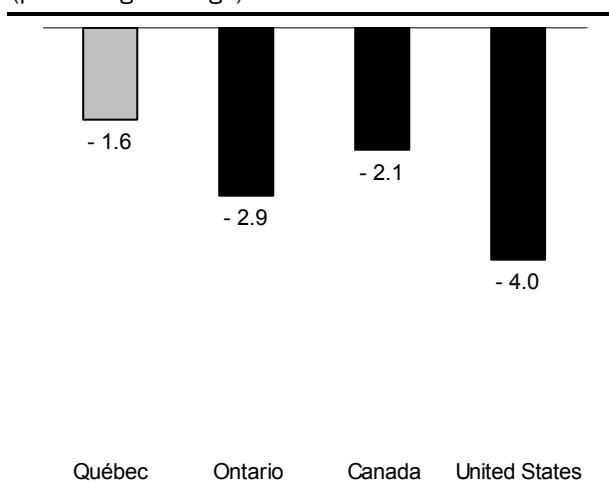
**Change in output between the third quarter of 2008 and the second quarter of 2009**  
(percentage change)



Sources: Statistics Canada, IHS Global Insight and Ontario Ministry of Finance.

CHART 4

**Change in employment between October 2008 and September 2009**  
(percentage change)



Sources: Statistics Canada and IHS Global Insight.

## ■ Limited impact on public finances

In 2009, Québec's budget deficit as a percentage of GDP will be one of the lowest among the advanced economies at 1.6%. By way of comparison, the budget deficit as a percentage of GDP will be 3.7% for the federal government and 9.9% in the United States.

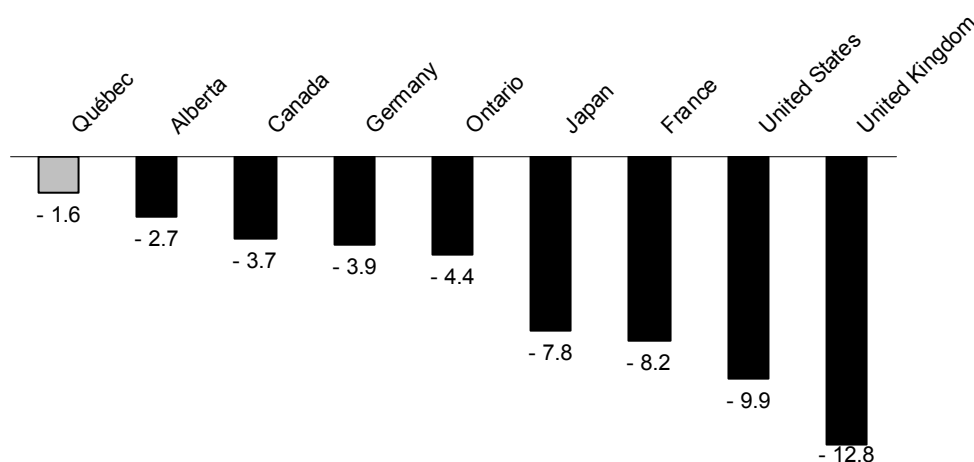
Moreover, many provincial governments have adjusted their respective deficit upward by a greater proportion than Québec. Examples include:

- Ontario, where the relative weight of its deficit in the economy in 2009 is rising from 2.4% to 4.4%. Its deficit now stands at \$24.7 billion, i.e. \$10.6 billion more than when the province's last budget was tabled;
- Alberta, which adjusted its deficit to \$6.9 billion in 2009, i.e. 2.7% of its GDP, after it was initially estimated at \$4.7 billion, i.e. 1.8% of GDP.

CHART 5

### Budget deficit in 2009

(as a percentage of GDP)



Sources: Ministère des Finances du Québec, governments' public accounts and Statistics Canada.

## □ Returning to balanced budgets

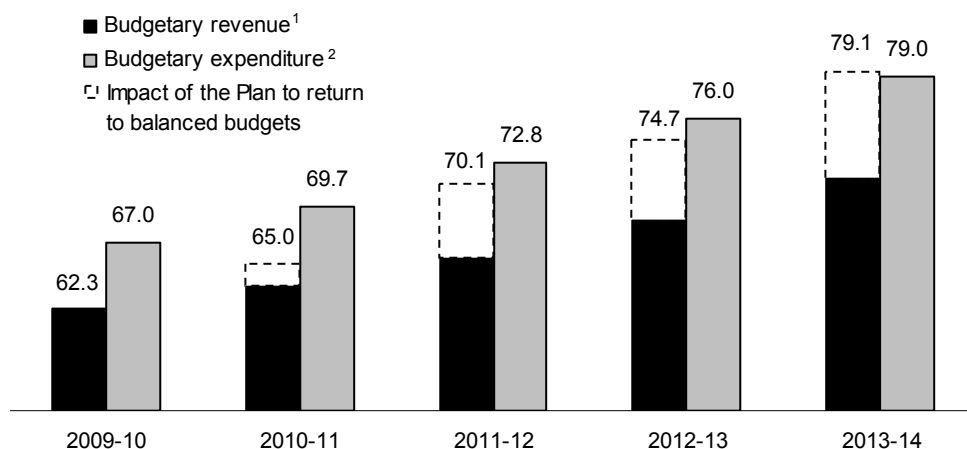
The government's budgetary forecasts show that at the time the economy recovers, the gap that emerged between revenue and spending during the recession remains significant. This revenue shortfall of \$4.7 billion in 2009-2010 will have to be eliminated gradually to ensure balanced public finances in the long run.

- In 2008-2009 and 2009-2010, the recession is eroding the government's revenues while the government maintained spending growth to support the economy.
- As of 2010-2011, revenue growth will be insufficient to fully offset the gap thus created. In fact, this gap could exceed \$7 billion by 2013-2014 if nothing is done.

In this context, the government must take the necessary measures to return to a balance between its revenue and its spending, failing which it will be faced with persistent deficits.

CHART 6

### Revenue and expenditure from 2009-2010 to 2013-2014 (billions of dollars)



- 1 Including the net results of the consolidated entities, the provision for revenue shortfalls and the stabilization reserve.
- 2 Including payments to the Generations Fund and taking into account program spending growth of 3.2% as of 2010-2011.



## ■ Five-year financial framework: eliminate the deficit by 2013-2014

The update to the government's budgetary forecasts brings the expected deficits for the period from 2009-2010 to 2013-2014 to \$13.2 billion after implementation of the Plan to return to balanced budgets, i.e. \$1.7 billion more than in the 2009-2010 Budget.

Accordingly, the additional measures that need to be identified to meet the targets of the Plan to return to balanced budgets as of 2010-2011 amount to \$5.1 billion by 2013-2014, an increase of \$1.3 billion compared to what was forecast last March.

TABLE 3

### 2009-2014 budgetary forecasts after the Plan to return to balanced budgets

(millions of dollars)

	Real	Forecasts		Projections		
	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
<b>BUDGETARY TRANSACTIONS</b>						
<b>Budgetary revenue</b>						
Total own-source revenue	48 893	46 869	48 619	50 886	53 207	55 375
% change	-1.2	-4.1	3.7	4.7	4.6	4.1
Federal transfers	14 023	15 156	14 966	14 594	14 824	15 593
% change	2.9	8.1	-1.3	-2.5	1.6	5.2
<b>Total budgetary revenue</b>	<b>62 916</b>	<b>62 025</b>	<b>63 585</b>	<b>65 480</b>	<b>68 031</b>	<b>70 968</b>
<b>% change</b>	<b>-0.3</b>	<b>-1.4</b>	<b>2.5</b>	<b>3.0</b>	<b>3.9</b>	<b>4.3</b>
<b>Budgetary expenditure</b>						
Program spending	-58 550	-60 139	-62 049	-64 019	-66 050	-68 145
% change	6.8	2.7	3.2	3.2	3.2	3.2
Debt service	-6 504	-6 154	-6 764	-7 796	-8 912	-9 768
% change	-7.4	-5.4	9.9	15.3	14.3	9.6
<b>Total budgetary expenditure</b>	<b>-65 054</b>	<b>-66 293</b>	<b>-68 813</b>	<b>-71 815</b>	<b>-74 962</b>	<b>-77 913</b>
<b>% change</b>	<b>5.2</b>	<b>1.9</b>	<b>3.8</b>	<b>4.4</b>	<b>4.4</b>	<b>3.9</b>
<b>Net results of consolidated entities</b>	<b>880</b>	<b>155</b>	<b>369</b>	<b>488</b>	<b>612</b>	<b>687</b>
Provision for revenue shortfalls	—	-300	—	—	—	—
<b>DEFICIT</b>	<b>-1 258</b>	<b>-4 413</b>	<b>-4 859</b>	<b>-5 847</b>	<b>-6 319</b>	<b>-6 258</b>
<b>BALANCED BUDGET ACT</b>						
<b>Plan to return to balanced budgets</b>						
- Measures already identified in the 2009-2010 Budget	—	—	615	1 590	1 950	2 360
- Additional measures to be identified	—	—	450	2 576	4 140	5 114
<b>Impact of the Plan to return to balanced budgets</b>	<b>—</b>	<b>—</b>	<b>1 065</b>	<b>4 166</b>	<b>6 090</b>	<b>7 474</b>
Deposit of dedicated revenues in the Generations Fund	-587	-715	-881	-958	-1 039	-1 128
Stabilization reserve	1 845	433	—	—	—	—
<b>BUDGETARY BALANCE – FALL 2009</b>	<b>0</b>	<b>-4 695</b>	<b>-4 675</b>	<b>-2 639</b>	<b>-1 268</b>	<b>88</b>



## 2. THE IMPORTANCE OF TIMELY ACTION

Québec has withstood the international economic turmoil better than its major trading partners.

However, unlike many other jurisdictions, we carry a heavier debt load and our population is aging more rapidly, two factors that must prompt us to give immediate consideration to the initiatives that will restore order to public finances.

It is crucial that we seize this short-term leeway provided by the resistance of Québec's economy and use it as a lever to act at the right time, while other economies are more severely affected and by the same token more constrained to carry out short-term measures.

Any delay or hesitation will inevitably result in a larger deficit and a heavier debt load, consequently forcing even more difficult decisions on us with even greater consequences.

### **□ Act without compromising recovery efforts**

The Plan to return to balanced budgets, tabled in the last budget, seeks to eliminate budget deficits by 2013-2014.

The plan contains specific measures as well as additional measures to be identified, whose measured implementation will help to gradually reduce budget deficits without compromising economic recovery efforts.

Accordingly, the government's strategy is to:

- adjust the deficits for 2009-2010 and 2010-2011 upward to avoid hindering economic recovery;
- confirm the implementation of the measures already stipulated in the Plan to return to balanced budgets for 2010-2011;
- consult with the public on the additional measures needed to achieve the initial targets in the Plan to return to balanced budgets starting in 2011-2012 and thus eliminate the deficit by 2013-2014.

## 2.1 Avoid using measures fraught with consequences

In the early 1990s, Québec was still grappling with chronic, growing deficits.

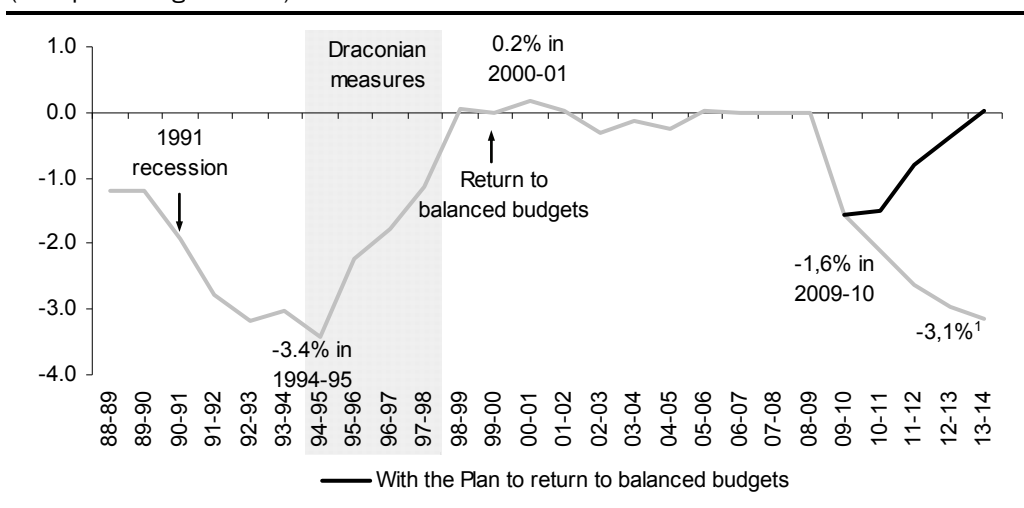
To put an end to them, the government applied severe measures, resulting in drastic cuts to health and education spending, and leading to a significant degradation in the quality of public services.

Nobody wants to go through that again, hence the importance of preparing for the return to balanced budgets now.

- If nothing is done, the budget deficit could reach 3.1% of GDP in 2013-2014, a level similar to the low point recorded in 1994.

CHART 7

**The Québec government's budgetary balance from 1988-1989 to 2013-2014**  
(as a percentage of GDP)



1 Assuming program spending growth of 4.6% per year, i.e. the average growth over the last seven years.

## 2.2 Limit our debt load

Québec's debt load weighs heavily on its public finances. The expenses it generates in terms of borrowing costs significantly limit the government's leeway to fund other government missions.

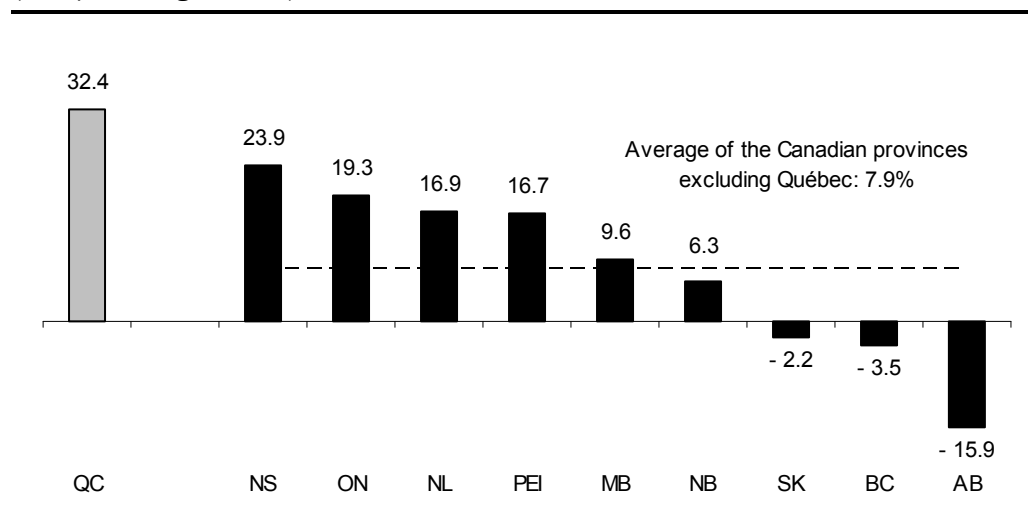
The successive deficits posted from the end of the 1970s to the mid-1990s caused the public debt to grow substantially. As a result of these deficits, Québec still carries the heaviest debt burden among the provinces of Canada and, in this regard, does not have the same leeway as its neighbours to incur additional deficits.

- The debt representing accumulated deficits stood at \$98.5 billion, representing 32.4% of GDP as at March 31, 2009, 25 percentage points higher than the average of the other provinces.
- A debt load similar to the average of the other provinces would mean almost \$90 billion less debt for Québec, a reduction of 91% compared with the existing debt.

In addition, over the coming years, the debt load will rise by further significant amount because of deficits of \$13.2 billion expected until 2013-2014.

CHART 8

### Debt representing accumulated deficits<sup>1</sup> as at March 31, 2009 (as a percentage of GDP)



1 A negative sign means that the government is in an accumulated surplus position.

2 After taking the stabilization reserve into account.

Sources: Ministère des Finances du Québec, governments' public accounts, 2009-2010 budget of Newfoundland and Labrador and Statistics Canada.

## ❑ Increased pressure of borrowing costs on the funding of public services

Unlike the prevailing situation over the last decade, the service on the debt of the Consolidated Revenue Fund will rise substantially over the coming years.

- Currently, the government allocates almost 10 cents per dollar of revenue to pay interest on the debt of the Consolidated Revenue Fund, making that the third largest item in its spending budget, after health and education.

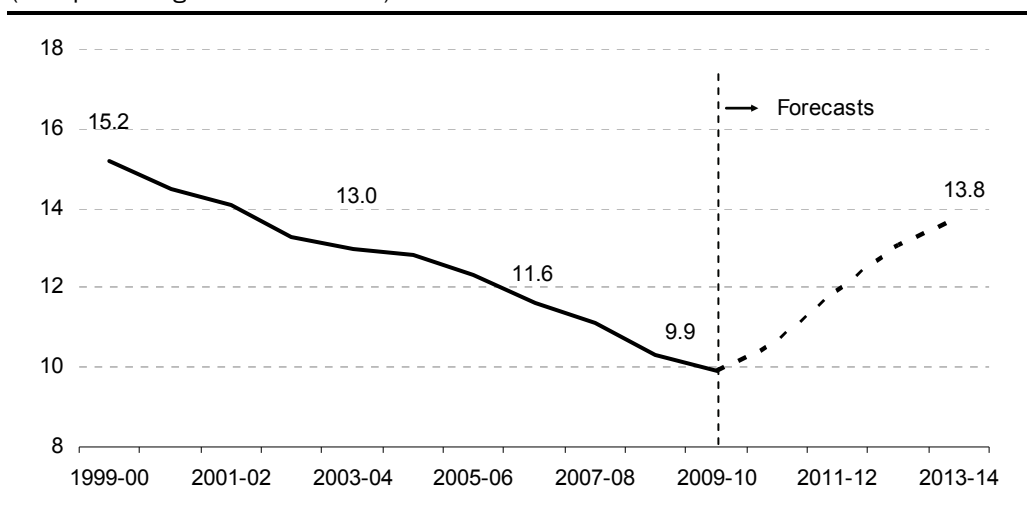
The forecast rise in interest rates, the increase in the debt stemming from the forecast deficits of 2009-2010 to 2012-2013 and the impact of the losses of the Caisse de dépôt et placement du Québec in 2008 on the income in subsequent years of the Retirement Plans Sinking Fund, will add significantly to the government's debt service. Consequently, the government's leeway to fund public services will be reduced.

- In 2013-2014, nearly 14 cents per dollar of revenue will be allocated to debt service and thus will not be available to the government to fund public services.

CHART 9

### Debt service of the Consolidated Revenue Fund

(as a percentage of total revenue)



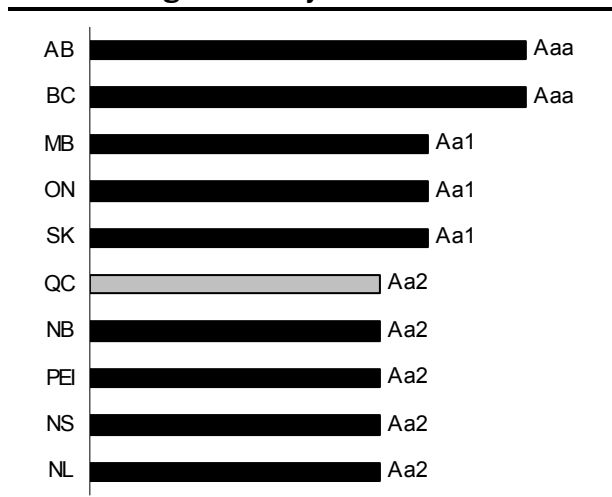
## ❑ A matter of concern to the credit rating agencies

The debt load is one of the important factors credit rating agencies take into account in assigning a credit rating. In Québec's case, the agencies have made clear their concerns over the size of the debt. They welcomed the creation of the Generations Fund in 2006 as well as the decision, announced in the Budget last March, to continue with payments to the Generations Fund despite the recession.

Moreover, in the analyses they have released since the beginning of 2009, the agencies have underscored the importance, for the provinces, of having a Plan to return to balanced budgets and to keep to it. If a province did not meet its undertakings in this regard, it would risk a downgrade to its credit rating, which would reduce the pool of investors wishing to hold its securities and lead to higher borrowing costs.

CHART 10

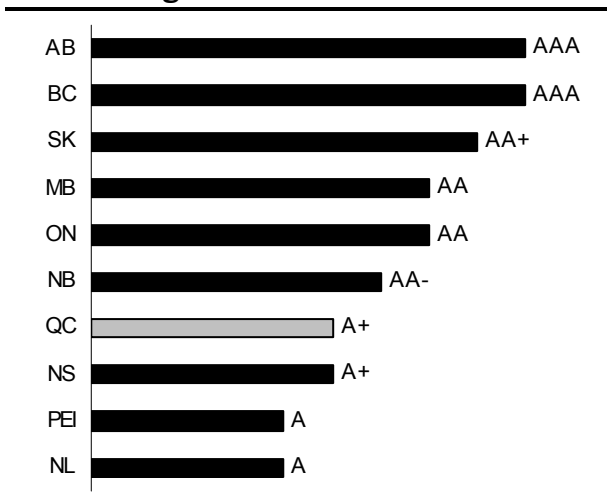
### Credit ratings – Moody's<sup>1</sup>



1 Credit ratings as at October 21, 2009.

CHART 11

### Credit ratings – Standard & Poor's<sup>1</sup>



1 Credit ratings as at October 21, 2009.

## 2.3 Preparing for the demographic challenge

The rapid elimination of the deficit, as stipulated in the government's plan, is especially important since over the coming years, demographic changes will have a major impact on our public finances. The expected aging of the population will reduce the number of workers and create additional pressure on health spending.

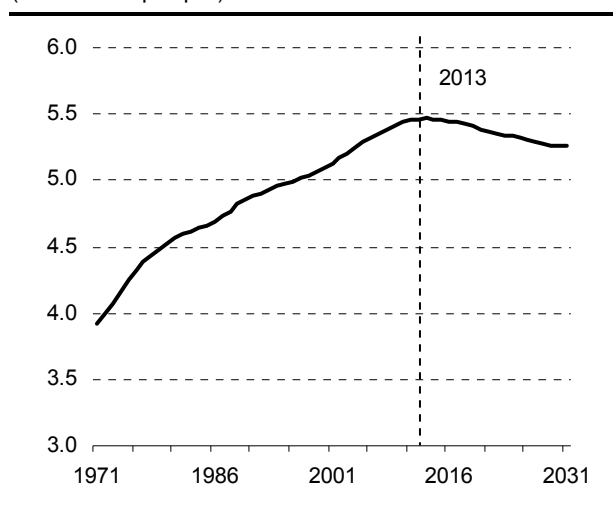
First, Québec will have to adjust to a smaller pool of potential workers, which will slow economic growth and thus put a brake on government revenues.

- According to the most recent demographic data of the Institut de la statistique du Québec, the population age 15 to 64, i.e. those of working age, will begin to decline in 2013.
- Between 2010 and 2030, Québec's pool of workers will contract by 3.3% while that same pool will grow substantially in the United States and Ontario, i.e. by 9.9% and 11.6% respectively.

CHART 12

### Population age 15 to 64

(millions of people)

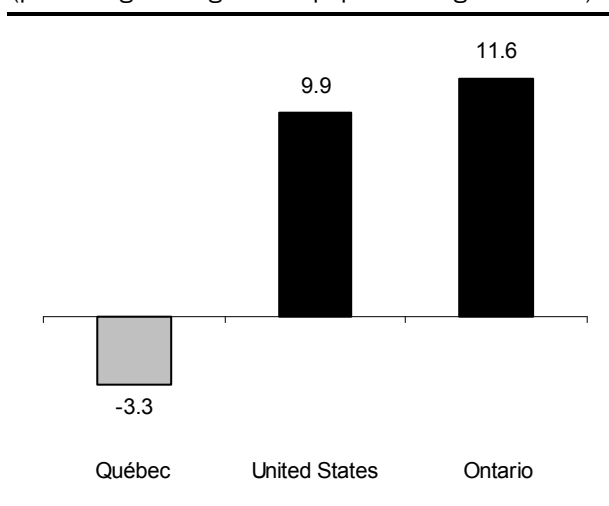


Source: Institut de la statistique du Québec (2009).

CHART 13

### Change in the pool of potential workers between 2010 and 2030

(percentage change in the population age 15 to 64)



Source: Chair in Taxation and Public Finance, Université de Sherbrooke.

Note: For the United States, population from age 16 to 64.



Second, the expected aging of Québec's population will exert additional pressure on people of working age in respect of the funding of public services.

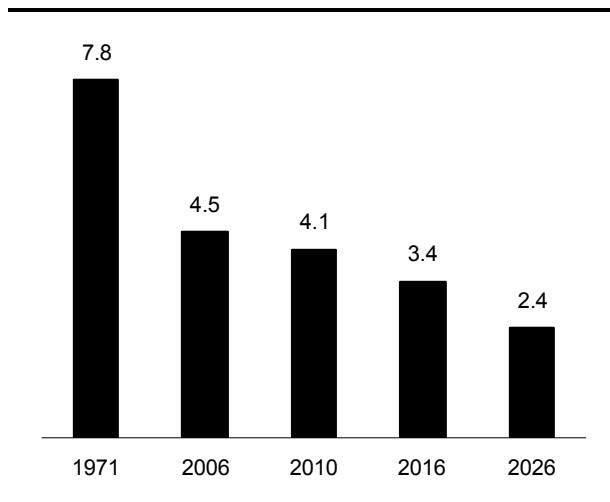
- In 2016, Québec will have 3.4 workers for each person age 65 or over compared to the current ratio of 4 to 1 and its value in 1971 of almost 8 to 1.
- Regarding public spending, the substantial rise in the population age 65 or over will exert even greater pressure on health costs.

Concerned by this question, the government set up a family policy a number of years ago that has already contributed to raising the birth rate in Québec as shown by recent demographic data.

In this context, it is important that the efforts needed to fund our public services not compromise the measures taken to mitigate the impact of the aging of the population and not inflict an unbearable burden on future generations.

CHART 14

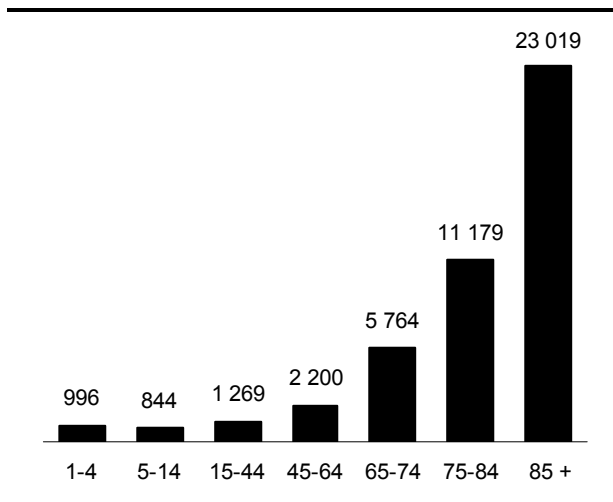
**Number of workers per retired person**  
(ratio of the population age 15 to 64 to that age 65 or over)



Source: Institut de la statistique du Québec (2009).

CHART 15

**Annual spending on health by the Québec government by age – 2006**  
(dollars per capita)



Source: Canadian Institute for Health Information.

## **How to Return to Balanced Public Finances Lessons from the Experience of a Number of OECD Countries**

The Bureau of the American Congress<sup>1</sup> as well as the Centre d'analyse stratégique<sup>2</sup>, a French government organization reporting directly to the Prime Minister, recently examined the best ways to return to balance in public finances.

Their analysis is based on many studies<sup>3</sup> that examine the experience of certain OECD countries that faced periods of high public deficits that constrained them to adopt a budget consolidation strategy. There emerge from this a number of rules that foster the success of a Plan to return to balanced budgets.

### **A budget consolidation usually has a better chance of succeeding when it is initiated at the very beginning of economic recovery**

For most countries, successful budgetary adjustments were put in place after the period of slowing economic activity, at the time of recovery.

### **A budget consolidation plan must be implemented gradually**

Spreading the implementation of measures to return to balanced budgets over a number of years is important economically and financially.

- The gradual implementation of restraint measures allows the public to adjust to the new policy which becomes credible over time.
- Consolidation measures should be announced ahead of time in order not to hinder recovery.
- Putting the adjustments off until later is not a good policy because the debt will continue to grow and the required adjustment will be even greater.

### **The announcement of a credible deficit reduction plan has positive effects on the economy**

Contrary to what is generally believed, major budgetary adjustments have positive effects on the economy by boosting the confidence of economic agents.

- The announcement of the introduction of a budgetary consolidation policy sends a signal that the return to sound public finances has started and dismisses the possibility of an even greater tax levy in the future.
- A fairly early announcement of a credible budgetary consolidation plan encourages recovery.

### **It is preferable to make one's own budgetary adjustments rather than have them imposed by creditors**

- Unduly delaying the implementation of measures to return to balanced budgets, especially for a state carrying a heavy debt load, increases the risk premium demanded by creditors to fund government debt.
- In this context, governments that delay adjustments will be forced to undertake a tardy but rapid budgetary consolidation with substantial tax increases and drastic spending cuts that will have major repercussions on economic growth.

- 1 *Deficit Reduction: Lessons from around the World*, Committee for a Responsible Federal Budget. Fiscal Roadmap Project, September 2009.
- 2 *Après la crise, quel retour à l'équilibre des finances publiques à moyen terme?*, Centre d'analyse stratégique, Note de veille n° 112, October 2008.
- 3 *Fiscal Adjustments: Determinants and Macroeconomic Consequences*. IMF, Working paper 178, July 2007. *Experience with Large Fiscal Adjustments*. IMF, Occasional paper 246, 2006. *Received Wisdom and Beyond: Lessons from Fiscal Consolidation in the EU*. European Commission, ÉcoFin, Economic Papers 320, April 2008. *Can Severe Fiscal Adjustments Be Expansionary?*, NBER Macroeconomics Annual, 1990. *Fiscal Adjustments in OECD Countries: Composition and Macroeconomic Effects*. NBER Working Paper, n° 5730.

### 3. TAKE STEPS TO PROTECT OUR VALUES

Fiscal consolidation is not an end in itself but must instead be perceived as an essential means of protecting and maintaining the quality of public services in light of the values and established privileges that all Quebecers cherish:

- a universally accessible healthcare system;
- quality education;
- upgraded infrastructure;
- unfailing support for families, seniors and culture;
- a debt burden that is fair to future generations.

The elimination of budget deficits leaves the government no alternative but to continue to soundly manage public finances in order to close the difference in revenues stemming from the recession and subsequently maintain growth in spending that is commensurate with economic growth. By mapping out this consolidation now, we can enable Québec to position itself favourably when the economy revives.

## ❑ Pursue the plan announced in the last Budget

The plan that the government tabled in the last Budget is intended to gradually reduce the deficit and achieve budgetary balance in 2013-2014. The realization of the plan will lead to:

- the establishment at 3.2% of annual growth in program spending starting in 2010-2011, equivalent to \$869 million in relation to the 4.6% trend growth noted in the past seven years;
- the implementation of initiatives already identified in revenues totalling \$615 million in 2010-2011, which will reach \$2.4 billion by 2013-2014;
- the identification of additional measures totalling \$450 million for 2010-2011.

Moreover, it should be noted that the increase in the deficits anticipated in the wake of the latest revisions presented in the fall 2009 economic and financial update bring the additional measures to be identified to attain fiscal balance to \$5.1 billion by 2013-2014, as against \$3.8 billion forecast in the Budget last March.

TABLE 4

### Plan to return to balanced budgets after the fall 2009 update

(in millions of dollars)

	2009-10	2010-11	2011-12	2012-13	2013-14
<b>BUDGETARY BALANCE WHEN GROWTH IN PROGRAM SPENDING STANDS AT 4.6%</b>	<b>- 4 695</b>	<b>- 6 609</b>	<b>- 8 611</b>	<b>- 10 172</b>	<b>- 11 284</b>
Efforts required to bring growth in spending down to 3.2%	—	869	1 806	2 814	3 898
<b>BUDGETARY BALANCE WHEN GROWTH IN PROGRAM SPENDING IS MAINTAINED AT 3.2%</b>	<b>—</b>	<b>- 5 740</b>	<b>- 6 805</b>	<b>- 7 358</b>	<b>- 7 386</b>
<b>Efforts in respect of revenues</b>					
Measures announced in the 2009-2010 Budget	—	615	1 590	1 950	2 360
Additional measures to be identified	—	450	2 576	4 140	5 114
<b>Total efforts in respect of revenues</b>	<b>—</b>	<b>1 065</b>	<b>4 166</b>	<b>6 090</b>	<b>7 474</b>
<b>Total efforts in respect of expenditures and revenues</b>	<b>—</b>	<b>1 934</b>	<b>5 972</b>	<b>8 904</b>	<b>11 372</b>
<b>BUDGETARY BALANCE - FALL 2009</b>	<b>- 4 695</b>	<b>- 4 675</b>	<b>- 2 639</b>	<b>- 1 268</b>	<b>88</b>

## ❑ Balance to be restored between our expenditures and our ability to pay

The current state of public finances leaves the government no alternative but to adjust growth in program spending below anticipated economic growth in the coming years, failing which we will be unable to maintain structural balance in public finances.

### ■ Québec's expenditure controls ranks it at the forefront

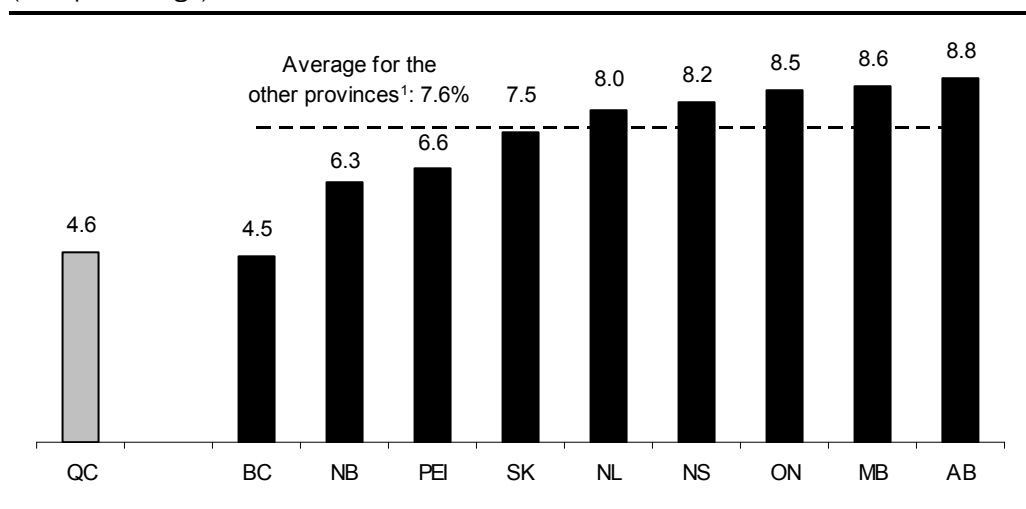
Between 2003-2004 and 2009-2010, the government held annual growth in spending at 4.6%, well below the average in the other Canadian provinces. This stringent control over spending ranks Québec at the forefront.

— By way of comparison, annual growth in program spending for the same period stands at 7.6%, on average, for the Canadian provinces, excluding Québec.

CHART 16

#### Average annual growth in program spending between 2003-2004 and 2009-2010

(as a percentage)



Note: Forecast for 2009-2010.

1 Weighted average.

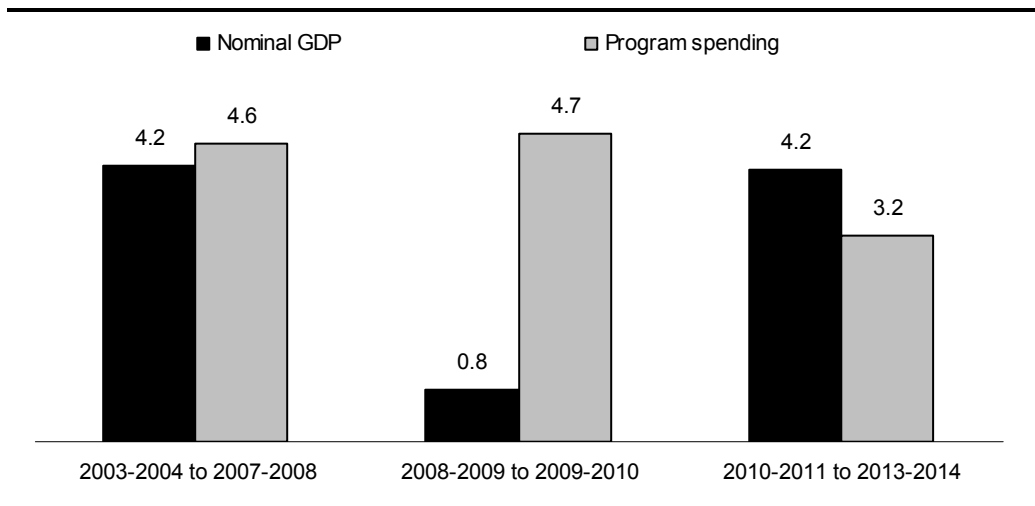
## ■ Balance must be restored

However, the recession that has struck Québec has shattered this balance. In 2008-2009 and 2009-2010, average annual growth in spending stands at 4.7% while growth in the economy stands at 0.8%, a difference that has led to a deficit.

Starting in 2010-2011, growth in spending must fall below growth in the economy in order to close the gap created during the recession.

CHART 17

### Economic growth and program spending (as a percentage)



Note: Forecasts for 2009-2010 and subsequent years.

## ❑ Measures totalling \$2.4 billion have already been identified

The measures identified in the Plan to return to balanced budgets total \$2.4 billion. As the last Budget indicates, none of these measures is being implemented in 2009-2010, either from the standpoint of revenues or expenditures. They will be introduced gradually starting in 2010-2011, to avoid hampering the resumption of economic growth when the recession ends.

In addition to limiting growth in program spending to 3.2% starting in 2010-2011, the government will:

- step up efforts to curb tax evasion and tax avoidance;
- index all non-indexed user fees, except for childcare service fees, starting January 1, 2011;
- increase the Québec sales tax rate from 7.5% to 8.5% as of January 1, 2011.

These initiatives will significantly reduce the deficits, by:

- \$615 million in 2010-2011;
- \$1.59 billion in 2011-2012;
- \$1.95 billion in 2012-2013;
- \$2.36 billion in 2013-2014.

TABLE 5

### Revenue-related measures already stipulated in the Plan to return to balanced budgets (in millions of dollars)

	2009-10	2010-11	2011-12	2012-13	2013-14
<b>Measures announced</b>					
Intensification of Revenu Québec's efforts to curtail tax evasion and tax avoidance	—	200	300	600	900
Indexation as of January 1, 2011 <sup>1</sup> of all non-indexed user fees	—	15	75	135	195
Increase as of January 1, 2011 <sup>2</sup> by one percentage point of the rate of the QST	—	400	1 215	1 215	1 265
<b>TOTAL OF THE MEASURES ANNOUNCED</b>	<b>—</b>	<b>615</b>	<b>1 590</b>	<b>1 950</b>	<b>2 360</b>

1 With the exception of childcare service fees.

2 Bearing in mind compensation for low- or middle-income households.

## □ Additional measures to attain our objectives

The government's revised budget estimates bring to \$5.1 billion the other measures to be identified to achieve budgetary balance in 2013-2014, compared with the \$3.8 billion forecast in the Budget last March.

The identification and implementation of the measures required to reach the targets stipulated in the Plan to return to balanced budgets must lie within the scope of the plan:

- \$450 million in 2010-2011;
- \$2.6 billion in 2011-2012;
- \$4.1 billion in 2012-2013;
- \$5.1 billion in 2013-2014.

These amounts are substantial and depend, moreover, on economic growth in the coming years and the government's ability to match growth in spending with economic growth and our ability to pay.

TABLE 6

### Additional effort required to achieve budgetary balance by 2013-2014 following the fall 2009 revisions (in millions of dollars)

	2010-11	2011-12	2012-13	2013-14
<b>2009-2010 Budget: measures to be identified</b>	<b>- 450</b>	<b>- 1 343</b>	<b>- 2 809</b>	<b>- 3 770</b>
Additional effort noted in the <i>Update on Québec's Economic and Financial Situation</i> to maintain the targets stipulated in the Plan to return to balanced budgets starting in 2011-2012	—	- 1 233	- 1 331	- 1 344
<b>Total additional measures to be identified</b>	<b>- 450</b>	<b>- 2 576</b>	<b>- 4 140</b>	<b>- 5 114</b>
<b>Additional measures to be identified by year</b>				
2010-2011	<b>- 450</b>	- 450	- 450	- 450
2011-2012	—	<b>- 2 126</b>	- 2 126	- 2 126
2012-2013	—	—	<b>- 1 564</b>	- 1 564
2013-2014	—	—	—	<b>- 974</b>
<b>TOTAL OF THE ADDITIONAL MEASURES TO BE IDENTIFIED</b>	<b>- 450</b>	<b>- 2 576</b>	<b>- 4 140</b>	<b>- 5 114</b>



### **3.1 The importance of adopting the right means**

The means to be adopted to protect our values must send clear signals and serve Québec's economic and social objectives. They must allow for the appropriate division of responsibilities between the State and individuals in light of new economic and demographic conditions.

From the standpoint of expenditures, it is incumbent upon the government, first and foremost, to establish growth in its spending according to changes in collective wealth and taxpayers' ability to pay, failing which any attempt at fiscal consolidation will be doomed.

As for the additional revenue-related measures to be identified, it is important to bear in mind their social and economic impact to make the right choices. To this end, we must:

- rely on the principles of fairness that the government advocates to preserve our values;
- take into account the means to be adopted to limit their impact on economic growth;
- rely on a balanced approach between the measures to be adopted to limit growth in expenditures and the implementation of new measures aimed at increasing revenues.

### 3.1.1 Rely on principles of fairness

The government is adopting an approach to fiscal consolidation in which each intervener contributes according to his means. This approach must, above all, rely on principles of fairness to:

- ensure that everyone pays his fair share of taxes;
- obtain a larger contribution from the users of public services;
- ensure a collective effort by consumers.

The measures announced in the last Budget in conjunction with the Plan to return to balanced budgets centred on these principles. They must once again serve as a guideline in the impending stages.

### 3.1.2 Limit the impact of the means adopted on economic growth

In the choice of means to be adopted to attain our objectives, it is important to limit their impact on economic growth. It is essential to adopt measures that foster the tax competitiveness of the Québec economy and seek to strike better balance in the funding of public services.

#### ☐ The advantage of taxing consumption instead of production is recognized

The Québec taxation system is today more competitive in Canada and at the international level. This improvement in the Québec taxation system's competitiveness stems from government initiatives taken since 2003 to enhance productivity.

- Since 2003, the government has significantly reduced the tax burden of individuals.
  - In 2009, individuals benefited from a \$5.4-billion reduction in their tax burden.
- As for businesses, the government has made the income tax system more conducive to investment, in particular through the elimination by January 1, 2011 of the capital tax and the introduction of an investment tax credit.
  - Overall, the tax burden of businesses will be reduced by \$2 billion in 2011-2012.

Despite these efforts, against a backdrop of a rapidly ageing population and keen international economic competition, Québec must pursue its attempts to bolster the competitiveness of its taxation system in order to boost productivity and, ultimately, enhance Quebecers' standard of living.

In the struggle to restore fiscal balance, it is important, above all, to make choices that do not compromise economic growth and Québec's development, in particular by:

- fostering investment and encouraging innovation, factors that are essential to wealth creation;
- encouraging individuals to work and ensuring that qualified workers are available;
- promoting exports of Québec products.

To collect additional revenues, value-added taxes such as the QST are being emphasized since they are less detrimental to the economy.

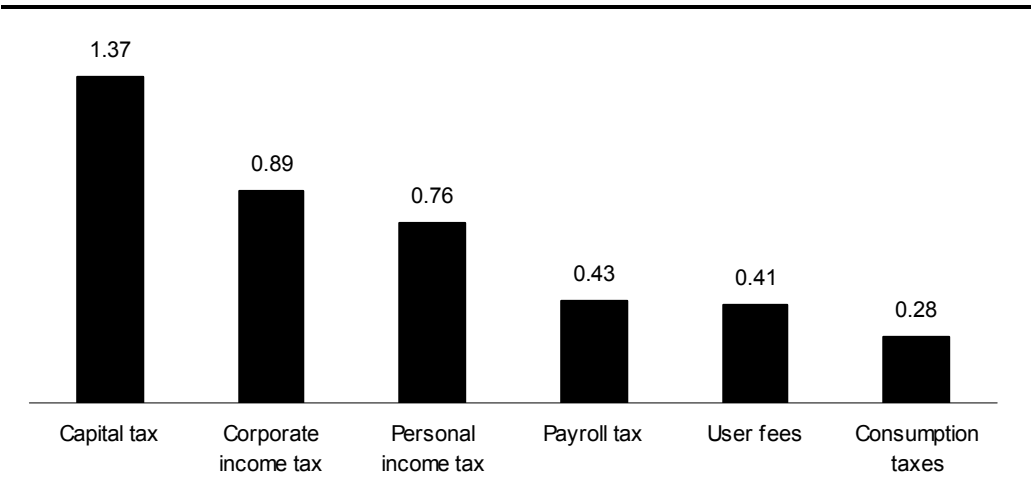
Moreover, the OECD and several Québec experts have recommended this approach:

- the Commission on Fiscal Imbalance (2002);
- the Task Force on the Sustainability of the Québec Health Care and Social Services System (2005);
- the Task Force on the Funding of the Health System (February 2008);
- the Task Force on Business Investment (March 2008).

CHART 18

**Long-term cost in real Québec GDP per additional dollar of taxes and user fees**

(cost in dollars of real GDP of each additional dollar collected)



Source: Ministère des Finances du Québec.

■ **Québec must remain competitive from the standpoint of personal income tax**

Quebecers no longer bear the heaviest individual tax burden in North America.

- Over the past six years, the difference in the tax burden between Québec and the other provinces has fallen by 40%, from \$2.1 billion in 2003 to \$1.3 billion in 2009.
- In 2009, Nova Scotia, Prince Edward Island and Manitoba have a higher personal income tax burden than Québec.

Since the last Budget, several provinces have announced new tax reductions in the coming years. Under the circumstances, an increase in personal income taxes is not a desirable solution since it would call into question the significant efforts made in recent years.

TABLE 7

**Personal income tax**  
**Difference in the tax burden between Québec and the other provinces**  
**when the taxation structure of the other provinces is applied to Québec<sup>1</sup>**  
(in millions of dollars)

	2003	2008 <sup>2</sup>	2009 <sup>2</sup>
<b>Difference between Québec and the other provinces<sup>3</sup></b>			
Alberta	4 449	3 589	5 127
British Columbia	3 569	3 292	3 109
Ontario	5 642	2 735	2 648
Saskatchewan	2 394	2 535	2 645
Newfoundland and Labrador	- 965	109	760
New Brunswick	1 701	- 341	289
Manitoba	692	- 702	- 856
Nova Scotia	664	- 898	- 1 083
Prince Edward Island	1 063	- 832	- 1 123
<b>Mean deviation</b>	<b>2 134</b>	<b>1 054</b>	<b>1 280</b>
<b>Difference in relation to 2003 (%)</b>		<b>- 50.6</b>	<b>- 40.0</b>

1 Bearing in mind health services contributions and family assistance measures such as family allowances and refundable tax credits.

2 Bearing in mind measures from the 2008-2009 Québec Budget, the federal and other provincial government budgets, and the economic statements published in the fall of 2008. The 2009-2010 Québec Budget and federal and other provincial budgets are also considered.

3 The 16.5% abatement for Québec is deducted from the difference in the tax burden.

Source: Ministère des Finances du Québec.

## ■ The Québec taxation system must remain competitive for Québec businesses

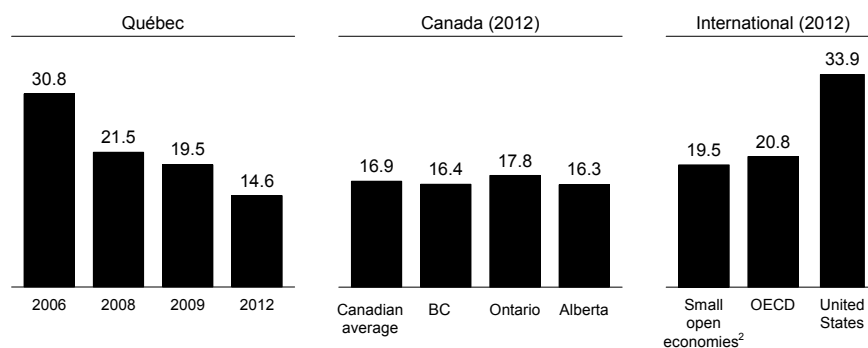
Businesses are important creators of wealth. The measures that Québec has adopted to reduce their tax burden favour enterprises that invest to bolster their productivity.

- Aside from the elimination of the capital tax at the end of 2010, businesses benefit from an investment tax credit on manufacturing and processing equipment.
- Moreover, in the early 1990s, Québec introduced an added value tax that significantly reduces the cost to businesses of investment because of the refund of the tax on inputs.

Consequently, the marginal effective tax rate (METR) on investment in Québec will stand at 14.6% in 2012, below the rate in most of the provinces. The METR in Québec in 2012 compares favourably with average rates at the international level.

CHART 19

### Comparison of marginal effective tax rates (METR)<sup>1</sup> (as a percentage)



1 METRs are indicators of the impact of the taxation system on new investments. They represent the effect of all tax expenses and tax rules that affect the return on capital invested. They take into account, in particular, the capital tax, the sales tax, corporate income tax, amortization rules and rates, and the method of counting inventories on hand.

2 Economies that rely heavily on trade with bigger economic partners. Switzerland, Australia, Ireland, Sweden and Norway are examples of small open economies.

Sources: C.D. Howe Institute and ministère des Finances du Québec.

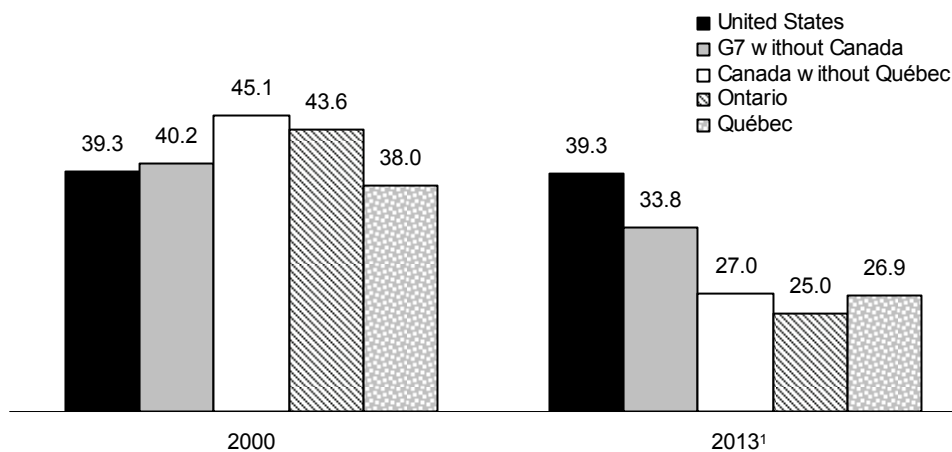
Furthermore, the competitiveness of the corporate taxation system is closely linked to the taxation rate of corporate profits.

- The combined Québec and federal taxation rate on corporate profits will stand at 26.9% in 2013.
- This rate will be competitive in Canada, despite recent announcements by several Canadian provinces, including Ontario, that they are lowering corporate tax.
- In 2013, the combined tax rate on corporate profits will be lower than the average rate anticipated in the G7 nations.

Bearing in mind the reductions in the tax burden announced by certain provinces, to increase the tax burden of businesses is not a desirable solution since it would risk compromising efforts in recent years to enhance our competitiveness.

CHART 20

### Change in statutory corporate taxation rates (as a percentage)



1 The rates presented for the G7 countries and the United States are the 2012 rates.

## ❑ Strive for balance in the funding of public services

The imperative of tax competitiveness makes it essential to arbitrate between the taxation of corporations and individuals and reliance on user fees to fund public services. User fees present several advantages in that they:

- encourage responsible consumption of public services;
- foster optimum use of our natural resources, a clean, sustainable development tool and an asset for future generations;
- achieve better sharing in the funding of public services between user-payers and taxpayers.

Moreover, the impact on services of the appropriate user fees is one of the least harmful sources of government revenues.

In this respect, the government will pursue the implementation of the *Politique sur le financement des services publics* tabled in the 2009-2010 Budget. The government and users will thus better grasp the costs and sources of funding of public services, which will make it possible to more transparently set user fees. Furthermore, it has committed itself, under this policy, to protect low-income households from user fee increases.

FIGURE 1

### Diversity of funding methods by type of goods or public services

Type of public goods and services	Public	Mixed	Private
	Justice Security Environmental protection	Health Education Mass transit	Automobile insurance Electricity Ferry service
Source of funding	0%	User fees	100%
	-		+
	100%	Taxes	0%
	+		-

Source: Report of the Task Force on Fees for Public Services, Québec government, 2008.



### 3.1.3 Rely on a balanced approach

A return to budgetary balance requires the implementation of measures aimed at establishing growth in spending at 3.2% starting in 2010-2011 and introducing new measures to increase revenues.

The government intends to emphasize a balanced approach that centres, first, on an examination of expenditures in light of the public services that we wish to protect, in order to limit the impact on taxpayers of the new revenue-related measures.

The total effort for 2010-2011 stands at \$1.9 billion and is apportioned proportionally between revenues and expenditures:

- \$869 million in respect of tightening of expenditures;
- \$1.065 billion as regards revenues, of which \$450 million has yet to be identified.

## 3.2 Steer a steady course based on the plan

Aside from the measures already identified in the last Budget, the Plan to return to balanced budgets calls for additional efforts to reduce the deficit starting in 2010-2011. The government's strategy in this respect centres on three key factors:

- stringently control expenditures;
- provide the staff necessary to counter tax evasion and tax avoidance;
- identify additional measures totalling \$450 million in 2010-2011 to limit the increase in the deficit.

Moreover, in order to achieve the targets stipulated in the plan beyond 2010-2011 and restore budgetary balance by 2013-2014, the government will have to identify and implement additional measures totalling \$5.1 billion as a result of the update of its budgetary forecasts.

### ☐ Stringently control expenditures

The Plan to return to balanced budgets calls for significant tightening of expenditures. In fact, the growth of program spending must be brought down to 3.2% starting in 2010-2011.

- This reduction in growth represents an effort of \$869 million in 2010-2011 in relation to the annual trend growth of 4.6% observed over the past seven years.

### ☐ Provide the staff necessary to counter tax evasion and tax avoidance

In order to implement measures to step up efforts to counter tax evasion and tax avoidance, the government intends to allocate next year to Revenu Québec the resources needed to hire 250 staff assigned to tax recovery.

- The government intends to recover some \$200 million in 2010-2011.

**□ Identify new measures to restore budgetary balance by 2013-2014**

The implementation in the fall of 2009 of the government's budgetary forecasts has raised the deficits for the next five years.

— These upward revisions bring to \$5.1 billion the additional measures to be targeted in order to achieve budgetary balance by 2013-2014, \$1.3 billion more than the \$3.8 billion forecast in the 2009-2010 Budget.

The government must also give priority to identifying these measures. To this end, it intends to consult the population during the pre-budgetary consultations that will begin in the coming weeks.

As the same time, as indicated in the 2009-2010 Budget, Québec will pursue its discussions with the federal government to ensure that funds paid to the provinces under major transfer programs such as the equalization program, and specific agreements such as those governing the harmonization of sales taxes, are appropriate, fair and based on solid principles.

### 3.2.1 Stringently control expenditures

#### ☐ Restore growth in spending at the same pace as growth in our collective wealth

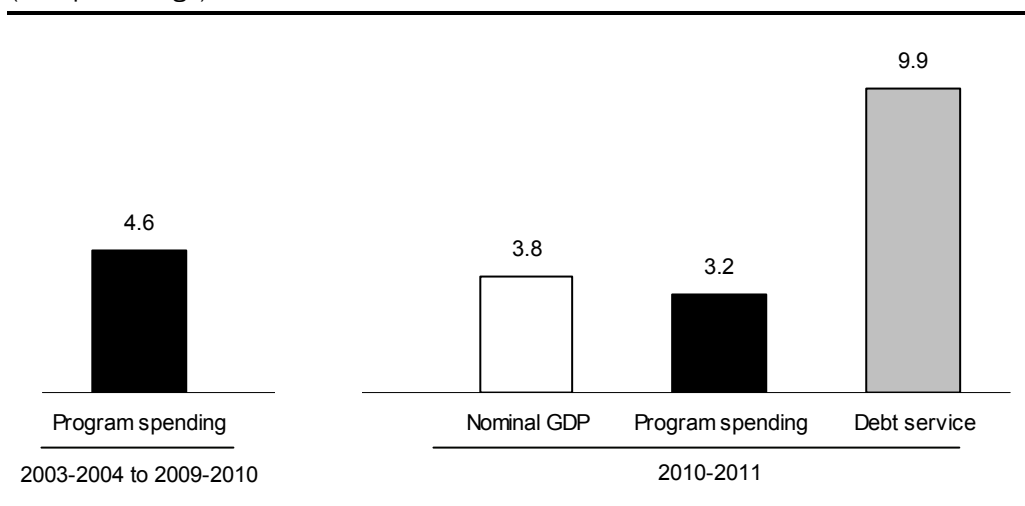
Between 2003-2004 and 2009-2010, average annual growth in program spending has stood at 4.6%.

Against the backdrop of the current economic slowdown and the Plan to return to balanced budgets, slower growth in revenues also demands a reduction in the growth of expenditures overall. Bearing in mind the significant increase in debt service, growth in program spending must be brought below levels in recent years.

As announced in the last Budget, annual growth in program spending must be reduced to 3.2% starting in 2010-2011, in keeping with economic growth and taxpayers' ability to pay.

CHART 21

#### **Growth in expenditures and economic growth** (as a percentage)



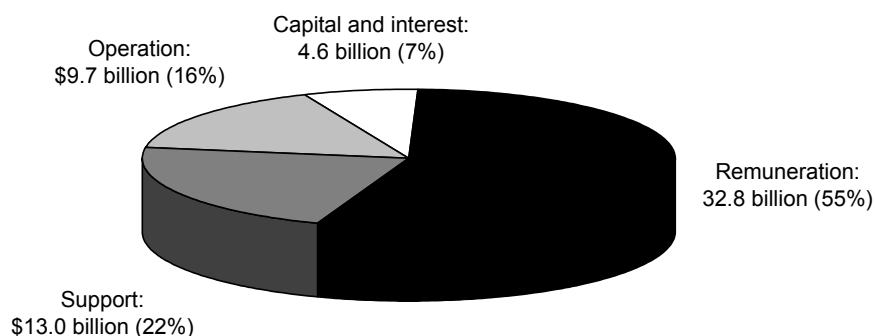
## □ An examination of programs for 2010-2011

To this end, the President of the Conseil du trésor, in conjunction with the examination of 2010-2011 programs now under way, will propose by the end of the year to the government a series of measures designed to ensure the attainment of this objective. All government departments and bodies will be called upon to participate in this collective effort.

CHART 22

### 2009-2010 program spending by key categories

(in millions of dollars and as a percentage)



**Program spending in 2009-2010: \$60.1 billion**

Source: Secrétariat du Conseil du trésor and ministère des Finances du Québec.

### 3.2.2 The intensification of efforts to counter tax evasion and tax avoidance

One component of the Plan to return to balanced budgets presented in the 2009-2010 Budget is the intensification of efforts by Revenu Québec to counter, starting in 2010-2011, tax evasion and tax avoidance.

The government is announcing immediately that additional staff will be assigned to Revenu Québec to enable it to achieve the tax recovery targets that have been set.

Furthermore, the government adopted new tools this fall to more effectively combat tax evasion and tax avoidance, which will facilitate Revenu Québec's initiatives.

These new tools and means made available to Revenu Québec will enable it to achieve the targets set.

#### ❑ More extensive resources for Revenu Québec to attain the targets in the Plan to return to balanced budgets

Under the Plan to return to balanced budgets, the government has defined clear targets for Revenu Québec. The objective is to make the department accountable for the results obtained and, in return, to provide it with the means necessary to achieve the objectives set.

The government will, therefore, grant Revenu Québec resources according to a cost-benefit approach to enable it to maintain tax control measures and step up the recovery of the amounts due.

TABLE 8

#### Attainment by Revenu Québec of tax recovery targets (in millions of dollars)

	2010-2011	2011-2012	2012-2013	2013-2014
Additional revenues	220	340	660	980
Costs	– 20	– 40	– 60	– 80
<b>Benefits</b>	<b>200</b>	<b>300</b>	<b>600</b>	<b>900</b>
<i>Additional staff at Revenu Québec</i>	250	400	600	825

Starting in 2010-2011, the appropriations available to Revenu Québec to combat tax evasion will be increased by \$20 million. Revenu Québec will also be able to hire 250 full-time employees.

In the coming years, the measures designed to counter tax evasion and tax avoidance should increase government revenues by \$200 million as of 2010-2011 and reach \$900 million in 2013-2014.

## **□ New tools**

In order to attain the tax recovery targets, Revenu Québec will rely on current audit methods and new means to recover more of the revenues that are eluding the government.

First, additional funding will be allocated to Revenu Québec to hire more tax auditing staff and develop new control systems. The intensification of monitoring and control will encourage more taxpayers to fulfil their tax obligations, thus encouraging self-assessment, the basis of our taxation system.

Moreover, funds will be earmarked for the enhancement of electronic service delivery, thereby making it easier for taxpayers to fulfil their tax obligations.

Second, the government has acquired new tools to prevent significant financial losses, in particular through tax avoidance, economic crime and tax evasion in the restaurant sector.

The government has adopted a twofold strategy to combat tax avoidance. First, from an administrative standpoint, a special unit has been established at Revenu Québec to combat aggressive tax planning schemes. Second, in terms of fiscal policy, new measures were announced in the newsletter published on October 15, 2009 by the ministère des Finances.

As for economic crimes, the government announced this fall the creation of two special squads to combat financial fraud, embezzlement and corruption. These teams will join the team established in 2004 to combat tax fraud.

The restaurant sector offers significant tax recovery potential. For this reason, sales registration modules will be connected to restaurant cash registers starting in 2011. These modules, which are designed to foil tax evasion stratagems, will be installed in certain restaurants starting in November 2009 in conjunction with a pilot project.

Additional staff at Revenu Québec combined with the adoption of new tools will enable Revenu Québec to attain the tax recovery targets set for it under the Plan to return to balanced budgets presented in the 2009-2010 Budget. The Minister of Revenue will subsequently specify the efforts to be made by Revenu Québec.

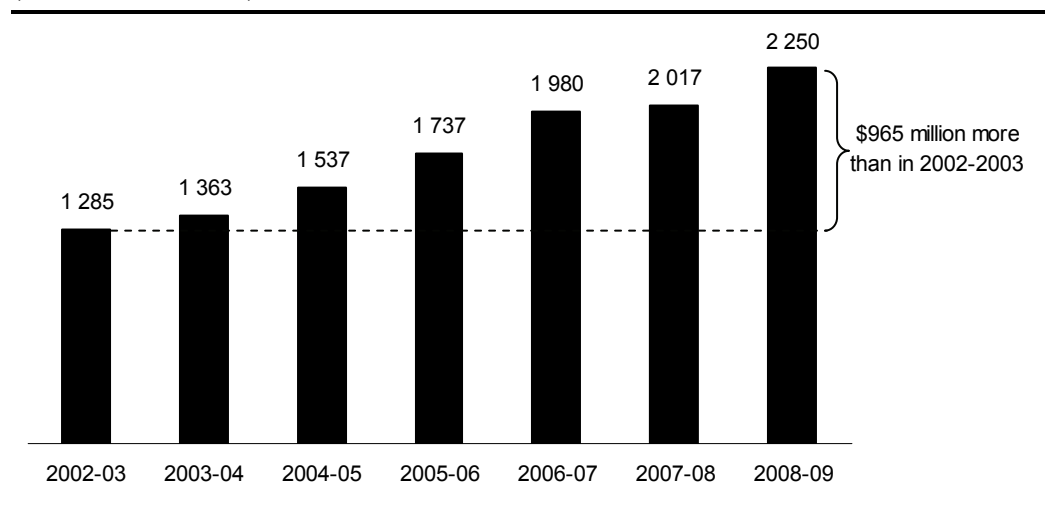
### □ Achievable objectives

Revenu Québec recovered \$2.3 billion in 2008-2009 through its tax recovery initiatives. Additional efforts to combat tax evasion and tax avoidance led to the recovery of \$965 million more than in 2002-2003.

In light of past experience, the tax recovery target of \$900 million in 2013-2014 is ambitious but clearly achievable.

CHART 23

#### Revenu Québec's tax recovery revenues (in millions of dollars)



Source: Revenu Québec.



## Concerted action against the underground economy and tax evasion

In addition to Revenu Québec's initiatives in conjunction with its regular audit and control activities, the government will maintain its concerted efforts to combat the underground economy in sectors such as construction, tobacco smuggling and tax-related economic crime.

Under a cost-benefit approach, the ministère des Finances funded in 2008-2009 measures that required a \$55-million investment but that enabled the government to recover tax revenues on the order of \$630 million, equivalent to a return of over \$11 for each dollar invested.

### Return on projects to combat tax evasion funded by the ministère des Finances

(in millions of dollars)

	2004-05	2005-06	2006-07	2007-08	2008-09
<b>Project</b>					
– Construction	291.2	317.1	336.0	334.5	336.0
– Revenu Québec – Specific projects <sup>1</sup>	170.6	331.6	83.1	103.1	148.8
– ACCES <sup>2</sup> alcool	72.0	72.0	66.0	66.0	66.0
– ACCES <sup>2</sup> tabac	26.0	26.0	32.0	35.0	40.0
– Tax-related economic and financial crimes	—	—	4.0	20.3	41.9
– Collection of receivables	46.4	67.2	21.0	—	—
<b>Total return from projects</b>	<b>606.2</b>	<b>813.9</b>	<b>542.1</b>	<b>558.9</b>	<b>632.7</b>
Amount granted by the ministère des Finances	77.3	69.1	45.1	49.6	55.3
<b>Return per dollar invested (\$)</b>	<b>7.85</b>	<b>11.79</b>	<b>12.03</b>	<b>11.28</b>	<b>11.44</b>

1 The reduction in the overall return on projects in 2006-2007 is largely attributable to the transfer of appropriations from the ministère des Finances to Revenu Québec's regular appropriations to enable the department to self-finance projects that have matured and whose profitability has been demonstrated. In the absence of this transfer, the return on Revenu Québec's projects funded by the ministère des Finances would have reached over \$337 million in 2006-2007.

2 Concerted efforts to counter the underground economy.

### **3.2.3 Identify additional measures to restore budgetary balance by 2013-2014**

When the Budget was tabled last March, measures totalling \$3.8 billion had yet to be identified in the Plan to return to balanced budgets in order to eliminate the deficits by 2013-2014.

Since then, the government's fall update of the budget estimates brings to \$5.1 billion the effort required within five years to restore budgetary balance.

- It should be noted that this increase is attributable to further deterioration in the economic outlook for 2009 and 2010 at a time when the government has decided not to exercise additional pressure on the economy given the considerable effort expended to foster economic revival.

The shortfall stands at:

- \$450 million in 2010-2011;
- \$2.6 billion in 2011-2012;
- \$4.1 billion in 2012-2013;
- \$5.1 billion in 2013-2014.

The identification of these additional measures is necessary to comply with provisions in Bill 40 (2009, c. 38), recently adopted by the National Assembly, which stipulates that:

- in 2009-2010 and 2010-2011, the government may record deficits warranted by the economic situation;
- starting in 2011-2012, the government must identify additional measures in order to comply with the deficit-reduction objectives established to ensure a gradual return to a balanced budget by 2013-2014.

TABLE 9

# Plan to return to balanced budgets in light of the fall 2009 revisions in the government's budget estimates

(in millions of dollars)

	2009-10	2010-11	2011-12	2012-13	2013-14
<b>BUDGETARY BALANCE WHEN GROWTH IN PROGRAM SPENDING IS MAINTAINED AT 4.6%</b>	<b>- 4 695</b>	<b>- 6 609</b>	<b>- 8 611</b>	<b>- 10 172</b>	<b>- 11 284</b>
Efforts to reduce growth in spending to 3.2%	—	869	1 806	2 814	3 898
<b>BUDGETARY BALANCE WHEN GROWTH IN PROGRAM SPENDING IS MAINTAINED AT 3.2%</b>	<b>—</b>	<b>- 5 740</b>	<b>- 6 805</b>	<b>- 7 358</b>	<b>- 7 386</b>
<b>Revenue-related measures in the 2009-2010 Budget</b>					
Intensification of Revenu Québec's efforts to counter tax evasion and tax avoidance	—	200	300	600	900
Indexation of all non-indexed user fees as of January 1, 2011 <sup>1</sup>	—	15	75	135	195
Increase the rate of the QST as of January 1, 2011 <sup>2</sup>	—	400	1 215	1 215	1 265
<b>Sub-total of the measures announced in the 2009-2010 Budget</b>	<b>—</b>	<b>615</b>	<b>1 590</b>	<b>1 950</b>	<b>2 360</b>
<b>New measures to be identified to restore budgetary balance</b>		<b>450</b>	<b>2 576</b>	<b>4 140</b>	<b>5 114</b>
<b>Total of all measures</b>	<b>—</b>	<b>1 065</b>	<b>4 166</b>	<b>6 090</b>	<b>7 474</b>
<b>Total of expenditure- and revenue-related measures</b>	<b>—</b>	<b>1 934</b>	<b>5 972</b>	<b>8 904</b>	<b>11 372</b>
<b>BUDGETARY BALANCE - FALL OF 2009</b>	<b>- 4 695</b>	<b>- 4 675</b>	<b>- 2 639</b>	<b>- 1 268</b>	<b>88</b>

1 Except for childcare service fees.

2 Bearing in mind compensation for low- and middle-income households.

## ❑ Choices that concern all Quebecers

The return to budgetary balance implies difficult choices that concern all of us. The implementation of the measures announced last March are a first step toward our objective of eliminating deficits by 2013-2014, as required by law.

To do so, we will have to contemplate, evaluate and adopt new initiatives in order to attain our goal. The means emphasized to this end must be guided by the principles spelled out in this document:

- expenditures commensurate with our ability to pay;
- a targeted increase in government revenues to eliminate the increase's impact on the creation of wealth.

Putting public finances in order is essential if we wish to protect and maintain the quality of public services both for the generations now benefiting from them and for future generations.

Furthermore, as we noted earlier, this step is not an end in itself but rather a means of obtaining the necessary leeway to act now to enable Québec to develop its enormous potential and thus ensure a prosperous future.

The tabling of this report launches the pre-budgetary consultations that will focus on two key problems:

- the government will initiate a consultation on the key economic policy directions that Québec must favour when the recession ends to develop its enormous economic potential and thus create the wealth necessary to maintain the quality of public services, based on the values that all Quebecers cherish;
- the government will also consult the population on the means to be implemented to restore budgetary balance by 2013-2014.

Many stakeholders in civil society have already focused, in this respect, on their own initiative or at the request of government bodies, on the funding of public services in Québec.

- The Clair, Ménard and Castonguay reports in the health sector, the deliberations of the Mouvement Desjardins and economist Pierre Fortin on the use of the economic rent on hydroelectric power in Québec, the recommendations of the Bédard and Ménard reports on education or the proposals in the Montmarquette report on user fees come to mind.

These deliberations have produced promising avenues to ensure the continuity of funding for Québec public services in the realms of health, education, the environment and infrastructure.

The consultations that are getting under way should draw inspiration from these reflections as well as allowing as many Quebecers as possible to participate in an examination of the policy directions to be emphasized by the government. This is a unique opportunity to contribute to discussions that will enable us to make choices and agree on the means to be adopted to attain our objectives. Extensive participation will ensure the success of this pivotal stage in Québec's future.



## CONCLUSION

Like other jurisdictions around the world, Québec has been hit by the recession. However, the economy has stood up well, thanks in particular to the steps taken by the government. Massive investment was required. In this regard, the implementation of the \$15.5-billion economic support plan will continue to sustain employment this year and next.

It is now time to prepare for a return to balanced budgets and identify the steps that will enable Québec to secure a prosperous future.

With the consultations that begin today, the government is reiterating its determination to implement the necessary and unavoidable measures to restore fiscal balance and thus lay the foundations for the broad economic policies that will guide Québec in the development of its economy over the coming years.

For Quebecers, invited without exception to contribute to these consultations, this is both a responsibility and an opportunity to shape the direction of their society for current generations, and to prepare the future of Québec for generations to come.





## **APPENDIX:**

### **THE MEDIUM-TERM ECONOMIC OUTLOOK IN QUÉBEC**

The recession proved less severe in Québec than in most industrialized countries because of massive public investments, the good performance of the housing market and the importance of the aerospace industry.

With a decline in real GDP of 1.5%, the current recession in Québec will be less severe than the two previous ones, when real GDP fell 3.6% in 1982 and 2.7% in 1991.

Just as in the United States and Canada, Québec economic growth should resume in the third quarter of 2009. Economic recovery should continue next year and lead to an acceleration in real GDP as of 2011.

However, real GDP growth over the coming years in Québec will not be enough to offset the loss of output caused by the recession, because of:

- the impacts for Québec of a slower American economic recovery than in the past;
- the end of stimulus measures and the Plan to return to balanced budgets.

In addition, the less severe drop in output and consumption during the recession will limit the potential rebound of Québec's economy.

## □ The five-year outlook

The forecast recovery in personal spending and non-residential investment as of the fall of 2009, combined with the recovery under way in the United States and the rest of the world, should support economic growth in Québec over the coming quarters.

Accordingly, after falling 1.5% in 2009, real GDP should gain 1.7% in 2010, and average 2.5% growth from 2011 to 2013.

At 1.6% for the period from 2009 to 2013, average real GDP growth forecast by the ministère des Finances du Québec is slightly below that of the private sector (1.7%), while the forecast for nominal GDP (3.3%) is slightly higher than that of the private sector (3.2%).

— It should be noted that the forecasts of the ministère des Finances du Québec take into account the Plan to return to balanced budgets that stipulates the elimination of deficits by 2013-2014.

TABLE 10

### Québec's economic outlook (percentage change)

	2009	2010	2011	2012	2013	Average 2009-2013
<b>Real GDP</b>						
Ministère des Finances du Québec	- 1.5	1.7	2.6	2.6	2.4	1.6
Private sector average	- 1.6	2.1	2.8	2.7	2.4	1.7
<b>Nominal GDP</b>						
Ministère des Finances du Québec	- 0.6	3.8	4.5	4.4	4.3	3.3
Private sector average	- 1.6	3.6	4.7	4.8	4.4	3.2

Source: Ministère des Finances du Québec and survey done by the ministère des Finances du Québec, of the forecasts of ten private-sector institutions produced between June 22 and October 19, 2009.

## ❑ An output gap to be filled

Over a long period, real GDP grows in step with growth in population and wealth. Accordingly, the underlying growth in real GDP is a measure of an economy's output capacity. In Québec, the underlying growth in real GDP over the last 28 years was 2%.

Québec has experienced two major business cycles over the last 30 years. The first started in 1982 and ended in 1990. The recession in Québec over the last few quarters marks the end of the second cycle that started in 1992.

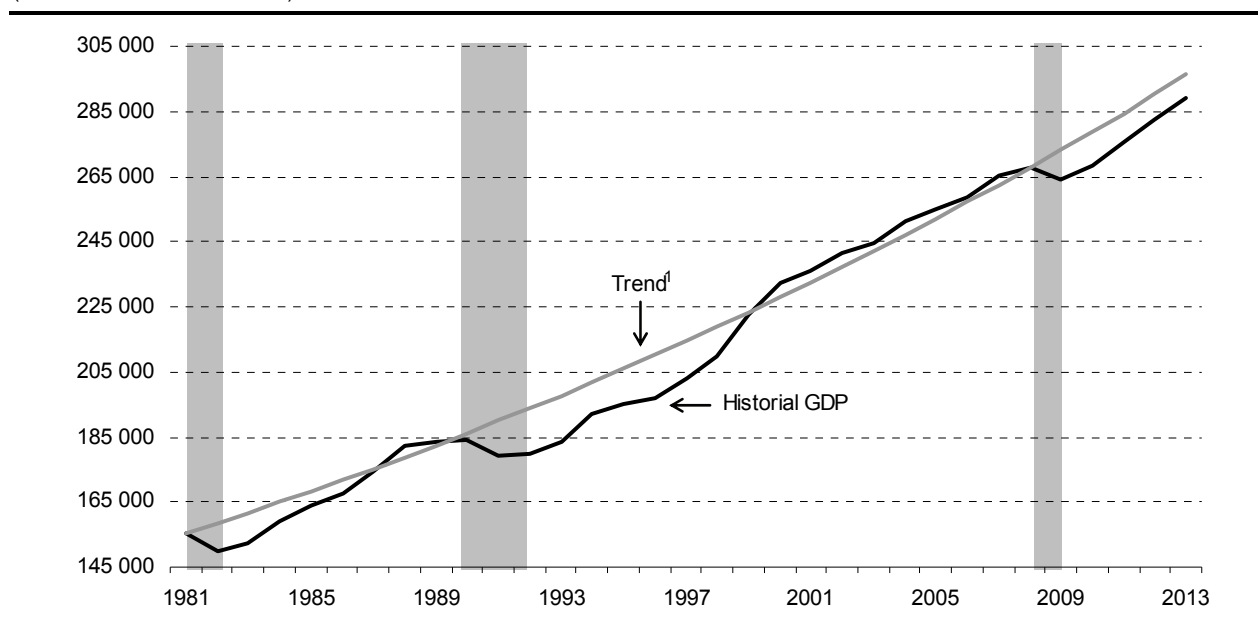
The current recession will leave significant traces over the coming years in Québec, with the level of output expected to remain well below what is forecast by the underlying growth of real GDP beyond the forecast horizon of 2009-2013.

- Projected real GDP will not reach the pre-recession peak achieved in the third quarter of 2008 until the third quarter of 2010, i.e. after eight quarters.
- In 2013, i.e. at the end of the five-year forecast period, Québec's real GDP will remain 3% below the level forecast by underlying growth.

CHART 24

### Québec's real GDP and trend

(millions of 2002 dollars)



1 Underlying growth was 2% over the last 28 years (1981 to 2008).

Sources: Institut de la statistique du Québec and ministère des Finances du Québec.

Note that output gaps were observed in the 1982 and 1991 recessions. In addition, during these last two business cycles, real GDP growth remained below underlying growth for a long period.

- Real GDP overtook the trend level six years after the 1982 recession and ten years after the 1991.

### **❑ A less robust recovery than in the past**

Real GDP growth in Québec from now until 2013 will not be enough to offset the loss of output caused by the recession, since:

- Québec's economy, being highly integrated to its southern neighbour, will suffer from the persistent problems of the U.S. economy associated with the financial crisis. According to the IMF and the OECD, the financial crisis will leave deep scars that will reduce potential economic growth in the U.S. over the coming years;
- the end of stimulus measures and the Plan to return to balanced budgets will limit growth over the next few years.

In addition, the less severe drop in output and consumption during the recession will limit the potential rebound of the economy.

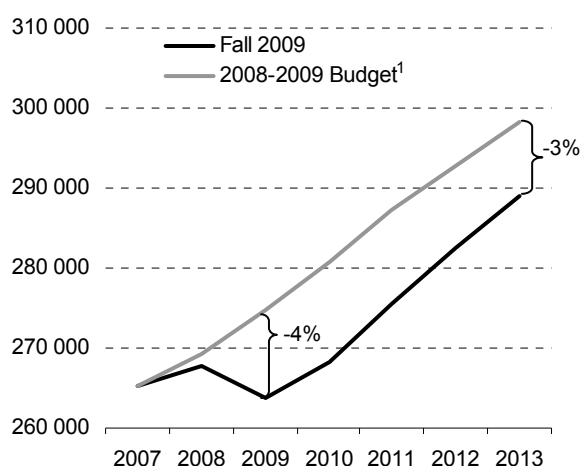
■ **Québec's economy will suffer from the difficulties of the American economy**

Given its high degree of integration to the American market, Québec's economy will continue to suffer from the effects of the persistent difficulties of the U.S. economy. In the United States, real GDP is expected to remain at least 5% below what was forecast prior to the recession until at least 2013.

- The financial crisis will reduce potential output in the United States over the coming years (see box "Analysis by the International Monetary Fund and the OECD on the slow pace of economic recovery (G-20)"). In addition, economic growth will be hampered over the next few years by the American government's efforts to restore order to public finances.

CHART 25

**Québec's real GDP**  
(millions of dollars)

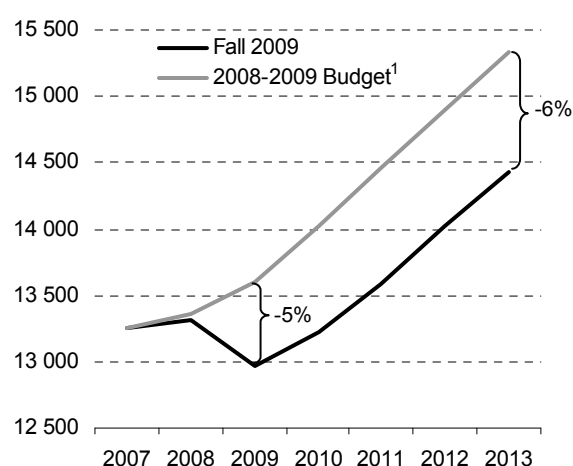


1 The data have been modified to reflect historical data revisions.

Sources: Institut de la statistique du Québec and ministère des Finances du Québec.

CHART 26

**United States real GDP**  
(billions of US dollars)



1 The data have been modified to reflect historical data revisions.

Sources: IHS Global Insight and ministère des Finances du Québec.

■ **The Plan to return to balanced budgets will limit economic growth in the short term**

The recession, resulting in lower revenue and higher spending, will cause substantial deficits, a situation that the government is committed to correct by 2013-2014.

Once the recovery is well under way, Québec will be in a position to implement the Plan to return to balanced budgets announced in the 2009-2010 Budget.

- Overall, the Plan to return to balanced budgets will reduce economic growth in Québec by 0.3 percentage point per year on average from 2011 to 2013, for a total of 1% over the entire period.

Funding economic activity with debt is not a viable long-term solution. Deficit reduction and elimination are necessary to maintain the standard of living and government's ability to deliver essential public goods and services. Businesses and consumers will be in a better position to make appropriate and necessary adjustments if they are informed in advance of the choices made to return to balanced budgets.

- Implementation of a budgetary consolidation policy sends a signal that the return to balanced budgets is under way and that future tax increases are ruled out, which will boost confidence among economic agents.

TABLE 11

**Overall impact of the Plan to return to balanced budgets on the economic outlook – annual average from 2011 to 2013**

(annual percentage change)

	<b>Situation before the plan</b>	<b>Impact of the plan</b>	<b>Situation after the plan</b>
Real GDP	2.8	– 0.3	2.5

Source: Ministère des Finances du Québec.

### **Analysis by the International Monetary Fund and the OECD on the slow pace of economic recovery (G-20)**

In August 2009<sup>1</sup>, the IMF carried out an analysis on the slow pace of economic recovery among G-20 countries. The study shows that in spite of the recovery, the economic crisis is expected to leave marks

- Economic growth may never return to its pre-recession level. The analysis of 88 banking crises shows that economic crises generally lead to a permanent drop in potential GDP.
- Governments are required to raise taxes, because the debts of governments of advanced economies are expected to reach 100% of GDP by 2011. The United States must make a particular effort to control its deficit. If it fails to act, a depreciation of the U.S. dollar could lead to another period of instability.
- The financial system remains fragile. The effect of lower interest rates implemented by central banks is mitigated by higher risk premiums.
- Lastly, advanced economies will have to increase demand for their export sectors to offset the decline in consumption. This assumes a rise in consumption among emerging economies, mainly China, which will happen only very gradually.

The IMF study follows the one done by the OECD<sup>2</sup> that reaches the same conclusions.

- The crisis in the financial system is responsible for roughly two thirds of the projected decline in potential GDP. Borrowing costs are expected to be higher in future years.
- While unrelated to the crisis, the decline in the labour market participation rate resulting from the aging of the population will contribute to reducing potential GDP.

1 Blanchard, Olivier, "Sustaining a Global Recovery", *Finance & Development*, September 2009, International Monetary Fund.

2 "Beyond the crisis: medium-term challenges relating to potential output, unemployment and fiscal positions", *OECD Economic Outlook No. 85, chapter 4*.

- **The less severe drop in output limits the potential for economic rebound**

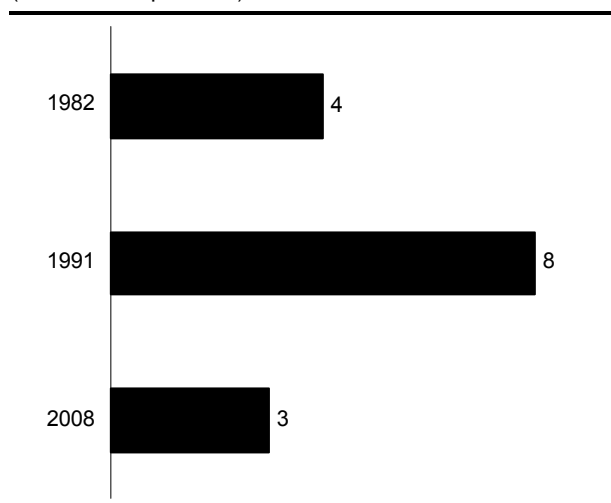
As a general rule, in a recession, households and businesses reduce their consumption and investment spending in view of the uncertain economic situation and, in some cases, lost income. Subsequently, when the economy recovers, they return to their pre-recession behaviour, supported by a more favourable economic climate. Accordingly, in this context, the less severe drop in output in Québec in 2008 and 2009, compared to previous periods, will limit the potential recovery as of 2010.

The two major business cycles recorded between 1981 and 2009 were separated by three recessions. The first extended from the fourth quarter of 1981 to the third quarter of 1982, a period of four quarters. The second lasted from the second quarter of 1990 to the first quarter of 1992, a period of eight quarters. The most recent started in the fourth quarter of 2008 and should end in the second quarter of 2009; it will have lasted three quarters.

Of these three, the 1982 recession was the deepest, with a decline in real GDP of 5.3% between the peak of output and the trough. The contraction in output reached 4.8% in the 1991 recession. This time, real GDP is expected to contract by 2.2%.

CHART 27

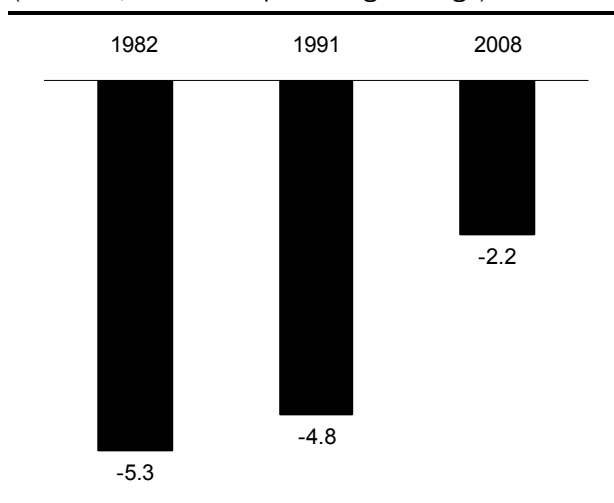
**Length of recessions in Québec**  
(number of quarters)



Sources: Institut de la statistique du Québec and ministère des Finances du Québec.

CHART 28

**Contraction in economic activity during recessions in Québec**  
(real GDP, cumulative percentage change)



Sources: Institut de la statistique du Québec and ministère des Finances du Québec.