DOCUMENT 3

QUÉBEC AND ITS CHALLENGES

A SUSTAINABLE PATH

TO MAINTAIN CONTROL OVER OUR CHOICES

Advisory Committee
on the Economy
and Public Finances

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Québec

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MESSAGE FROM THE MINISTER

In the wake of just over three months of intensive deliberations, the Advisory Committee on the Economy and Public Finances is submitting its third and final document, thus drawing to a conclusion its reflections initiated in conjunction with the 2010-2011 prebudgetary consultation.

Considerable progress

It was my wish, in establishing and inviting to sit on this committee four respected academics devoted to the public interest, to make available to all Quebecers an array of analyses and proposals on the key policy directions to be emphasized from the standpoint of economic growth and public finances.

My wish has been fully satisfied: the documents that the committee has already published have sustained discussions pertaining to the preparation of the budget. They have offered a diagnosis and put forth a perspective of the medium and long terms. The reception that these documents have received and the debate that they have aroused have enabled us to move forward.

The knowledge and rigour of Pierre Fortin, Robert Gagné, Luc Godbout and Claude Montmarquette have allowed us to make considerable progress.

This progress has been achieved with complete independence. Even though I acted as Co-Chair of the committee, I wanted the committee members to maintain complete freedom in their choices and preferences. The very credibility of their deliberations depended on it. The opinions voiced in this document are of course those of the Committee and do not commit the Minister or the ministère des Finances.

An impressive task

I have made careful note of the suggestions and proposals put forward in the first two documents. I will attentively analyze the possible solutions defined in the third document. As I emphasized at the outset of the committee’s deliberations, I will discuss with my government colleagues the entire array of analyses and proposals formulated in order to determine the appropriate follow-up.

Above all, I would like to warmly thank the committee members for what they have accomplished. Under the leadership of Co-Chair Robert Gagné, the committee members have performed in short order an impressive task, shedding light on very complex issues and proposing to Quebecers a comprehensible reading of the economic and financial questions to which we must respond.

I would also like to thank the entire support team that worked with the committee during its deliberations. The team, mainly made up of staff from the ministère des Finances, once again illustrated the rigour and excellence of government employees and their dedication to the public interest.

Making the right decisions

As the worldwide financial crisis and recession draw to a close, Québec must make the right decisions and move in the right direction.

The forthcoming budget will mark a key step in this respect.

I am convinced that the deliberations of the Advisory Committee on the Economy and Public Finances will contribute directly to this process.

Raymond Bachand

Québec Minister of Finance

MESSAGE FROM THE CO-CHAIR OF THE ADVISORY COMMITTEE

The publication of the third document of the Advisory Committee on the Economy and Public Finances marks the conclusion of the deliberations initiated by Québec Minister of Finance Raymond Bachand.

On behalf of the entire committee, I would like to thank the Minister for his trust in asking us to reflect on questions that are crucial to Québec's economic and financial health, and to thus contribute to the prebudgetary consultations that he wanted to be open and thorough.

Basic questions

The mandate that the Minister defined was at once demanding and specific.

The committee was to examine the economic and financial issues that Québec is facing in order to sustain and enrich debate surrounding the preparation of the forthcoming budget.

The questions raised were basic ones, since we were asked to reflect on our public services, our current and future debt, our current financial position, and the medium- and long-term impact of demographic changes.

A three-stage approach

We adopted a three-stage approach that allowed us to clearly separate the questions and encourage discussion and exchanges on what we deem to be essential points.

The titles chosen for the documents illustrate this approach and clearly summarize our concerns: Québec's economic and financial situation is characterized by extensive public services, limited leeway and new challenges to be met; there are solutions if we spend more effectively and better fund our public services; these solutions are embodied in what we have called a "sustainable path," which will enable us to maintain control over our choices.

Pierre Fortin, Luc Godbout, Claude Montmarquette and I quickly agreed on the observations to be made, the scope of the challenges to be met, and the nature of the initiatives to be taken to this end. The committee's third and final document takes stock of this situation and proposes a number of solutions. As we emphasize in this document, it is now incumbent upon Quebecers to express themselves concerning the measures to be adopted and upon the government to choose and act.

The committee's independence

The Minister of Finance co-chaired the Advisory Committee on the Economy and Public Finances. Mr. Bachand's presence at several of our meetings was enlightening and stimulating.

The Minister succeeded at the same time in maintaining sufficient distance to allow us to enjoy the complete freedom and independence without which we would have been unable to engage in serious, credible deliberations.

The committee could not have successfully completed its deliberations without the effective, dedicated support of a team drawn, by and large, from the ministère des Finances, whose excellence we wish to emphasize. We are indeed grateful to Simon Bergeron, Pierre Côté, Luc Monty and Jean-Pierre Pellegrin, who assisted us throughout our deliberations.

A message

This third document concludes with several messages, which we are addressing to Quebecers and to the government.

One message provides, in our view, the key to the other messages: whatever we do, the only sustainable way to manage public finances is to ensure that spending rises at the same pace as the revenues that fund it, i.e. at the same pace as economic growth. This is an inescapable reality, one of which every Quebecer is probably aware.

We hope that our deliberations will have brought this reality to the forefront of ongoing discussions.

Robert Gagné

Co-Chair

Advisory Committee on the Economy and Public Finances

FOREWORD

The Advisory Committee on the Economy and Public Finances is publishing its third and final document, thus concluding the process initiated by Minister of Finance Raymond Bachand. The first two documents were released in December 2009[1] and January 2010[2].

The Advisory Committee comprises Pierre Fortin, Robert Gagné, Luc Godbout and Claude Montmarquette and is co-chaired by the Finance Minister and Robert Gagné[3].

Mandate of the Advisory Committee on the Economy and Public Finances
Under its mandate, the Minister of Finance asked the Advisory Committee on the Economy and Public Finances to: – Propose an approach to implement measures aimed at ensuring a prompt return to sustainable economic growth and the funding of quality public services accessible to everyone. – More specifically, in the economic sphere, the committee was asked to: ▪ Take stock of the initiatives to be emphasized and the appropriate approach to accelerate economic recovery and ensure that Québec is competitive and creates wealth in the medium and long terms, bearing in mind, in particular, the impact of demographic changes and the need to ensure that all regions benefit from economic development. – In this respect, it was also asked to specify the means of enhancing productivity both in the private and public sectors. – From the standpoint of public finances, the committee was asked to: ▪ Take stock of priority initiatives and the appropriate approach to restore fiscal balance, anticipated in 2013-2014, and bolster public finances in the medium term, while: ○ ensuring funding for quality public services, especially in the health and education sectors; ○ enabling Québec to acquire adequate, updated infrastructure; ○ reducing the debt burden, which is already excessive, for future generations; ○ obtaining the leeway necessary to ensure the development of the economy so that it remains competitive. The committee will deliberate from November 2009 to February 2010, i.e. until the elaboration of the 2010-2011 Budget. The ministère des Finances will support the committee's deliberations.

1 Advisory Committee on the Economy and Public Finances, *Québec and Its Challenges, Document 1, Extensive public services, constrained leeway, and emerging challenges*, Québec, December 2009, 60 pages.

2 Advisory Committee on the Economy and Public Finances, *Québec and Its Challenges, Document 2, Possible solutions: Spend more effectively and better fund our public services*, Québec, January 2010, 94 pages.

3 As indicated in the first document, the Minister's presence as co-chair of the committee in no way hampered its deliberations. The Minister will analyse the committee's proposals and discuss with his government colleagues the appropriate follow-up.

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The Advisory Committee on the Economy and Public Finances, established by the Minister of Finance in conjunction with the 2010-2011 prebudgetary consultation, comprises Pierre Fortin, Robert Gagné, Luc Godbout and Claude Montmarquette and is co-chaired by the Minister and Robert Gagné[4].

The committee is presenting the third and final stage in the process initiated in November 2009.

— In the first document,[5] made public in December 2009, the committee defined the question that the Minister submitted to it by illustrating with concrete examples the current state of Québec's public finances and presenting a number of statistical observations.

— In the second document, the committee reached an essential conclusion: we must give priority to spending more effectively and better funding our public services.[6] The committee spelled out a number of simple principles to this end. These principles can lead rapidly to concrete initiatives, of which 10 or so have been pinpointed.

— In the third document, the committee analyses the choices available to us in order to ascertain their consequences and determine the path most likely to attain the objectives formulated in the mandate assigned to it. To this end, the committee summarizes in two series of scenarios the options with which we are faced.

The same hypotheses are formulated in respect of economic growth for each scenario. The first part of the document is devoted to an evaluation of the impact of demographic changes on economic growth, which warrants thorough examination.

The impact of demographic changes on economic growth

Over the past quarter century (from 1981 to 2008), annual economic growth in Québec has averaged 2%. This is the real growth rate, obtained by eliminating the impact of price increases.

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4 As indicated in the first document, the Minister's presence as co-chair of the committee has in no way hampered its deliberations. The Minister will analyse the committee's proposals and discuss with his government colleagues the appropriate follow-up.

5 *Québec and Its Challenges*, Document 1, *op. cit.*

6 *Québec and Its Challenges*, Document 2, op. cit., page 83.

This growth stemmed in almost equal measure from changes in the potential labour pool, the employment rate and productivity.

During the period 2009-2025, the reduction in the potential labour pool will significantly affect future economic growth. It will reduce average annual growth in GDP by 0.1% during the period 2013-2019 and by 0.2% during the period 2019-2025.

One initial way to counteract the impact of demographic changes is to increase the employment rate. The committee has adopted optimistic hypotheses according to which the increase in the employment rate would positively affect economic growth in the coming years. However, we have observed that this contribution would level off and decline at the end of the period.

Stepping up productivity is, in fact, the only way for Québec to achieve permanent, long-term gains in economic growth. According to the hypotheses that the committee adopted for the period 2009-2025, the increase in productivity would partially offset the impact on economic growth of changes in the potential labour pool.

❑ The economic growth rate projected until 2025

The integration of the forecasts adopted in respect of changes in the potential labour pool, the employment rate and productivity make it possible to determine Québec's anticipated economic growth rate in the coming years.

Annual growth in real GDP, which stood at 2% for the period 1981-2008, would gradually decline throughout the period, following a slight rebound in 2009-2013. At the end of the period, between 2019 and 2025, the average annual growth rate would stand at 1.4%, i.e. a reduction of 0.6 percentage point in relation to the historical average.

TABLE 1

Economic growth factors – Breakdown of real GDP
(as a percentage)

	1981-2008	2008-2009	2009-2013	2013-2019	2019-2025
Potential labour pool[1]	0.6	0.5	0.3	– 0.1	– 0.2
Employment rate[2]	0.6	– 1.6	0.5	0.8	0.5
Productivity[3]	0.8	– 0.4	1.4	1.1	1.1
Real GDP	**2.0**	**– 1.5**	**2.2**	**1.8**	**1.4**

1 Population between 15 and 64 years of age.
2 Total number of workers divided by the population between 15 and 64 years of age.
3 Real GDP per job.
Source: Projection of the ministère des Finances du Québec.

The projection that the committee adopted is fairly optimistic. It takes into account the anticipated change in employment rate and productivity against a backdrop of demographic changes and hypothesizes that the economy will react favourably after the recession.

Options that must be rejected

Based on these economic growth projections, the committee applied an initial series of two scenarios to the budgetary balance that the government made public in October 2009. These two scenarios, grouped under the theme "failure to act," correspond to options whose rejection the committee recommends.

❑ Scenario 1: the status quo

Scenario 1, dubbed "the status quo," was based on proposals and perceptions that are clearly evident in current discussions.

Under this scenario, no action would be taken in respect of expenditures to reduce growth in public spending. From the standpoint of revenues, the government would do nothing more than was announced and promised in March 2009, i.e. combat tax evasion and tax avoidance, index certain user fees[7], and introduce a one-point increase in the QST.

Among the arguments invoked to justify this option, the key one pertains to economic growth, which would ultimately suffice to resolve all of the problems.

From a financial standpoint, scenario 1 would lead to a rapid, striking deterioration in the fiscal position.

- The growing imbalance between revenues and expenditures would spur a veritable explosion in the deficit.
- The deficit would almost double by 2013-2014, rising in four years from $4.7 billion to $8.9 billion.
- The deficit would more than triple during the 12 subsequent years and thus reach $31.4 billion in 2025-2026.
- During the period overall, the deficit would rise from 1.6% of GDP in 2009-2010 to 5.9% in 2025-2026.

The steadily rising succession of deficits would affect the size of the debt, which would reach an astronomical figure at the end of the period.

[7] All user fees that are not indexed, except for reduced-contribution childcare service fees.

❑ A variant: rollback

Scenario 2, “rollback,” goes even further than the failure to act since it even calls into question the three remedial measures that the government announced in March 2009. Under this scenario, the government would relinquish its fight against tax evasion and tax avoidance, abandon the indexing of certain user fees and cancel the one-point increase in the QST, and would do nothing to reduce public spending.

To the arguments invoked in respect of the first scenario is added another one: the economic revival is so precarious that we must not attempt to slow growth in public spending. For the same reason, we must abandon the increase in the QST and the indexing of user fees.

The results of the rollback scenario are very obviously worse than the outcome of the status quo scenario.

- In 2013-2014, the budgetary deficit would reach $11.3 billion, compared with $8.9 billion under the preceding scenario.
- Between 2009-2010 and 2025-2026, the deficit would increase eightfold, from $4.7 billion to $38.2 billion, i.e. from 1.6% of GDP to 7.2%.
- The debt would reach unthinkable levels. Québec’s gross debt would stand at $548 billion in 2025-2026, i.e. $14 billion more than GDP. Debt service would approach $28 billion in 2025-2026, mobilizing at the end of the period nearly 25% of the government’s budgetary revenues.

The committee simulated the economic growth that would be necessary to balance public finances under scenarios 1 and 2, in keeping with the argument invoked to justify them. The results obtained demonstrate the unrealistic nature of this argument.

❑ The reality: failing to act is not an option

The committee is convinced that neither of these two scenarios could ever occur, for a very simple reason: the government will be incapable of funding a deficit and debt of such proportions unless it assumes unbearable interest costs.

In point of fact, the first two scenarios would very quickly exacerbate the state of public finances. The government would be subject to pressure from lenders, as was virtually the case in the mid-1990s, or as is now the case in several European countries.

— The government would be quickly compelled to make major spending cuts or implement substantial tax increases to restore a situation that it delayed remedying.

— By doing nothing or virtually nothing by 2013-2014, the government would then have to absorb an $11-billion deficit, which would necessitate program spending cuts of nearly 16% or an increase of nearly 20% in taxation.

This is obviously unrealistic: we would have to choose between cutting programs deemed priorities or implementing a tax system that might discourage work and cause a brain drain.

By refusing to promptly adopt the right measures, the government would find itself in an impossible situation stemming from the combined effect of the structural imbalance between growth in revenues and expenditures and the impact of demographic changes.

The results of taking action

The other two scenarios are intended to assess the results of taking action.

❑ Scenario 3: the partial response

Scenario 3, “the partial response,” corresponds to the plan to restore fiscal balance announced in March 2009, including measures as yet to be defined to restore fiscal balance by 2013-2014. The scenario thus integrates the measures already announced and the measures that we will have to adopt to attain the desired objective.

The scenario includes the four measures announced in the March 2009 Budget Speech, i.e. measures to counteract tax evasion and tax avoidance, the indexing of certain user fees, the one-point increase in the QST, and tight control over spending to limit annual growth in program spending to 3.2% between 2010-2011 and 2013-2014.

The other measures necessary will be added to achieve fiscal balance in 2013-2014.

- The committee has adopted the hypothesis whereby these additional measures solely cover revenues, as indicated in the October 2009 document.[8]
- Based on official data from the fall of 2009, the government will thus seek $5.1 billion in additional revenues by 2013-2014.

This scenario has been dubbed “the partial response” since it makes no provision beyond 2013-2014, even though the *Balanced Budget Act* calls for a return to balance in 2013-2014, after which growth in program spending will resume according to a structural trend.

■ The results

Scenario 3 makes it possible to restore fiscal balance in 2013-2014, since it is the very basis for the option analysed. On the other hand, and in the absence of additional initiatives, the committee observed the rapid reappearance of a structural deficit after this date. The figures are much less spectacular than under the first two scenarios, but the increase in indebtedness is real.

We thus find ourselves in 2013-2014 in a situation that cannot be considered sustainable.

- Since no measure has been announced to restore structural balance between revenue and spending, we once again observe deterioration in public finances.
- This occurs at a time when Québec’s financial position is worse than it was prior to the 2009 recession. The debt has increased by nearly $30 billion, equivalent to 18%, in four years.
- By increasing its revenues, the government has implemented a tax system that is even less competitive in relation to our competitors. In 2013-2014, each adult Quebecer must assume additional fiscal levies of $1 200.

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8 Ministère des Finances du Québec, *Sound Public Finances to Protect Our Values: A Return to Balanced Budgets by 2013-2014*, Québec, October 27, 2009, page 24, Table 4.

Unlike the first two scenarios, “the partial response” scenario calling solely for a return to fiscal balance is manageable. It includes an initial stage that moves in the right direction with the restoration of fiscal balance in 2013-2014. However, it does not provide a lasting response to the problem of public finances. In addition, it implies significant risks should a recession occur or should the government lose control over spending.

❑ Scenario 4: the sustainable path

Scenario 4, “the sustainable path,” represents the logical outcome of the committee’s deliberations. It is based on the observations and principles presented in the first two documents.

By 2013-2014, fiscal balance would be restored through equivalent restraint measures focusing on revenue and spending, under a pact proposed by the government. This approach lies midway between policies that concentrate all restraint measures on spending and other policies focusing solely on increased revenue. The path that the committee has adopted thus avoids radically calling into question the basket of services or a significant tax increase.

After 2013-2014, fiscal balance would be maintained by linking growth in spending to growth in the revenue.

The committee’s arguments underpin this scenario.

- In the short term, to restore fiscal balance, we must rely in a balanced manner on revenues (an increase in taxes and user fees) and expenditures (greater control over growth in spending).
- In the medium and long terms, the only sustainable way to maintain sound public finances is to adjust growth in spending to economic growth. We must link growth in spending to growth in the revenue on which we can rely to cover this spending.

The scenario that the committee favours focuses much more extensively on spending than is now the case.

❑ The results obtained

This scenario is that of fiscal balance restored and maintained.

- Through the efforts made, the discrepancy between revenue and spending would be eliminated by 2013-2014.
- After that date, revenue and spending would grow at the same pace and fiscal balance would be maintained.

We would witness a gradual improvement in Québec's level of indebtedness and a reduction in the interest burden. At the end of the period, in 2025-2026, program spending would account for 20% of Québec's GDP, the same proportion as in 2009-2010. This means that restraint measures in respect of spending would not call into question the place that public services occupy in the Québec economy.

As for revenue, the scenario that the committee favours would lead in 2025-2026 to a certain increase in the tax pressure in relation to 2009-2010. Between the beginning and the end of the period, the proportion of own-source revenue in Québec's GDP would increase from 15.5% to 17.4%, equivalent to 1.9% of GDP. In fact, the bulk of this increase occurs between 2009-2010 and 2013-2014.

In practical terms, scenario 4 involves a smaller levy on the taxpayer than scenario 3 does: in 2013-2014, each adult Quebecer would have to assume additional fiscal levies of just under $900, compared with $1 200 under scenario 3.

■ Implementation of the scenario that the committee favours

In this scenario, the committee suggests an array of initiatives affecting both revenues and expenditures. The committee is proposing principles and a framework for action but is not choosing between these initiatives. It is, in fact, incumbent upon Quebecers to express themselves on the measures to be adopted and upon the government to make choices and act.

With regard to expenditures and revenues, restraint measures have been set at $5.6 billion by 2013-2014. Annual growth in program spending would be reduced to 2.5% by 2013-2014, after which control over spending must ensure that growth in such spending is linked to the pace of economic growth. Growth in program spending would stand at 4.2% between 2013-2014 and 2019-2020 and at 4.0% between 2019-2020 and 2025-2026.

The committee believes that it is important to initially give priority to spending more effectively and better funding our public services. This means that by 2013-2014, we must restore fiscal balance through measures that apply equally to revenue and spending.

This is the essence of the pact proposed: each of us must do his part to achieve and maintain a balanced budget framework. The government will not levy one additional dollar in taxes or user fees if it has not exercised equivalent restraint in respect of spending. Through this pact, restraint measures and commitments will be shared between public service providers, their users and taxpayers, with a view to putting public finances in order and protecting the future.

Expenditures: a veritable cultural revolution in public management

The scenario that the committee favours assumes a veritable cultural revolution in the management of public spending focusing, first, on how the government and government corporations spend. This cultural revolution goes much further than what is now anticipated in Québec.

- We have adopted the hypothesis that half of the restraint measures in respect of spending required by 2013-2014 would be obtained through annual productivity gains of 1%. The committee has formulated an analogous expectation as regards government corporations.
- The other half of these restraint measures would stem from the systematic reassessment of programs that would lead, depending on the case, to the elimination of certain programs, a freeze in development, or the revision of the programs.
- We believe that after 2013-2014, control over growth in program spending will be obtained primarily through productivity and efficiency gains.

To obtain the anticipated productivity gains, the government can rely on an array of possibilities, which the committee presents. As for the $3 billion that must be recovered in respect of spending by 2013-2014, numerous possibilities are available. The calculation of the discrepancy in spending in relation to Ontario, which the committee presented in the first document,[9] should reveal the fields to be analyzed as a matter of urgency.

Revenue: restraint measures will be concentrated above all at the outset

Scenario 4 assumes that half of the initiatives necessary to restore fiscal balance in 2013-2014, i.e. $5.6 billion, will come from an increase in government revenues. Of this amount, the measures that the government has already announced account for $2.4 billion. There thus remains $3.2 billion in additional revenue to be pinpointed.

The principles geared to more effective funding identified in the second document indicate the path that the government must follow. The committee refers to principles such as the avoidance of heavier income taxes, or opting for government tax levies that are the least damaging to economic growth, in particular consumption taxes.

Beyond 2013-2014, growth in own-source revenue would follow economic growth.

The committee has identified several orders of magnitude concerning the potential measures that could be adopted to generate additional government revenues.

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9 *See Québec and Its Challenges*, Document 1, *op. cit.*, page 11.

It is of the opinion that the government should give priority to analyzing user fees. It should also be noted that more closely aligning user fees to costs has the twofold advantage of scarcely hampering economic growth and leading to sound behaviour among those who use fee-based services.

Conclusion

The results obtained reveal the interest of "the sustainable path" scenario that the committee is proposing.

This scenario makes it possible to restore fiscal balance within four years and maintain it subsequently, without calling into question the government's role and place in the economy. In fact, at the end of the period, the weight of program spending in relation to GDP remains constant and the share of revenues rises slightly, which is far from representing a withdrawal by the government.

❑ Four messages

From its deliberations overall, the committee has drawn four essential messages, which it is addressing both to the government and to all Quebecers.

- **In the realm of public finances, it would be a serious mistake not to act now.**

It is imperative that we reach the target set in the March 2009 Budget Speech and restore within four years balance in public finances. To defer beyond 2013-2014 a return to balance would make us highly vulnerable since it is then that we will start to feel the impact of the ageing of the population.

- **To balance the budget, we must focus equally on revenue and spending.**

The committee's proposals contrast sharply with the easy solution whereby levies would be increased without altering expenditures. Ultimately, the committee is convinced that the only way to ensure that Québec's public finances can be balanced on a long-term basis is to adjust growth in spending to that in revenue, which itself is determined by economic growth.

- **It is imperative that we improve how we spend and how we fund our public services.**

The committee has heavily stressed the need to spend more effectively, based on convincing examples that many advanced countries offer us. The same is true of revenue. The choice of taxes and types of levy directly affect economic growth. We must emphasize indirect taxes and user fees rather than direct taxes. This option can be made compatible with a genuine concern for the situation of the least privileged members of society. An appropriate strategy in this respect might earn us additional growth points, which are highly valuable against a backdrop of demographic changes.

- **A message of hope**

The scenario developed to give practical shape to the observations and proposals presented shows that it is possible to maintain long-term balance in public finances, reduce our indebtedness and lessen the weight of "bad debt," despite demographic changes, while maintaining a comparable basket of public services and avoiding heavier taxation.

A forgotten fact

Having completed its deliberations, the Advisory Committee on the Economy and Public Finances can only conclude with a fact that is all too often forgotten: whatever we do, the only sustainable way to manage public finances is to ensure that spending rises at the same rate as the revenue that funds it, i.e. at the same rate as economic growth.

The challenges facing Québec compel us to come to terms with this reality.

INTRODUCTION

The Minister of Finance set up the Advisory Committee on the Economy and Public Finances in conjunction with the 2010-2011 prebudgetary consultation, which focuses on two key problems:

— the resumption of growth and major medium- and long-term economic policy directions in order to create the wealth necessary to fund public services;

— the means to be implemented to restore fiscal balance in 2013-2014 and to control the debt by the year 2025.

The committee decided to adopt a three-stage approach under which each stage has led to the publication of a separate document.[10]

— In the first stage, the committee defined the question and illustrated the current state of public finances with concrete examples.

— In the second stage, it focused its reflection on two possible solutions concerning expenditures, and the funding of public services.

❑ Make choices and act

In the first document, the committee drew inferences from its observations:[11] Québec has now reached a limit. Our financial position is worrisome. The challenges that Québec must face are genuine, immediate and considerable. It is thus necessary to make choices and to act.

The choices to which the committee is referring should target:

— a level of public spending that is commensurate with our ability to pay;

— efficient taxation that does not compromise our economic development;

— debt that is under control and whose size does not jeopardize our children's choices.

These choices should enable Québec to benefit from balanced public finances in the long term in keeping with the ability of future generations to make their own choices, which is the very definition of sustainable development.

10 *Québec and Its Challenges, Document 1*, *op. cit.*, page 7.

11 *Ibid*, page 49.

The observations of the Advisory Committee on the Economy and Public Finances presented in its first document

The advisory committee's observations presented in the first document were summarized in a statistical snapshot.[12]

Québec funds more public services than Ontario does.

- Québec funds 26% more public services than Ontario does.
- If Québec offered Quebecers the basket of services that Ontario publicly funds, it would reduce its spending by $17.5 billion.[13]

Québec creates less wealth than Ontario does.

- Québec's GDP per capita is 14% lower than Ontario's per capita GDP.
- This means that Québec's potential tax base (adjusted according to its population) is $50 billion smaller than Ontario's potential tax base.

To fund public services, we have opted for levying higher taxes and going deeper into debt than is the case elsewhere. We have got into debt mainly to fund current spending, commonly called "the groceries."

- Québec's gross debt, on which the interest payable is calculated, now stands at $150 billion.[14]
- Two-thirds of this amount comprises "bad debt," i.e. the accumulated deficits.

Our high level of indebtedness reduces our budget flexibility.

- Nearly 60% of the QST collected is allocated to debt service.
- We are increasingly vulnerable to interest rate fluctuations.
- We are more exposed than ever to fluctuations in federal transfers.

Despite this high level of indebtedness, we have not invested sufficiently in infrastructure, which is forcing us to catch up quickly.

Over time, our leeway has dwindled even as new challenges are looming on the horizon:

- higher healthcare costs;
- the impact of demographic changes on wealth creation;
- upgrading infrastructure.

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12 *Ibid*., page 49.

13 If Québec funded public services in the same way that the Ontario government does, its spending in 2008-2009 would have stood at $68.6 billion instead of $86.1 billion (data from the Statistics Canada financial management system adjusted by the ministère des Finances du Québec, *Québec and Its Challenges, Document 1*, *op. cit*., page 12)

14 See *ibid*., page 29, concerning the concept of the Québec government's debt

❑ Spend more effectively and better fund our public services

In its second document, the committee reached an essential conclusion: we must give priority to spending more effectively and better funding our public services.[15] The committee spelled out a number of simple principles to this end. These principles can lead rapidly to concrete initiatives, of which 10 or so have been pinpointed.

The committee is confident of the possibility of meeting the challenges that we are facing from the standpoint of the economy and public finances. Much can be done without calling into question the basket of public services that the Québec government offers Quebecers. Once again, however, the committee wishes to emphasize that this implies that we make choices and act.

The Advisory Committee on the Economy and Public Finances concluded in its second document that we can spend more effectively and better fund our public services

At the conclusion of the second stage of its approach, the committee reached a significant conclusion: given the scope of our expenditures and taxes, we must give priority to spending more effectively and better funding our public services.[16]

- We can spend more effectively, i.e. make better use of the funds earmarked for public services.
- We can also better fund our public services.

A source of hope

This is a source of hope. It means that by learning from what has been done elsewhere (in some instances for a long time), it is possible to reduce the cost of the services now offered or to deliver more extensive services at the same cost.

In the healthcare sector, we have very specific examples of procedures that cost money and curtail what we obtain in relation to what we pay. This is also true in the education sector and in big commercial government corporations such as Hydro-Québec.

At the same time, we can better fund our public services by defining an efficient tax system that does not jeopardize our economic development, and by relying more extensively on user fees to fund public services, as is the case in countries that offer substantial publicly funded services.

Simple principles

We can achieve this end by applying several simple principles. Specifically, we must:

- bring into general use and depoliticize program performance assessment;
- encourage sound management, penalize poor management and foster competition;
- define an efficient tax system and thus reduce the negative impact of taxes on economic development;
- rely more extensively on user fees.

Concrete initiatives

These principles can lead rapidly to concrete initiatives, of which the committee has pinpointed 10 or so.

15 *Québec and Its Challenges, Document 2*, *op. cit.*, page 83.

16 *Ibid*.

❑ Analyze the choices available to us: two series of scenarios

In the third stage of its approach, the committee is analyzing the choices available to us in order to ascertain their consequences and pinpoint the path most likely to attain the objectives spelled out in the mandate assigned to it.

To this end, the committee summarized in two series of scenarios the options before us.

— The first series of scenarios corresponds to the **failure to act** and comprises two variants, dubbed "**the status quo**" (scenario 1) and "**rollback**" (scenario 2).

— The second series of scenarios illustrates the **results of taking action** and also comprises two variants, dubbed "the partial response" (scenario 3) and "**the sustainable path**" (scenario 4).

■ Two contrasting paths

These two series of scenarios encompass the options from which the government will have to choose from the standpoint of revenue, spending and the debt.

The scenarios present two contrasting paths that reflect, by and large, what is now on the table in ongoing public discussion. Three of them incorporate initiatives already launched or announced by the government. To analyze and comment on them, the committee has relied on fiscal projections requested for this purpose from the ministère des Finances.

The committee could have provided other response scenarios but doing so would only have confused discussion. It preferred to adopt two groups of scenarios, each one with its own logic.

❑ A first option: the failure to act

The first two scenarios have in common the failure to act.

— Under scenario 1, "**the status quo**," nothing would be done from the standpoint of expenditures to reduce growth in public spending. As for revenue, the government would do nothing in addition to the commitments announced in March 2009, i.e. combat tax evasion and tax avoidance, index certain user fees,[17] and introduce a one-point increase in the QST.

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[17] All user fees that are not indexed, except reduced-contribution childcare service fees.

- Scenario 2, “**rollback**,” goes even further in the failure to act since it even calls into question the three remedial measures that the government announced in March 2009. Under this scenario, the government would abandon the fight against tax evasion and tax avoidance, relinquish the indexing of certain user fees, and cancel the one-point increase in the QST, and would not alter public spending.

■ A path that must be rejected

The committee believes that this first path must be firmly rejected.

The **status quo**, and even more so **rollback**, are tantamount to giving up balanced budgets once and for all beyond 2013-2014 and letting the situation drift with the belief that economic growth will solve everything.

- Under these two scenarios, we are spending in the same way, which means, in practical terms, that we are contemplating the pace of growth in healthcare spending without intervening, even if such growth is structurally higher than economic growth.
- We are funding in the same manner, which means that we are maintaining a tax structure that is prejudicial to wealth creation and our economic development, and that we remain heavily reliant on income tax.

These two scenarios are untenable and will ultimately lead to a policy for restoring order to public finances imposed under pressure from the financial markets in the worst conditions.

❑ A second option: the results of taking action

The other two scenarios are intended to assess the results of action.

- Scenario 3, “**the partial response**,” corresponds to the plan to restore fiscal balance announced in March 2009, including measures yet to be defined to balance the budget by 2013-2014. The scenario thus incorporates the measures already announced and the measures that will have to be adopted to attain the desired objective.

  The scenario includes the four measures announced in the March 2009 Budget Speech, i.e. the fight against tax evasion and tax avoidance, the indexing of certain user fees, the one-point increase in the QST, and stringent control of spending in order to limit annual growth in program spending to 3.2% between 2010-2011 and 2013-2014.

— Scenario 4, "**the sustainable path**," represents the logical outcome of the committee's deliberations. It is based on the observations and principles presented in the first two documents.

  By 2013-2014, the budget would be balanced through equivalent restraint measures pertaining to revenue and spending, under a pact proposed by the government. After 2013-2014, the budget would remain balanced by linking growth in spending to economic growth.

  In this scenario, the committee suggests an array of initiatives affecting both revenue and spending. The committee is proposing principles and a framework for action but is not choosing between these initiatives. It is, in fact, incumbent upon Quebecers to express themselves on the measures to be adopted and upon the government to make choices and act.

■ The government's plan is an incomplete response

The committee believes that scenario 3 moves in the right direction but only affords an incomplete response to the questions that the Minister raised. The scenario does not include any measure aimed at ensuring long-term balanced public finances after 2013-2014, bearing in mind the impact that demographic changes will have.

It is thus insufficient, since it does not guarantee sound public finances over a long period, in light of demographic changes and the need to pursue the modernization of infrastructure.

■ A sustainable path to maintain control over our choices

The committee deems the fourth scenario to be the only long-term "sustainable path." It illustrates a workable option.

Scenario 4 allows for a return to balanced budgets in 2013-2014 by protecting public services and limiting the impact of heavier taxation on economic growth. It centres on very short-term initiatives in order to quickly balance our public finances and reduce indebtedness.

In the longer term, this scenario proposes an approach designed to ensure that overall revenue and spending grow at the same pace, which is the only way to ensure in a sustainable manner sound, robust public finances. It thus gives Québec the means to respond under favourable conditions to the impact of demographic changes and to ensure the renewal and modernization of our infrastructure.

Under the terms of the mandate that the Minister of Finance assigned to the committee, this scenario thus makes it possible to:

- return to balanced budgets by 2013-2014;
- bolster public finances in the medium term.

It does so while:

- ensuring funding for quality public services, in particular healthcare and education;
- enabling Québec to equip itself with adequate, updated infrastructure;
- reducing the debt burden for future generations and thus obtaining the leeway necessary to ensure economic development so that the economy remains competitive.

This scenario is the committee's response to the questions that were put to it. The "sustainable path" option has the considerable merit of ensuring that we maintain control over our choices.

❑ The simulation of the scenarios

The ministère des Finances simulated these four scenarios at the committee's request. The approach adopted is indicated below.

■ Common assumptions

The same assumptions were formulated in respect of the scenarios from the standpoint of economic growth, the attendant own-source revenue and federal transfers.

- From the standpoint of economic growth, the assumptions adopted take into account the impact of demographic changes on the growth rate of gross domestic product (GDP). As we will see, these assumptions are relatively optimistic as regards the Québec economy's ability to offset, at least partially, the consequences of the ageing of the population.
- Own-source revenue linked to economic growth is based on changes in the tax bases stemming from these growth assumptions. In particular, we surmised that new retirees would draw on their savings to support consumption. We also took into account the enrichment of future seniors in relation to the seniors belonging to preceding age groups.

— As for federal transfers, we assumed that such transfers would be defined according to the existing rules. The rules remain unchanged, regardless of the scenario analyzed.[18]

The impact of government policies

In light of these basic assumptions, which are identical for all of the scenarios, the approach consists in ascertaining the impact of government policies concerning revenue, e.g. an increase in own-source revenue, the fight against tax evasion and tax avoidance, and spending (control over growth in public spending).

A common starting point

These policies were simulated using a common starting point, dubbed the "initial conditions," i.e. the financial framework made public last fall.[19]

This financial framework covers the five years from 2009-2010 to 2013-2014. According to this financial framework, with annual growth in program spending of 4.6%,[20] the deficit would increase from $4.7 billion in 2009-2010 to $11.3 billion in 2013-2014.

TABLE 2

Budgetary balance after the fall 2009 update
(millions of dollars)

	2009-2010	2010-2011	2011-2012	2012-2013	2013-2014
BUDGETARY BALANCE WITH 4.6% GROWTH IN PROGRAM SPENDING	– 4 695	– 6 609	– 8 611	– 10 172	– 11 284

Source: *Sound Public Finances to Protect Our Values: A Return to Balanced Budgets by 2013-2014*, Québec, October 27, 2009, page 24, extracted from Table 4.

The simulations effected

Under each of the scenarios defined, we estimated changes in government revenues and expenditures, the resulting budgetary balance, the debt and debt service.

The simulations go beyond the financial framework presented in October 2009. The horizon studied covers a 15-year period from 2010-2011 to 2025-2026.

18 We have assumed that the federal government would not cut transfers to the provinces to reduce its own deficit, as it has promised. This means that the federal government would not define reduction measures, as was the case in the 1990s.

19 *Sound Public Finances…*, *op. cit.*, page 24, Table 4.

20 The growth rate in public spending actually observed between 2003-2004 and 2009-2010.

❑ The guiding principle

The third document published by the Advisory Committee on the Economy and Public Finances uses as a guiding principle the two main options summarized.

It comprises three parts:

— The **first part** is devoted to an evaluation of the **impact of demographic changes on economic growth**. This impact will be substantial and it is important to thoroughly examine this question.

— In the **second part**, the committee analyses the option corresponding to the **failure to act** (the scenarios that illustrate "**the status quo**" and "**rollback**").

— The **third part** examines the option entitled "**the results of taking action**," i.e. the "**partial response**" (the plan to restore fiscal balance) and "**the sustainable path**," the scenario corresponding to the proposals formulated by the advisory committee.

PART ONE
The impact of demographic changes on economic growth

The first part of this document is devoted to the impact of demographic changes on economic growth.

The committee believes that it was important to establish the scenarios pertaining to changes in public finances on a solid footing by analyzing trends that affect Québec's economic growth.

In particular, it was essential to thoroughly assess the impact of demographic changes on future economic growth and to derive a realistic projection of future economic growth.

To this end, the committee proceeded in five stages, each one presented in a separate section:

- The committee first analyzed the past quarter century of economic growth to determine **the sources of such growth** in the recent past.
- It then evaluated the **potential labour pool**, the factor that demographic changes will directly affect.
- The committee examined an initial means of countering this impact, i.e. **growth in the employment rate**.
- It then focused on the second means of combating demographic changes, i.e. the **acceleration of productivity**.
- The committee then integrated these three sources of growth in order to determine the projected **economic growth rate** by 2025.

Beforehand, the committee wanted to review in a brief introduction the importance of economic growth for a society.

The importance of economic growth

Economic growth can be defined as the year-over-year increase in the volume of all goods and services produced in an economy, commonly called gross domestic product.[21] One speaks of real GDP when the effect of price increases is eliminated from the data to obtain the volume of goods and services.

Any prospective analysis of public finances is based on an evaluation of future economic growth. Economic growth will determine government revenues and the resources available to fund public services.

❑ What economic growth allows

As the Task Force on Business Investment, chaired by Pierre Fortin and whose report was published in March 2008, emphasized, economic growth and thus increased wealth can only serve to broaden our possibilities.[22] For example, economic growth will enable us to better respond to healthcare needs or face environmental challenges.

Moreover, we must remember that economic growth is the only way to raise the standard of living of society overall. Experience over the past 20 years has shown that poverty increases when economic growth lags and diminishes when it accelerates.[23]

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21 Also called "nominal gross domestic product" (nominal GDP).

22 Report of the Task Force on Business Investment, *Québec Welcomes Investment*, Québec, 2008, page 15.

23 Report of the Task Force on Business Investment, *op. cit.*, page 13.

1.1 Sources of economic growth

It should be noted here that economic growth stems from three sources, i.e. changes attributable to demography, employment and productivity.

- Economic growth can stem, first of all, from a positive contribution by demography, i.e. the increase in the potential labour pool. If the pool increases, demography contributes positively to economic growth.

  To measure the potential labour pool, statistical agencies usually adopt as a reference the population between 15 and 64 years of age, although individuals under 15 years of age or over 64 years of age may be working.

- Second, economic growth can be triggered by a change in employment. In other words, economic growth can stem from an upturn in the proportion of potential workers who are actually employed. In fact, this is the definition of the employment rate.

- Third, economic growth can be attributable to an increase in productivity, i.e. the volume of output per employed worker.

From a statistical standpoint, we are thus able to break down the annual economic growth rate into three components:

- the change in the potential labour pool (essentially the change in the population between 15 and 64 years of age);

- the change in the employment rate, i.e. the changes noted in the proportion of potential workers who are employed;

- the change in productivity, i.e. the change in each worker's economic return.

An increase in the potential labour pool, the employment rate or productivity leads to economic growth, i.e. to an increase in real GDP.

❑ Sources of growth over the past quarter century

Over the past quarter century (from 1981 to 2008), annual economic growth in Québec averaged 2%. This is the real growth rate, obtained by eliminating the effects of price increases.

This growth stems in almost equal measure from changes in the potential labour pool, the employment rate and productivity.

— The population between 15 and 64 years of age increased 0.6% a year and stood at 5.4 million in 2008. During the period, nearly 30 000 individuals, on average, entered the labour market each year.

— The employment rate rose 0.6% per year, which means that for the period overall, nearly 1.1 million workers joined the Québec labour force.

— During the same period, annual output per job increased 0.8%, which means that output per worker rose from $62 300 in 1981 to $77 900 in 2008 (2008 dollars).

TABLE 3

Economic growth factors – Breakdown of real GDP
(as a percentage, annual average)

	Average, 1981-2008
Potential labour pool[1]	0.6
Employment rate[2]	0.6
Worker productivity[3]	0.8
Real GDP	**2.0**

1 Population 15 to 64 years of age.
2 Total number of workers divided by the population 15 to 64 years of age.
3 Real GDP per job.
Source: Projection of the ministère des Finances du Québec.

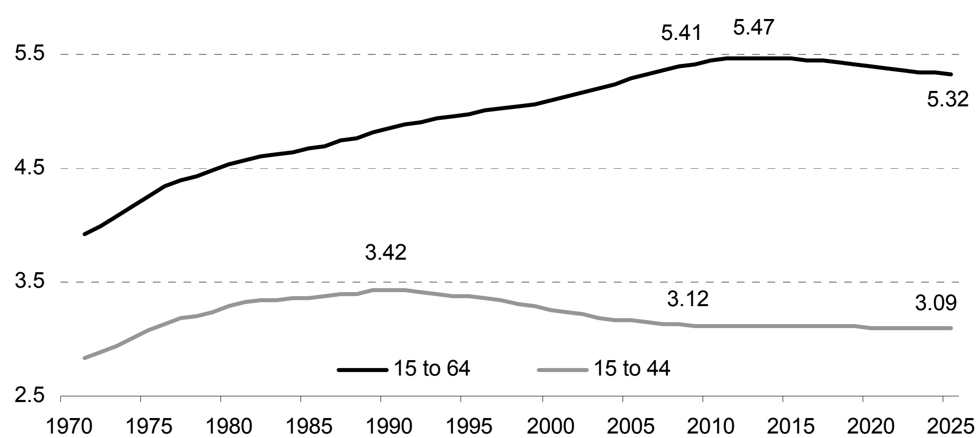
1.2 Demographic changes will reduce the potential labour pool

According to the reference scenario of the Institut de la statistique du Québec (ISQ), the population between 15 and 64 years of age will start to dwindle in 2014. All told, between 2013 and 2025, the Québec population in that age group will decline by 2.7%. This represents a reduction of nearly 150 000 people for the period overall, i.e. on average just over 12 000 individuals per year.

The population between 15 and 44 years of age has already started to shrink. The number of individuals in this age group fell 9% between 1990 and 2009, a reduction of 308 000.

CHART 1

Québec's potential labour pool
(millions of individuals)



Source: Institut de la statistique du Québec.

The reduction in the potential labour pool will significantly affect future economic growth. It will lower average annual growth in GDP by 0.1% for the period 2013-2019 and by 0.2% for the period 2019-2025. For comparison purposes, it should be noted that the increase in the number of potential workers contributed 0.6% to growth each year between 1981 and 2008.

TABLE 4

Economic growth factors – Impact on real GDP of the decline in the potential labour pool
(as a percentage)

	1981-2008	2008-2009	2009-2013	2013-2019	2019-2025
Potential labour pool[1]	0.6	0.5	0.3	– 0.1	– 0.2

1 Population 15 to 64 years of age.
Source: Projection of the ministère des Finances du Québec.

1.3 An initial way to offset the impact of demographic changes: increase the employment rate

It is anticipated that in the coming years improvements on the labour market, i.e. the reduction of unemployment, will lead to an increase in the employment rate, i.e. the total number of workers divided by the population between 15 and 64 years of age.

- In the short term, the labour market will experience an improvement stemming from the cyclical decline in unemployment resulting from economic revival.
- During the period overall, several phenomena will have a similar impact.
  - Individuals who were previously inactive, e.g. retired, at school or not seeking work, will decide to work because of the worthwhile opportunities open to them.
  - Individuals who are employed will decide to postpone retirement.
  - The increase in the level of schooling of individuals now between 15 and 64 years of age will prolong their presence on the labour market.
  - Participation by women in the labour market should also continue to rise, as has been the case for several years.

The committee has adopted the following assumptions for the period 2008-2025.

- The employment rate of the 15-to-54 age group will increase from 76.5% in 2008 to 79.7% in 2025, equivalent to an additional 120 000 workers in relation to the situation where the employment rate remains unchanged.
- The employment rate of the 55-to-64 age group will rise from 50.2% to 60.3% during the same period, equivalent to an additional 135 000 workers compared with the situation where the employment rate remains the same. The employment rate in this age group stood at 59.8% in Ontario in 2008.
- We will witness an increase in employment among individuals 65 years or over, from 6.8% in 2008 to 11.9% in 2025, equivalent to 100 000 additional workers during the period, using the same comparison as above.

All told, based on the hypotheses adopted, the employment rate will increase from 73% in 2008 to 79.6% in 2025. These hypotheses would draw Québec's employment rate closer to the employment rates observed in Ontario and the United States in recent decades.

TABLE 5

Québec labour market projection, 2008-2025

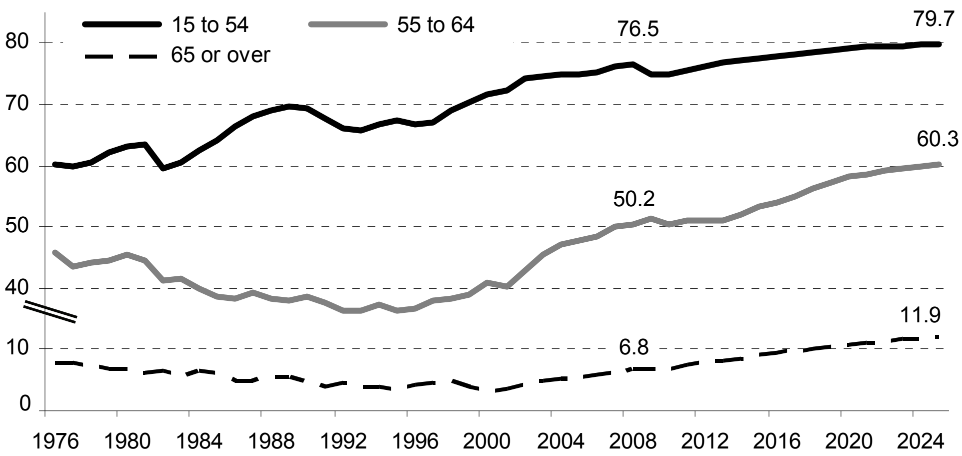
(thousands of individuals)

	Population			Employment				
	2008	Change	2025	2008	Change			2025
					Impact of population	Impact of employment rate	Total	
15 to 64 years of age	**5 388**	**– 69**	**5 319**	**3 810**	**– 85**	**255**	**170**	**3 980**
– 15 to 54	4 394	– 219	4 175	3 310	– 140	120	– 20	3 290
– 55 to 64	994	150	1 144	500	55	135	190	690
65 or over	**1 132**	**842**	**1 974**	**70**	**50**	**100**	**150**	**220**
15 or over	**6 520**	**773**	**7 293**	**3 880**	**– 35**	**355**	**320**	**4 200**

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

CHART 2

Employment rate of Quebecers by age group
(rate as a percentage)



Sources: Institut de la statistique du Québec and projection of the ministère de Finances du Québec.

The increase in the employment rate will positively affect economic growth in the coming years. According to the assumptions adopted, during the period 2013-2019, this contribution will even exceed the contribution made by the employment rate observed between 1981 and 2008 (0.8 percentage points, as against 0.6 percentage points).

However, we have noted a levelling off and a reduction in this contribution at the end of the period, in particular because of the increase in the proportion of older age groups, in which the employment rate is lower, which in fact results from the ageing of the population.

Productivity gains are, in fact, the only means for Québec to achieve sustainable gains in economic growth.

TABLE 6

Economic growth factors – Impact on real GDP of the decline in the potential labour force and the increase in the employment rate
(as a percentage)

	1981-2008	2008-2009	2009-2013	2013-2019	2019-2025
Potential labour pool[1]	0.6	0.5	0.3	– 0.1	– 0.2
Employment rate[2]	0.6	– 1.6	0.5	0.8	0.5

1 Population 15 to 64 years of age.
2 Total number of workers divided by the population 15 to 64 years of age.
Source: Projection of the ministère des Finances du Québec.

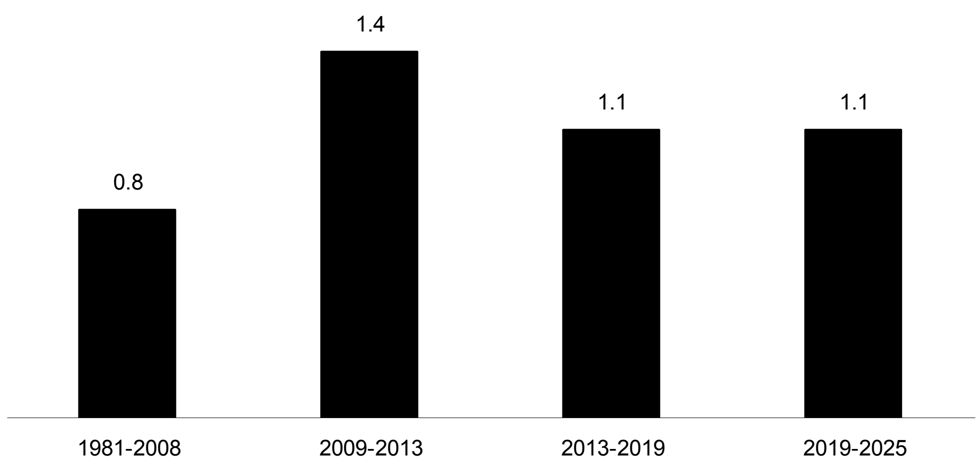
1.4 A second way to offset the impact of demographic changes: the acceleration of worker productivity

Productivity, i.e. the volume of output (real GDP) per job, increased 0.8% a year, on average, between 1981 and 2008. The committee adopted the hypothesis that growth in productivity would accelerate in the coming years and stand, on average, at 1.1% for the periods 2013-2019 and 2019-2025.

This is a striking increase: on average, for the period 2013-2025, we would thus witness an increase in the annual change in worker productivity of nearly 40%.

CHART 3

Productivity in Québec
(real GDP per job, annual percentage change)



Source: Projection of the ministère des Finances du Québec.

❑ The reasons that justify the projected increase in productivity

The assumption of an increase in worker productivity is optimistic but is based on an array of reasons.

At the beginning of the period, we will likely witness acceleration in growth in productivity linked to a revival in economic activity.

— Before the economic recovery plan, the government had already launched initiatives aimed at supporting private investment.

— Important measures have been added since then to support the economy and offset the impact of the financial crisis. Over two years, the government has thus invested just over $15 billion in the economy.[24] These measures will have a significant impact during the period 2010-2013.

— *Canada's Economic Action Plan* will also favourably affect growth in productivity in Québec.

Throughout the period, the reduction in the potential labour pool will encourage businesses to make better use of technology, machines and equipment. This same decrease in the potential labour pool could reduce part-time work and unemployment.

Moreover, during the period overall, the Québec public infrastructure plan will affect productivity. Its realization will enhance transportation infrastructure and thus improve trade. The plan will fund municipal infrastructure and thus foster the location of businesses. The Québec public infrastructure plan will also apply to educational infrastructure and, consequently, promote worker training, research and innovation.

■ Acceleration that is essential to offset the impact of demographic changes

The increase in growth in productivity is the only sustainable, permanent means available to us to offset the impact of demographic changes on economic growth. Between 2009 and 2025, it would partially compensate the impact on economic growth of changes in the potential labour pool.

TABLE 7

Economic growth factors – Impact on real GDP of the decline in the potential labour pool, the increase in the employment rate and productivity
(annual change in percentage)

	1981-2008	2008-2009	2009-2013	2013-2019	2019-2025
Potential labour pool[1]	0.6	0.5	0.3	– 0.1	– 0.2
Employment rate[2]	0.6	– 1.6	0.5	0.8	0.5
Productivity[3]	0.8	– 0.4	1.4	1.1	1.1

1 Population 15 to 64 years of age.
2 Total number of workers divided by the population 15 to 64 years of age.
3 Real GDP per job.
Source: Projection of the ministère des Finances du Québec.

[24] See Appendix 2, page 85, for a breakdown of funding under the government action plan.

This acceleration is essential all the more so as Québec has, since 2000, lagged significantly behind the rest of North America from the standpoint of productivity.

Québec and Ontario are lagging behind considerably in respect of productivity

Between 2000 and 2008, the Québec and Ontario economies have clearly stood pat as regards growth in productivity in relation to the rest of North America and the advanced nations overall, i.e. the OECD member countries.

During this period, productivity rose only 0.2% a year, on average, in Québec, compared with 1.7% in the United States and 0.9% in the advanced countries overall. We have noted that Ontario did not achieve better results than Québec did.

A cumulative lag

Cumulatively, in 2008 the Québec and Ontario economies were roughly 30% less productive than the US economy and 10% less productive than the economies of the other advanced countries. The Québec and Ontario economies are lagging considerably in relation to competing economies from the standpoint of productivity.

Productivity (output per job) in the United States, the OECD countries, Ontario and Québec: average annual growth rate from 2000 to 2008 and level attained in 2008

Country or region	Average annual growth rate between 2000 and 2008	Level attained in 2008 (US = 100)
United States	1.7%	100
OECD median	0.9%	79
Ontario	0.2%	71
Québec	0.2%	68

Note: The OECD encompasses 22 member countries. We have excluded very small countries such as Iceland and Luxembourg, emerging nations such as Mexico and Turkey, and countries in transition such as the Czech Republic, Hungary, Poland and Slovakia. The level of productivity attained in 2008 is calculated according to the OECD method.
Sources: OECD for the United States and the other OECD member countries; Statistics Canada for Québec and Ontario.

■ Must the government mobilize new efforts to support economic recovery?

In the projection of worker productivity, the committee took into account the recovery plan implemented by the government to support the economy in the wake of the 2008 financial crisis.

The committee was thus induced to take a stance on the relevance of extending this plan in order to bolster the recovery now under way.

The committee believes that the means adopted by the government in 2008-2009 are largely sufficient, bearing in mind that the recession that struck Québec is one of the mildest ones from an international perspective. It would be pointless at best to add other means and, at the worst, doing so would only aggravate the budgetary deficit.

1.5 The projected economic growth rate by the year 2025

The integration of the forecasts adopted concerning changes in the potential labour pool, the employment rate and productivity allow us to determine Québec's anticipated economic growth rate in the coming years.

According to the projection adopted by the committee, this growth rate should reach 2.2% a year, on average, during the period 2009-2013. It should then fall to 1.8% for the period 2013-2019 and to 1.4% for the period 2019-2025. This is the real growth rate, calculated without taking into account price increases.

TABLE 8

Economic growth factors – Breakdown of real GDP
(annual change in percentage)

	1981-2008	2008-2009	2009-2013	2013-2019	2019-2025
Potential labour pool[1]	0.6	0.5	0.3	– 0.1	– 0.2
Employment rate[2]	0.6	– 1.6	0.5	0.8	0.5
Productivity[3]	0.8	– 0.4	1.4	1.1	1.1
Real GDP	**2.0**	**– 1.5**	**2.2**	**1.8**	**1.4**

1 Population between 15 and 64 years of age.
2 Total number of workers divided by the population 15 to 64 years of age.
3 Real GDP per job.
Source: Projection of the ministère des Finances du Québec.

The projection takes into account the anticipated change in the employment rate and productivity against a backdrop of demographic changes and assumes a favourable post-recession reaction by the economy.

Despite the foregoing, annual growth in real GDP, which stood at 2% during the period 1981-2008, would gradually decline throughout the period, following a slight rebound in 2009-2013. At the end of the period, in 2019-2025 the annual growth rate would stand, on average, at 1.4%, a 0.6 percentage point reduction in relation to the historical average.

❑ Economic growth projection taking price increases into account

In order to simulate the government's financial framework, this projection of real GDP was converted into nominal GDP by adding to it the impact of price increases. In fact, it is nominal GDP that determines government revenues. To this end, we adopted a change in inflation close to the Bank of Canada's target, i.e. an annual increase in prices on the order of 2%.

Growth in nominal GDP would thus diminish from 5.0% (growth observed during the period 1981-2008) to 4.2% in 2009-2013, to 3.6% in 2013-2019 and to 3.3% in 2019-2025.

TABLE 9

Components of Québec's nominal GDP
(as a percentage)

	1981-2008	2008-2009	2009-2013	2013-2019	2019-2025
Real GDP	2.0	– 1.5	2.2	1.8	1.4
Prices	3.0	1.0	2.0	1.8	1.9
Nominal GDP	**5.0**	**– 0.5**	**4.2**	**3.6**	**3.3**

Source : Projection ot fhe ministère des Finances du Québec.

❑ The accumulated savings of future seniors

The projections presented above enable us to define changes in the tax bases and thus to calculate the government's own-source revenue between now and 2025.

It is sometimes said that the financial problem linked to the ageing of the population will be solved by the accumulated savings of future seniors. According to this thesis, seniors born during the baby boom will be richer than seniors from preceding generations. They will thus be taxed and will consequently contribute more extensively to government revenues.

As we saw earlier, this reality has been incorporated into the calculation of the four scenarios. In particular, we have adopted the assumption that new retirees would draw on their savings to support their consumption. We have thus taken into account the enrichment of future seniors in relation to seniors belonging to preceding age groups.

■ Demographic changes will reduce government revenues

We have thus noted that demographic changes will directly affect our future financial position from the standpoint of revenues. Economic growth projections indicate, in fact, that demographic changes will lead to a slowdown in growth in government revenues.

This reality serves as the economic basis for the four scenarios that the committee analyzed.

PART TWO
Options that must be rejected

Based on the economic growth projections that have been presented, the committee applied an initial series of two scenarios to the budgetary balance the government released in October 2009.

These two scenarios, which are combined under the theme “failure to act”, correspond to options the committee recommends be rejected.

The second part of the document also includes three sections in which the committee lays out:

- the simulation of scenario 1, “**the status quo**”,
- the simulation of scenario 2, “**rollback**”,
- the reasons why, in reality, **failing to act is not an option**.

2.1 Scenario one: the status quo

The first scenario was developed from proposals and perceptions that have figured prominently in the current discussion.

❑ Content of the scenario

These proposals and perceptions are:

- We can rely mainly on economic growth to return to balanced budgets.
- There is no need for further initiatives beyond those already taken. Regarding the government's initiatives designed to return to balanced budgets, the scenario is accordingly limited to the implementation of the three revenue measures identified in the 2009-2010 Budget, i.e. raising the QST by one percentage point, measures to combat tax evasion and avoidance, and the indexing of certain fees.[25]

No measure is taken to control the current growth in program spending. The scenario includes no measures to achieve the objective of holding the rise in spending to 3.2% annually by 2013-2014. Program spending grows by 4.6% per year until then.

After 2013-2014, the scenario forecasts structural growth for program spending. The structural growth in program spending was determined based on the following three assumptions:

- inclusion of the impact of demographic changes on health (rising costs because of the aging of the population) and education spending (declining costs as a result of falling enrolment);
- inclusion of spending related to the implementation of the infrastructure program;
- for other program spending components, spending growth at the same rate as GDP.

Any new initiative is excluded (no resources to meet new needs relating to the environment, dropping-out of school, or health, for instance).

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25 As previously indicated, this covers all fees that are not indexed, except for reduced-contribution daycare service fees.

As a result of these assumptions, the structural growth in program spending is estimated at an average of 4.4% per year for the period from 2013-2014 to 2025-2026.

This initial scenario means that the efforts made to balance the budget will only deal with a small part of the budgetary balance expected in 2013-2014: they represent $2.4 billion, compared with a forecast deficit of $11.3 billion.

TABLE 10

Total efforts to balance the budget and keep it balanced by 2013-2014 – Scenario 1
(millions of dollars)

	Initial conditions[1]	**Scenario 1 The status quo**	**Difference: efforts applied**
Revenue[2]	70 527	72 887	2 360
Spending	– 81 811	– 81 811	0
BALANCE	**– 11 284**	**8 924**	**2 360**

1 Annual spending growth held at 4.6% without revenue measures.
2 Including net results of consolidated entities.

❑ The arguments

Among the arguments made in support of this option, the main one deals with economic growth: economic growth will be enough to resolve all problems in the long run.

This scenario also depends on other arguments that are frequently made:

- Economic recovery must not be jeopardized by additional taxes or a reduction in public spending.
- The burden of the debt on the economy is declining, as is debt service.
- In short, why return to balanced budgets faster than others?

❑ Results

Looking at the financial aspect, scenario 1 leads to a swift and substantial deterioration in the budgetary situation.

- The gap between budgetary expenditure and revenue grows wider (at the end of the period, average annual growth of 4.8% for expenditure and 3.6% for revenue).

— Spending is affected by the impact of the aging of the population (in health) and the cost of infrastructures, while no measure is taken to control or fund it.

— The growing imbalance between revenue and spending causes the deficit to explode.

— The deficit almost doubles by 2013-2014, rising from $4.7 billion to $8.9 billion in four years.

— The deficit more than triples over the next twelve years, reaching $31.4 billion in 2025-2026.

— Over the entire period, the deficit vaults from 1.6% of GDP in 2009-2010 to 5.9% in 2025-2026.

TABLE 11

Scenario 1 – The status quo
Simulation of the government's financial framework

	2009-10	**Average annual change, 2009-10 to 2013-14**	**2013-14**	**Average annual change, 2013-14 to 2019-20**	**2019-20**	**Average annual change, 2019-20 to 2025-26**	**2025-26**
	($ million)	(%)	($ million)	(%)	($ million)	(%)	($ million)
Own-source revenue	46 869	5.4	57 735	3.7	71 892	3.4	87 988
Federal transfers	15 156	0.7	15 593	4.6	20 368	4.4	26 309
Budgetary revenue	**62 025**	**4.3**	**73 328**	**3.9**	**92 261**	**3.6**	**114 296**
Program spending	60 139	4.6	72 043	4.5	93 757	4.4	121 200
Debt service	6 154	12.2	9 768	9.0	16 409	6.9	24 541
Budgetary expenditure	**66 293**	**5.4**	**81 811**	**5.1**	**110 166**	**4.8**	**145 741**
Consolidated entities[1]	**– 427**		**– 441**		**0**		**0**
Budgetary balance according to the law[2]	**– 4 695**	**—**	**– 8 924**	**—**	**– 17 905**	**—**	**– 31 445**
As a % of GDP	***– 1.6***	**—**	***– 2.5***	**—**	***– 4.1***	**—**	***– 5.9***
Gross debt	161 621	7.1	212 309	7.1	321 040	7.2	486 324
As a % of GDP	*53.5*	—	*59.7*	—	*73.1*	—	*91.2*
Debt representing accumulated deficits	102 439	5.8	128 594	8.0	203 950	8.9	340 983
As a % of GDP	*33.9*	—	*36.1*	—	*46.4*	—	*63.9*
Nominal GDP	302 059	4.2	355 761	3.6	439 221	3.3	533 410

Note: Figures have been rounded off, so they may not add up to the total indicated.
1 This item includes the net results of consolidated entities, excluding the results of the Generations Fund. For 2009-2010, it also includes the provision for revenue shortfall and drawings from the stabilization reserve.
2 Budgetary balance for the purposes of the Balanced Budget Act.

CHART 4

Budgetary revenue and expenditure – Scenario 1
(as a percentage of GDP)

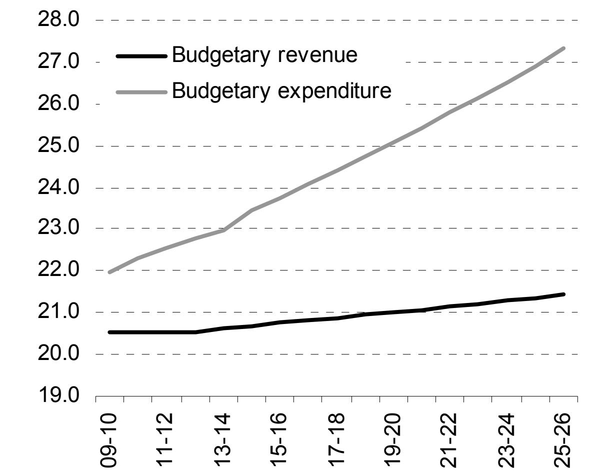
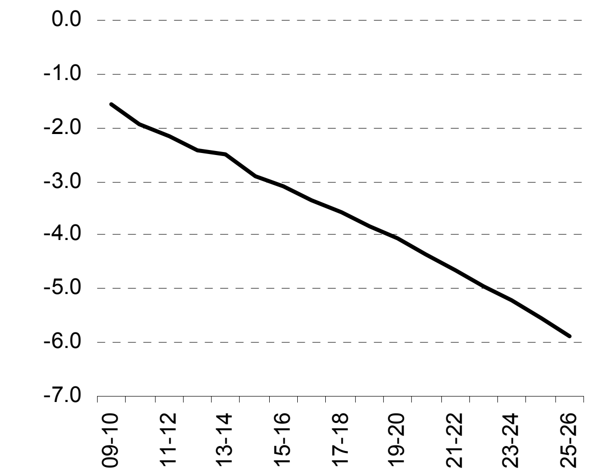


CHART 5

Budgetary balance[1] – Scenario 1
(as a percentage of GDP)



1 Budgetary balance for the purposes of the Balanced Budget Act.

The succession of constantly rising deficits is reflected in the size of the debt, which at the end of the period reaches an astronomical level.

— Québec's gross debt, excluding the federal debt, triples over the period, rising from $162 billion in 2009-2010 to $486 billion in 2025-2026.

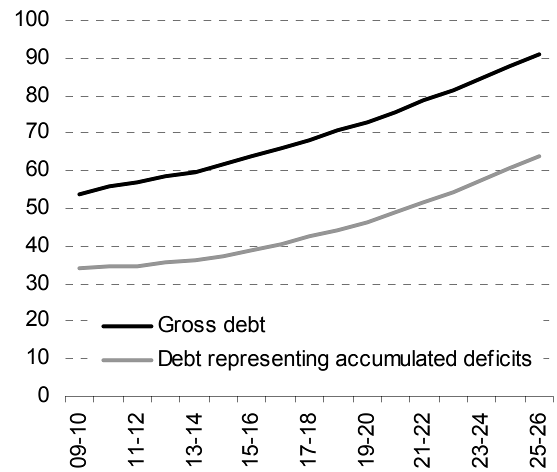
— As a percentage of GDP, Québec's gross debt balloons by almost two thirds, from 54% to 91% in 15 years.

— As a consequence of the increase in the debt, debt service quadruples between 2009-2010 and 2025-2026, from just over $6 billion to almost $25 billion.

Clearly, these figures are a catastrophe.

CHART 6

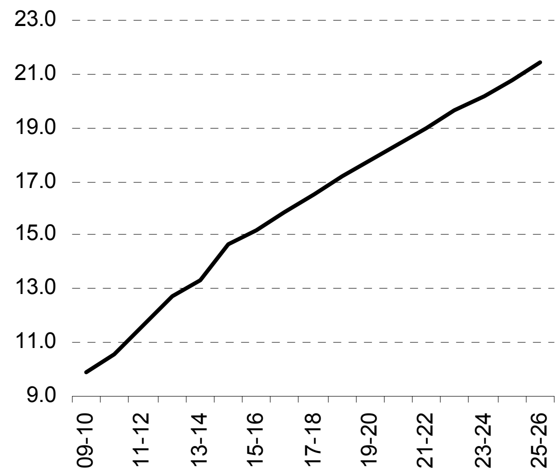
Gross debt and debt representing accumulated deficits[1] – Scenario 1
(as a percentage of GDP)



1 After inclusion of the Generations Fund.

CHART 7

Debt service[1] – Scenario 1
(as a percentage of budgetary revenue)



1 Debt service of the Consolidated Revenue Fund.

2.2 A variation: rollback

Scenario two, called “rollback”, was developed using proposals and perceptions similar to those embodied in the first scenario, but goes even further in rolling back the initiatives the government announced in March 2009.

In this scenario, the proposals used result in the grounds for the three initiatives the government announced being questioned and abandoned.

❑ Content of the scenario

In scenario two, economic growth alone provides the basis for returning to balanced budgets.

Contrary to the first scenario, the government decides not to combat tax evasion and avoidance, does not index certain fees[26] and cancels the one-point rise in the QST.

As in the earlier scenario, program spending rises 4.6% per year until 2013-2014, in the absence of effective measures to achieve the 3.2% spending growth objective identified in the plan to restore fiscal balance.

In scenario 2, no effort is made to return to balanced budgets by 2013-2014: the actual deficit is the forecast deficit of $11.3 billion.

TABLE 12

Total efforts to balance the budget by 2013-2014 – Scenario 2
(en millions de dollars)

	Initial conditions[1]	Scenario 2 Rollback	Difference: efforts applied
Revenue[2]	70 527	70 527	0
Spending	– 81 811	– 81 811	0
BALANCE	**– 11 284**	**– 11 284**	**0**

1 Annual spending growth held at 4.6% without revenue measures.
2 Including net results of consolidated entities.

26 As previously indicated, this covers all fees that are not indexed, except for reduced-contribution daycare service fees.

After 2013-2014, program spending rises at the structural growth rate estimated earlier. Until 2025-2026, program spending grows at an average annual rate of 4.4%, based on the same assumptions as in scenario one – i.e. pressure on health spending because of the aging of the population, a downward trend in education spending because of declining enrolment, implementation of the infrastructure program and growth in other spending components that keeps pace with GDP. Any new initiative is excluded.

❑ The arguments

In addition to the arguments made in the first scenario, another is advanced: the recovery is so tentative that no effort must be made to slow the growth in public spending. For the same reason, plans to raise the QST and index fees must be shelved.

■ Results

Obviously, the results of this scenario are worse than those of the status quo scenario.

— By 2013-2014, the gap between budgetary expenditure and revenue grows quickly, with spending rising by 5.4% per year and revenue by just 3.4%.

— In 2013-2014, the budget deficit reaches $11.3 billion, compared with $8.9 billion in the earlier scenario.

TABLE 13

Scenario 2 – Rollback
Simulation of the government's financial framework

	2009-10	Average annual change, 2009-10 to 2013-14	2013-14	Average annual change, 2013-14 to 2019-20	2019-20	Average annual change, 2019-20 to 2025-26	2025-26
	($ millions)	(%)	($ millions)	(%)	($ millions)	(%)	($ millions)
Own-source revenue	46 869	4.3	55 375	3.7	68 979	3.4	84 449
Federal transfers	15 156	0.7	15 593	4.6	20 368	4.4	26 309
Budgetary revenue	**62 025**	**3.4**	**70 968**	**3.9**	**89 347**	**3.6**	**110 758**
Program spending	60 139	4.6	72 043	4.5	93 757	4.4	121 200
Debt service	6 154	12.2	9 768	10.5	17 780	7.7	27 753
Budgetary expenditure	**66 293**	**5.4**	**81 811**	**5.3**	**111 537**	**4.9**	**148 953**
Consolidated entities[1]	**– 427**		**– 441**		**0**		**0**
Budgetary balance according to the law[2]	**– 4 695**	—	**– 11 284**	—	**– 22 189**	—	**– 38 195**
As a % of GDP	***– 1.6***	—	***– 3.2***	—	***– 5.1***	—	***– 7.2***
Gross debt	161 621	7.9	218 824	8.1	348 712	7.8	547 892
As a % of GDP	*53.5*	—	*61.5*	—	*79.4*	—	*102.7*
Debt representing accumulated deficits	102 439	7.2	135 109	9.4	231 623	9.6	402 552
As a % of GDP	*33.9*	—	*38.0*	—	*52.7*	—	*75.5*
Nominal GDP	302 059	4.2	355 761	3.6	439 221	3.3	533 410

Note: Figures have been rounded off, so they may not add up to the total indicated.
1 This item includes the net results of consolidated entities, excluding the results of the Generations Fund. For 2009-2010, it also includes the provision for revenue shortfall and drawings from the stabilization reserve.
2 Budgetary balance for the purposes of the Balanced Budget Act.

Between 2009 2010 and 2025 2026, the deficit rises eight-fold, from $4.7 billion to $38.2 billion, i.e. from 1.6% to 7.2% of GDP.

CHART 8

Budgetary revenue and expenditure – Scenario 2
(as a percentage of GDP)

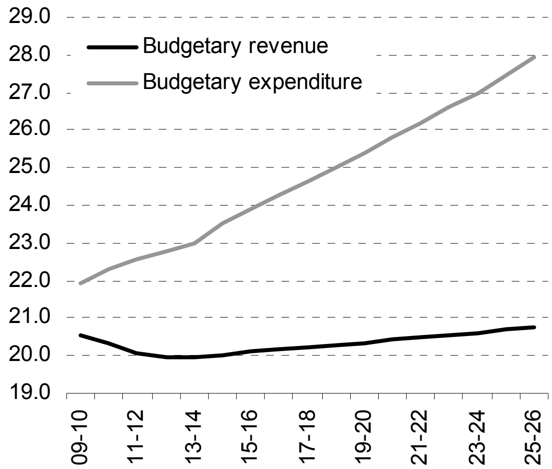
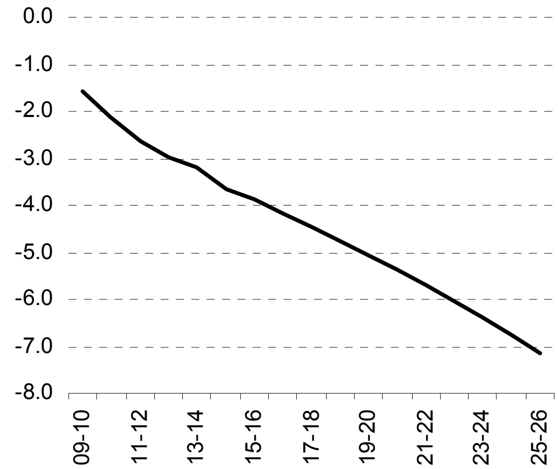


CHART 9

Budgetary balance[1] – Scenario 2
(as a percentage of GDP)



1 Budgetary balance for the purposes of the Balanced Budget Act.

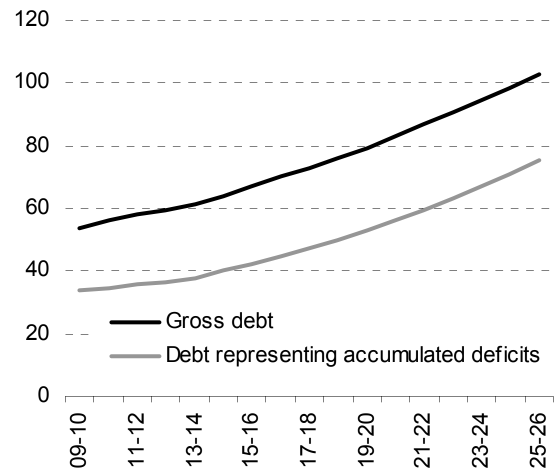
In scenario 2, the debt reaches amounts that are scarcely imaginable.

— Québec's gross debt amounts to $548 billion in 2025-2026, i.e. $14 billion more than GDP.

— Debt service approaches $28 billion en 2025-2026, requiring almost 25% of the government's budgetary revenue at the end of the period.

CHART 10

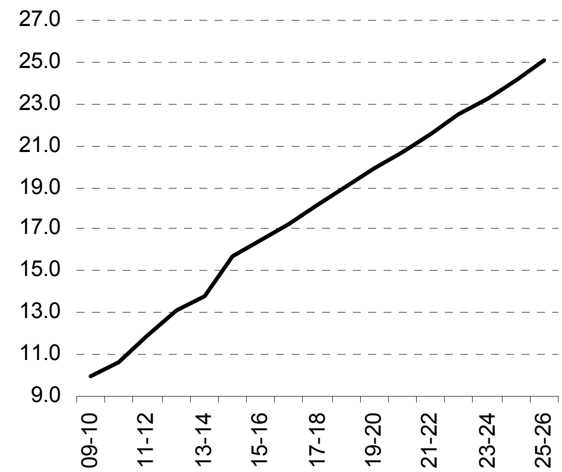
Gross debt and debt representing accumulated deficits[1] – Scenario 2
(as a percentage of GDP)



1 After inclusion of the Generations Fund.

CHART 11

Debt service[1] – Scenario 2
(as a percentage of budgetary revenue)



1 Debt service of the Consolidated Revenue Fund.

2.3 The reality: failing to act is not an option

The committee is convinced that neither of these two scenarios will happen, and for a very simple reason: the government will never be able to fund a deficit and a debt of such magnitudes – unless it accepts intolerable interest costs.

❑ The economic growth argument

At this point we must return to the core argument used to justify the “failure to act” scenarios and assess its credibility. The argument is the idea that wealth creation will be enough to resolve every problem in the long run.

The committee simulated the economic growth that would be needed to balance public finances in scenarios 1 and 2. The results show that this argument is unrealistic.

- For the first four years alone, i.e. by 2013-2014, Québec’s real annual economic growth would have to average 6.2% (nominal GDP growth of 8.2%) to return to balanced public finances – a feat not seen in 45 years.
- Over the entire fifteen–year period, from 2010 to 2025, real economic growth would have to reach 3.1% per year – a rate that Québec has not achieved for many decades, when the demographic situation was much more favourable.

Accordingly, we must conclude that this argument does not hold water. Wealth creation alone will not be enough to balance public finances.

❑ The reality

In reality, the first two scenarios lead to a very swift deterioration in public finances. In four fiscal years, the deficit would double or even triple, depending on the scenario, and the gross debt would rise by one third (scenario one) or almost 40% (scenario two).

This swift deterioration would eventually have an explosive impact, given the “snowball” effect of compound interest. The fact is, the government would come under pressure from lenders, as Québec did in the mid-1990s – or as a number of European countries are currently experiencing.

- The government would quickly be forced to make major spending reductions or raise taxes significantly, to return to a situation it failed to correct in a timely manner.

— By having done nothing or virtually nothing by 2013-2014, the government would then have to absorb a deficit of $11 billion, which would require reducing program spending by almost 16% or raising taxes by almost 20%.

Obviously, that is unrealistic: the choice would be between cutting what are considered priority programs or implementing a tax system that discourages work and could provoke a brain drain.

❑ Impasse

The first two scenarios, illustrating the failure to act, lead to an impasse.

By failing to take the right measures quickly, the government finds itself in an impossible situation, the result of the combined effect of the structural imbalance between growth in revenue and in spending and the impact of demographic changes.

PART THREE
The results of taking action

After the first two scenarios corresponding to a “failure to act”, the committee simulated two other scenarios under the theme “the results of taking action”. As with the first two scenarios, the calculations were carried out taking as the starting point the budgetary balance the government released in October 2009.

Scenarios 3 and 4 illustrate the approach in which action is taken now to restore order to public finances according to the timetable set by the government, i.e. by 2013 2014. These two scenarios differ sharply with the first two insofar as their financial implications are concerned.

The third part of the document has three sections in which the committee lays out:

- the simulation of scenario 3, “**the partial response**”,
- the simulation of scenario 4, “**the sustainable path**”,
- **the difference between the failure to act and the results of taking action**.

3.1 Scenario three: the partial response

The third scenario was defined on the basis of the government's plan to restore fiscal balance. It reproduces the approach announced by the Minister of Finance on October 27, 2009, when the update on Québec's economic and financial situation was released.[27]

The scenario forecasts a return to balanced budgets by 2013-2014: all the initiatives required to eliminate the expected deficit of $11.3 billion are implemented.

TABLE 14

Plan to return to balanced budgets after the fall 2009 update
(millions of dollars)

	2009-2010	2010-2011	2011-2012	2012-2013	2013-2014
BUDGETARY BALANCE WITH PROGRAM SPENDING GROWTH AT 4.6%	**– 4 695**	**– 6 609**	**– 8 611**	**– 10 172**	**– 11 284**
Efforts to reduce spending growth to 3.2%	—	869	1 806	2 814	3 898
BUDGETARY BALANCE WITH PROGRAM SPENDING GROWTH HELD AT 3.2%	—	**– 5 740**	**– 6 805**	**– 7 358**	**– 7 386**
Revenue measures					
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
Total revenue measures	—	**1 065**	**4 166**	**6 090**	**7 474**
Total revenue and expenditure measures	—	**1 934**	**5 972**	**8 904**	**11 372**
BUDGETARY BALANCE – FALL 2009	**– 4 695**	**– 4 675**	**– 2 639**	**– 1 268**	**88**

Source: *Sound Public Finances to Protect Our Values, A Return to Balanced Budgets by 2013-2014*, Québec, October 27, 2009, page 24, table 4.

❑ Content of the scenario

In scenario 3, we have simulated the implementation of the measures needed to return to balanced budgets by 2013-2014, as the government announced in March 2009.

Accordingly, the scenario includes the implementation of the measures identified in the 2009-2010 Budget Speech, i.e. raising the QST by one percentage point, steps to combat tax evasion and avoidance, the indexing of certain fees[28] and capping program spending growth at 3.2% per year until 2013 2014.

27 *Sound Public Finances to Protect Our Values – A Return to Balanced Budgets by 2013-2014*, Québec, October 27, 2009.

28 As previously indicated, this covers all fees that are not indexed, except for reduced-contribution daycare service fees.

In addition to these measures, others are needed to balance the budget in 2013-2014.

- The committee has assumed that these additional measures only concern revenue, as indicated in the October 2009 document.[29]
- On the basis of the official data from the fall of 2009, the government will seek additional revenue of $5.1 billion by 2013-2014.

This scenario has been labelled the "partial response" because it stipulates nothing for the period after 2013 2014, even though the Balanced Budget Act requires a return to balanced budgets as of 2013 2014.

After 2013-2014, program spending resumes growing at a structural rate. The committee has used the same assumptions as in the first two scenarios:

- inclusion of the impact of demographic changes on health (rising costs because of the aging of the population) and education spending (declining costs as a result of falling enrolment);
- inclusion of spending related to the implementation of the infrastructure program;
- for other program spending components, spending growth at the same rate as GDP;
- in total, 4.4% average annual growth in program spending from 2014-2015 to 2025-2026.

Any new initiative is excluded.

❑ An approach announced by the government

This scenario illustrates an approach announced by the government until 2013-2014. According to this scenario, the government sticks to its objective of returning to balanced budgets.

- With scenario 3, steps are taken to eliminate the forecast deficit of $11.3 billion.
- In addition to what has already been explicitly announced, the government limits its options to traditional means – i.e. an increase in its revenue - to offset the deficit not yet eliminated in 2013-2014.

29 *Sound Public Finances…*, *op. cit.*, page 24, table 4.

- There is no review of how money is spent and no effort is made to curb the structural growth in program spending.
- The approach the government confirmed and detailed in October 2009 does not specify the budgetary initiatives to take to respond to demographic changes.
- In fact, we are buying time as far as the response to the demographic challenge is concerned. Matters are put off to be dealt with after 2013-2014.

TABLE 15

Total efforts to balance the budget by 2013-2014 – Scenario 3
(millions of dollars)

	Initiales conditions[1]	Scenario 3 Partial response	Difference: efforts applied
Revenue[2]	70 527	78 001	7 474
Spending	– 81 811	– 77 913	3 898
BALANCE	**– 11 284**	**88**	**11 372**

1 Annual spending growth held at 4.6% without revenue measures.
2 Including net results of consolidated entities.

❑ Results

Under scenario 3, the budget is balanced in 2013-2014 – since that is the very basis of the option being examined.

TABLE 16

Scenario 3 – Partial response
Simulation of the government's financial framework

	2009-10	Average annual change, 2009-10 to 2013-14	2013-14	Average annual change, 2013-14 to 2019-20	2019-20	Average annual change, 2019-20 to 2025-26	2025-26
	($ million)	(%)	($ million)	(%)	($ million)	(%)	($ million)
Own-source revenue	46 869	7.6	62 849	3.7	78 206	3.4	95 655
Federal transfers	15 156	0.7	15 593	4.6	20 368	4.4	26 309
Budgetary revenue	**62 025**	**6.0**	**78 442**	**3.9**	**98 575**	**3.6**	**121 964**
Program spending	60 139	3.2	68 145	4.5	88 584	4.4	114 397
Debt service	6 154	12.2	9 768	2.6	11 376	1.3	12 325
Budgetary expenditure	**66 293**	**4.1**	**77 913**	**4.2**	**99 960**	**4.0**	**126 722**
Consolidated entities[1]	**– 427**		**– 441**		**0**		**0**
Budgetary balance according to the law[2]	**– 4 695**	—	**88**	—	**– 1 386**	—	**– 4 758**
As a % of GDP	***– 1.6***	—	***0.0***	—	***– 0.3***	—	***– 0.9***
Gross debt	161 621	4.2	190 642	2.3	218 610	2.3	251 136
As a % of GDP	*53.5*	—	*53.6*	—	*49.8*	—	*47.1*
Debt representing accumulated deficits	102 439	1.1	106 927	– 0.9	101 521	0.7	105 796
As a % of GDP	*33.9*	—	*30.1*	—	*23.1*	—	*19.8*
Nominal GDP	302 059	4.2	355 761	3.6	439 221	3.3	533 410

Note: Figures have been rounded off, so they may not add up to the total indicated.
1 This item includes the net results of consolidated entities, excluding the results of the Generations Fund. For 2009-2010, it also includes the provision for revenue shortfall and drawings from the stabilization reserve.
2 Budgetary balance for the purposes of the Balanced Budget Act.

However, and in the absence of additional initiatives, a structural deficit quickly reappears after this date.

— From 2013-2014 to 2025-2026, average annual growth in spending is always greater than revenue growth.

— The return to balanced budgets is short-lived. Deficits reappear in 2014-2015 and reach $4.8 billion at the end of the period.

— The rapid reappearance of deficits and their growth cause both the gross debt and debt service to rise.

CHART 12

Budgetary revenue and expenditure – Scenario 3
(as a percentage of GDP)

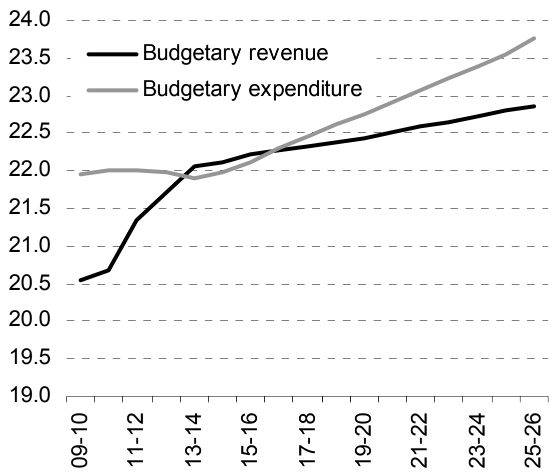
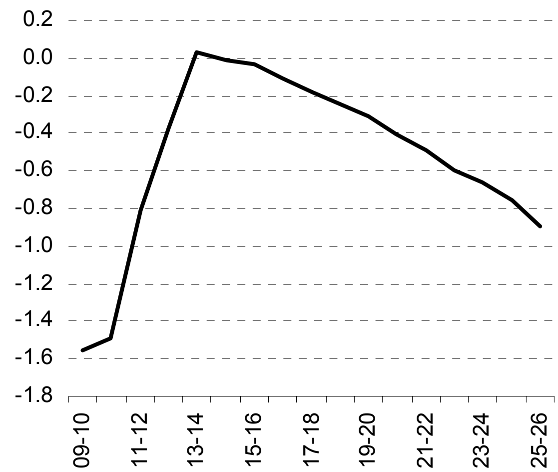


CHART 13

Budgetary balance[1] – Scenario 3
(as a percentage of GDP)



1 Budgetary balance for the purposes of the Balanced Budget Act.

Although the figures are much less spectacular than in the first two scenarios, the increase in the debt load is real.

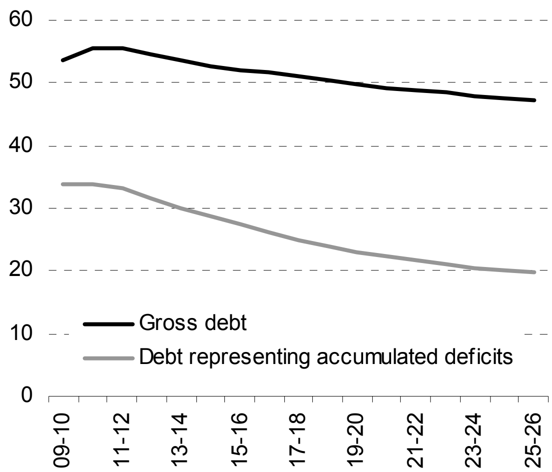
According to this scenario, at the end of the period the gross debt reaches $251 billion, an increase of almost one third in ten years.

Debt service exceeds $12 billion, compared with $6 billion in 2009-2010 and almost $10 billion in 2013-2014.

On the other hand, the debt declines as a percentage of GDP. At the end of the period, Québec's gross debt represents 47% of GDP, compared with 54% in 2009-2010.

CHART 14

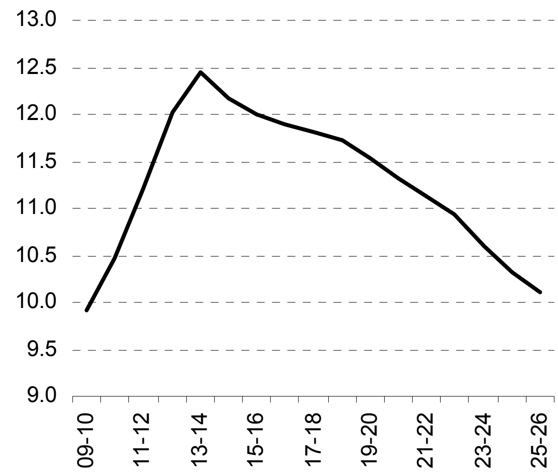
Gross debt and debt representing accumulated deficits[1] – Scenario 3
(as a percentage of GDP)



1 After inclusion of the Generations Fund.

CHART 15

Debt service[1] – Scenario 3
(as a percentage of budgetary revenue)



1 Debt service of the Consolidated Revenue Fund.

❑ In 2013-2014, a vulnerable situation

The estimates shown here illustrate the reality of this scenario.

Returning to balanced budgets by 2013-2014 does indeed avoid the financial catastrophe presented in the first two scenarios. However, in 2013-2014 we find ourselves in a situation that cannot be considered sustainable.

— With no measure announced to restore structural balance between revenue and spending, public finances begin to deteriorate once again.

— This happens at a time when Québec's financial situation is worse than before the 2009 recession. The debt has risen by almost $30 billion, i.e. 18%, in four years.

— By raising revenue, the government has implemented a tax system that is even less competitive in relation to our competitors. In 2013-2014, each adult Quebecer must pay additional fiscal levies of $1 200.

TABLE 17

Efforts pertaining to own–source revenue to return to balanced budgets by 2013-2014 – Scenario 3 “The partial response”

	Effort in 2013-2014[1]
Effort pertaining to own-source revenue ($ million)	**7 474**
Effort in terms of revenue per adult ($)[2]	1 187

1 Effort when fully implemented.
2 Based on the number of adults age 18 or over, which stands at 6 298 617 in 2009.

Accordingly, after 2013-2014, Québec’s situation is vulnerable. The financial framework deteriorates once again and the debt load rises.

Unlike the first two scenarios, the scenario contemplating just returning to balanced budgets (“the partial response”) is manageable. It includes an initial stage in the right direction, with the return to balanced budgets in 2013-2014.

However, nothing is stipulated beyond that date. This scenario offers no sustainable response to the problem of public finances. In addition, it comes with substantial risks to the extent that there could be a recession or spending could get out of control.

3.2 Scenario four: the sustainable path, a pact to meet the challenges ahead

The fourth and last scenario put forward by the committee is the logical extension of the observations and proposals made in the first two documents.

3.2.1 The content of the scenario and the results obtained

According to the committee, it is important, as a priority, to begin spending more effectively and funding our public services better. That means that by 2013-2014, the return to balanced budgets must be achieved with measures distributed equally between revenue and spending. This approach lies midway between the policies that concentrate all their efforts on the spending side, and those that focus solely on increasing revenue. The path the committee is advocating thus avoids a radical re-examination of the basket of services or a significant increase in taxes.

That is the meaning of the proposed pact: each must do their part to achieve and maintain a balanced budgetary framework. The government will not collect one dollar more in taxes or fees unless it has made an equivalent effort on the spending side. As a result of this pact, the effort and commitment are shared among providers of public services, their users and taxpayers, in order to restore order to public finances and protect the future.

■ From now to 2013-2014: an effort divided between spending and revenue

In this scenario, the efforts made to return to balanced budgets by 2013 -2014 are distributed equally among spending and revenue initiatives: measures are taken to reduce spending by $5.6 billion and to raise own-source revenue by $5.6 billion.

TABLE 18

Total efforts to balance the budget by 2013-2014 – Scenario 4
(millions of dollars)

	Initial conditions[1]	Scenario 4 The sustainable path	Difference: efforts applied
Revenue[2]	70 527	76 169	5 642
Spending	– 81 811	– 76 169	5 642
BALANCE	**– 11 284**	—	**11 284**

1 Annual spending growth held at 4.6% without revenue measures.
2 Including net results of consolidated entities.

In scenario 4, program spending growth is reduced to 2.5% per year from now to 2013-2014, compared with 3.2% in scenario 3. The spending efforts are $1.7 billion greater than what is needed to achieve the targets in scenario 3.

Turning to revenue, the additional revenue represents a less onerous effort than in scenario 3 – i.e. $5.6 billion compared with $7.5 billion.

■ After 2013-2014: spending growth at the same rate as revenue growth

After 2013-2014, public finances are kept balanced year after year by correcting spending growth. Growth in own-source revenue keeps pace with economic growth. Overall, total spending (including debt service) and total revenue (including federal transfers) must increase at the same rate.

For spending, scenario 4 means that program spending grows by 4.2% between 2013-2014 and 2019-2020 and by 4% between 2019-2020 and 2025-2026.

❑ The arguments

The arguments underpinning this scenario are the committee's.

— In the short term, to return to balanced budgets, the effort must be spread evenly between revenue (higher taxes and fees) and spending (tighter control of spending growth).

— In the medium and long term, the only sustainable way to maintain sound public finances is to adjust growth in spending to that of the economy. Spending growth must be matched to that of the revenue we can count on to pay for this spending.

The committee's preferred scenario therefore consists in acting on spending more vigorously than is currently the case.

❑ Results

TABLE 19

Scenario 4 – The sustainable path
Simulation of the government's financial framework

	2009-10	Average annual change, 2009-10 to 2013-14	2013-14	Average annual change, 2013-14 to 2019-20	2019-20	Average annual change, 2019-20 to 2025-26	2025-26
	($ million)	(%)	($ million)	(%)	($ million)	(%)	($ million)
Own-source revenue	46 869	6.8	61 017	3.7	75 999	3.4	92 975
Federal transfers	15 156	0.7	15 593	4.6	20 368	4.4	26 309
Budgetary revenue	**62 025**	**5.4**	**76 610**	**3.9**	**96 367**	**3.6**	**119 283**
Program spending	60 139	2.5	66 401	4.2	85 125	4.0	108 012
Debt service	6 154	12.2	9 768	2.4	11 242	0.0	11 271
Budgetary expenditure	**66 293**	**3.5**	**76 169**	**4.0**	**96 367**	**3.6**	**119 283**
Consolidated entities[1]	**– 427**		**– 441**		**0**		**0**
Budgetary balance according to the law[2]	**– 4 695**	—	**0**	—	**0**	—	**0**
As a % of GDP	***– 1.6***	—	***0.0***	—	***0.0***	—	***0.0***
Gross debt	161 621	4.2	190 730	2.0	214 932	1.0	228 386
As a % of GDP	*53.5*	—	*53.6*	—	*48.9*	—	*42.8*
Debt representing accumulated deficits	102 439	1.1	107 015	– 1.5	97 842	– 2.7	83 045
As a % of GDP	*33.9*	—	*30.1*	—	*22.3*	—	*15.6*
Nominal GDP	302 059	4.2	355 761	3.6	439 221	3.3	533 410

Note: Figures have been rounded off, so they may not add up to the total indicated.
1 This item includes the net results of consolidated entities, excluding the results of the Generations Fund. For 2009-2010, it also includes the provision for revenue shortfall and drawings from the stabilization reserve.
2 Budgetary balance for the purposes of the Balanced Budget Act.

In this scenario, the budget is balanced once again and remains so.

— Thanks to the efforts made, the gap between revenue and spending is eliminated by 2013-2014.

— Thereafter, revenue and spending grow at the same rate and balanced budgets are maintained.

CHART 16

Budgetary revenue and expenditure – Scenario 4
(as a percentage of GDP)

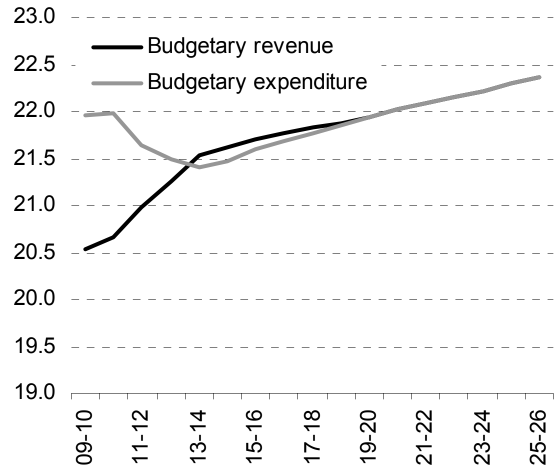
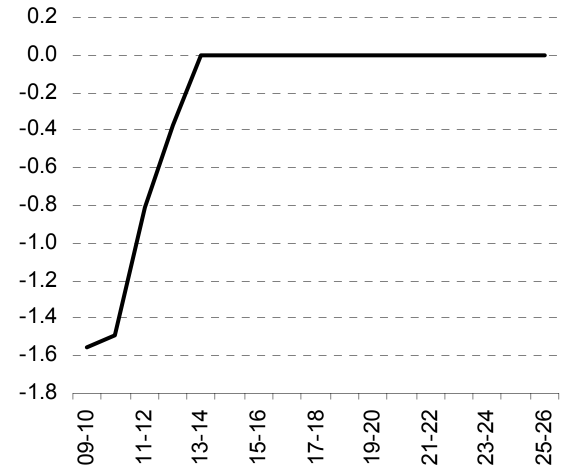


CHART 17

Budgetary balance[1] – Scenario 4
(as a percentage of GDP)



1 Budgetary balance for the purposes of the Balanced Budget Act.

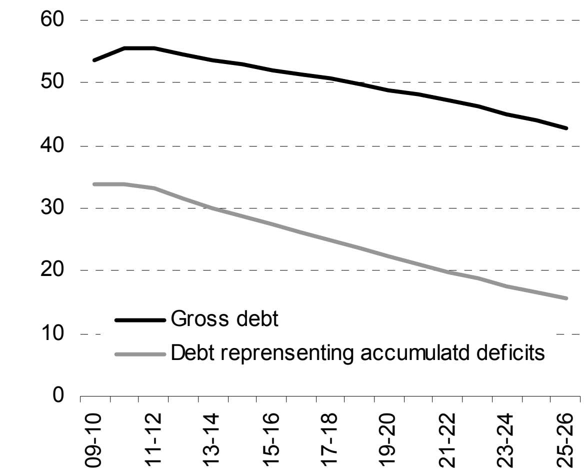
The level of Québec's indebtedness gradually declines, as does the burden of interest payable on the debt.

At the end of the period, the gross debt represents 43% of GDP, compared with 54% in 2009-2010.

— Debt service peaks at $11 billion as of 2019-2020. Less than 9.5% of budgetary revenue is allocated to debt service in 2025-2026, compared with 9.9% in 2009-2010.

CHART 18

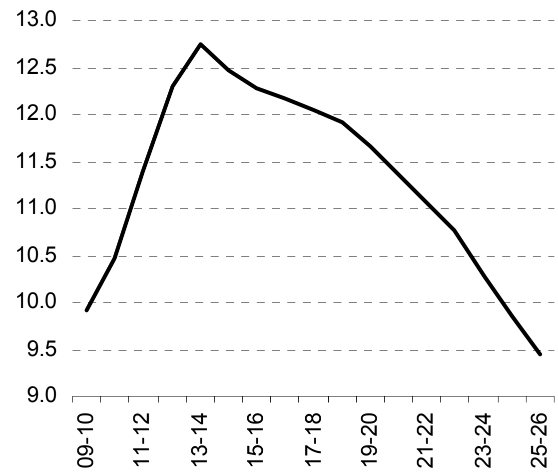
Gross debt and debt representing accumulated deficits[1] – Scenario 4
(as a percentage of GDP)



1 After inclusion of the Generations Fund.

CHART 19

Debt service[1] – Scenario 4
(as a percentage of budgetary revenue)



1 Budgetary balance for the purposes of the Balanced Budget Act.

❑ Public services maintained, tax pressure under control

At the end of the period, in 2025-2026, program spending represents 20% of Québec's GDP, the same proportion as in 2009-2010. That means that the effort made on the spending side does not call into question the place of public services in Québec's economy.

On the revenue side, still in 2025-2026, the scenario the committee is advocating leads to a certain increase in tax pressure compared to 2009-2010. Between the beginning and the end of the period, own-source revenue as a percentage of Québec's GDP rises from 15.5% to 17.4%, equivalent to 1.9% of GDP. In fact, the bulk of this increase occurs between 2009-2010 and 2013-2014.

— The rise in fees and taxes produces $5.6 billion of extra revenue in 2013-2014, compared to the deficit forecast in March 2009.

— Thereafter, own-source revenue remains stable compared to GDP. It is $1.8 billion less than in scenario 3.

In practical terms, the fourth scenario implies a smaller levy on the taxpayer than scenario 3: in 2013-2014, each adult Quebecer would have to pay additional fiscal levies of a little less than $900 compared with $1 200 under scenario 3.

TABLE 20

Efforts pertaining to own–source revenue to return to balanced budgets by 2013-2014 – Scenario 4 "The sustainable path"

	Effort in 2013-2014[1]
Effort pertaining to own-source revenue ($ million)	**5 642**
Effort in terms of revenue per adult ($)[2]	896

1 Effort when fully implemented.
2 Based on the number of adults age 18 or over, which stands at 6 298 617 in 2009.

3.2.2 Implementation of the scenario the committee is advocating

While demanding, the committee believes this scenario represents the only sustainable way to restore the health of public finances.

This scenario is the logical extension of the observations and proposals made in the first two documents. The committee therefore undertook to detail its implementation, keeping to the level of principles and the framework of intervention: the public will express their views on the measures to take, and finally it will be up to the government to make choices and act.

For spending as well as revenue, the effort has been estimated at $5.6 billion from now until 2013-2014. Thereafter, spending must be controlled so that its growth matches the rate of economic growth.

❑ Spending: a true cultural revolution in public management

The scenario the committee is advocating assumes a true cultural revolution in the management of public spending, beginning with the government administration and government corporations in how they spend. This revolution goes much further than what is currently anticipated in Québec.

It means, for instance, that the introduction of any new government program must be funded by the reduction or elimination of a financially equivalent existing program. It also assumes that priority is given to spending that favours economic growth in the long run, such as spending on education and training.

As we saw earlier, economic growth projections rely on productivity growth of 1.2% per year from 2009 to 2025. The committee is of the view that the public sector should be able to do the same.

- Accordingly, we have assumed that half the spending effort required by 2013-2014 is to be obtained through gains in efficiency and productivity of 1% per year. The committee's expectation regarding government corporations is similar.
- The other half of these efforts will result from the systematic reassessment of programs, leading to the elimination of some, a freeze on development, or their review, depending on the case.
- It is estimated that after 2013-2014, program spending growth will be controlled mainly through gains in productivity.

TABLE 21

Efforts pertaining to program spending to return to balanced budgets – Scenario 4 "The sustainable path"

	Effort in 2013-2014	**average annual effort, 2010-2011 to 2013-2014**	
	($ million)	($ million)	(%)
Efforts pertaining to program spending[1]	**5 642**	**1 411**	***2.1***
Productivity gains[2]	2 687	672	*1.0*
Examination of programs[3]	2 955	739	*1.1*

1 Compared to the trend growth of 4.6% per year over the last seven years.
2 Assuming efficiency and productivity gains of 1% per year.
3 Elimination of programs, freeze on development and review of programs following their assessment.

Productivity gains

To achieve the expected productivity gains, the government has an array of possibilities to choose from.

As indicated in the second document, application of simple principles would help achieve the objective.

- Program performance assessment must be generalized and depoliticized.
  - Québec needs regular, systematic and credible performance assessment of existing programs.
  - This assessment must have an impact on how money is spent and on budget-setting.
- Good management must be encouraged, poor management sanctioned and competition must be allowed.
  - Emulation is the key to success in the efficient use of public funds.
  - Such emulation can stem from financial incentives for managers or organizations, or from competition.

In its second document, the committee also indicated a series of initiatives that can be considered immediately and concern public spending:

- a clear choice between the centralized approach and regionalization in the management of our health and education systems;
- generalization of activity-based funding in the health sector;
- development of the opportunities offered by competition in the health sector, mirroring what is already done in the education sector;
- application to commercial government corporations beginning with Hydro Québec – of quantified performance requirements, defined on the basis of a comparison with results from other jurisdictions;
- adoption of comprehensive budget rules defining multi-year and sector-based targets;
- implementation of a systematic program performance assessment process;
- establishment of an assessment process for the basket of public services in the health sector, making full use of the future Institut national d'excellence en santé et services sociaux;

— effective application of the Act to provide for balanced budgets in the public health and social services network to hospitals and CSSS, to ban deficits in these institutions.

These possibilities point to avenues to be explored to obtain the desired productivity gains. Unless they are undertaken, the effort to be made through the examination of programs will have to be raised accordingly.

■ Examination of programs

Productivity gains should, therefore, be sufficient to resolve half of the problem. For the remaining $3 billion that must be found on the spending side by 2013-2014, many possibilities are available.

TABLE 22

Difference in program spending between Québec and Ontario[1]
Consolidated provincial and local public administrations 2008–2009
(millions of dollars)

	Difference
SECTORS	
Health	**1 533**
Education	**1 496**
Health and social services	**5 480**
Other	
Transportation and communications	4 029
Justice and protection	– 556
Development of industry and resources	1 845
General services	1 133
Environment	464
Recreation and culture	908
Industrial accidents	348
Housing	98
Regional planning and development	269
Labour, employment and immigration	262
Research institutions	366
Other items	– 162
TOTAL – PROGRAM SPENDING	**17 511**

1 Difference between effective spending in Québec and publicly-funded spending in Ontario adjusted to the cost of production of public services in Québec (prices and salaries) and normalized to Québec's population.
Source: Figures from Statistics Canada's financial management system adjusted by the ministère des Finances du Québec. For more details, see *Québec and Its Challenges*, Document 1, *op. cit.*, table 1, page 15.

The approach the committee is proposing consists in systematically assessing existing programs resulting in, depending on the case, elimination, a freeze on development or a review.

The calculation of the difference in spending compared to Ontario, which the committee presented in its first document,[30] should be used to identify priority fields for analysis. The overall difference identified amounts to $17 billion, i.e. nearly six times the objective sought.

The committee points out that the government has every interest in carrying out this review exercise as quickly as possible. By taking prompt action on public spending, the government will make it easier to control such spending subsequently and thus it will be less painful for Québec to deal with the coming demographic changes.

As an example, in the comparison of program spending between Québec and Ontario, the third-largest difference is due to spending made under the heading "development of industry and resources".

According to the assessment made for 2008-2009, the difference between Québec and Ontario was then $1.8 billion. The difference stemmed from tax credits and specific measures, but also larger subsidies in Québec, in particular in the agricultural sector.

— Taken as a whole, the Québec government's initiatives in favour of businesses amounted to $3.3 billion in 2008-2009.[31] They consist of fiscal measures, such as tax credits, budgetary measures resulting from a variety of policies and strategies, and participations taken by government corporations in various economic projects.

— In the committee's view, there is a pressing need to systematically assess existing programs and tax credits offered, to measure their results and adjust or eliminate those programs that have not achieved their original objectives.

30 See *Québec and Its Challenges, Document 1*, *op. cit.*, page 11.

31 See *Update on Québec's Economic and Financial Situation*, fall 2008, page 117.

Still, Spending Efforts Are Less Onerous Than in the 1990s

Scenario 4, "the sustainable path", focuses on program spending, limiting its growth to 2.5% per year until 2013-2014.

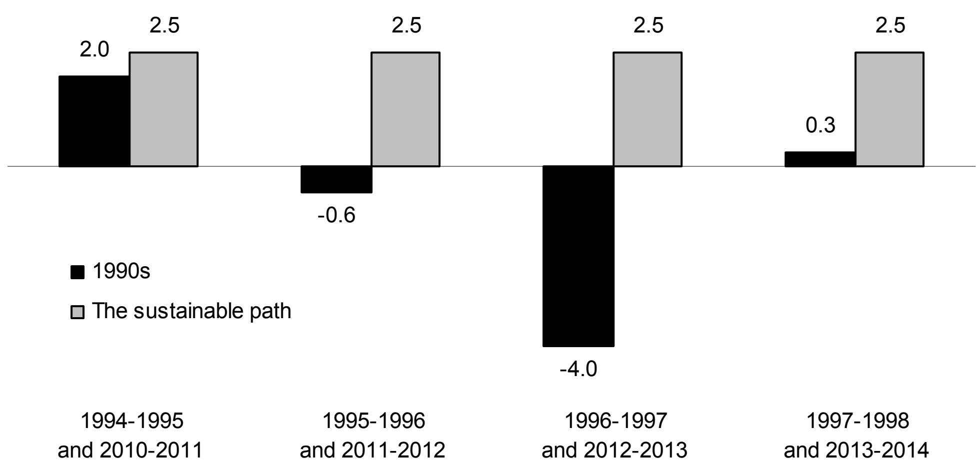
Program spending will thus continue to grow, from $60.1 billion in 2009-2010 to $66.4 billion in 2013-2014 – an increase of $6.3 billion over five years.

A decrease in absolute value terms

By way of comparison, during the 1990s, drastic measures were taken to eliminate the budget deficit.

Between 1994-1995 and 1997-1998, program spending declined by an average of 0.6% per year. Program spending fell from $35.5 billion in 1993-1994 to $34.7 billion in 1997-1998, a decline of $0.8 billion over four years.

Annual change in program spending
(per cent)



Sources: Secrétariat du Conseil du trésor, 2009-2010 Expenditure Budget, Volume IV and ministère des Finances calculation.

Moreover, the annual rate of program spending growth averaged 4.7% from 1998-1999 to 2009-2010.

❑ Revenue: the bulk of the effort early in the period

Scenario 4 assumes that half the initiatives required to return to balanced budgets by 2013-2014 – i.e. $5.6 billion – will involve raising public revenues. Of this total, the measures the government has already announced account for almost $2.4 billion. Accordingly, there remains just over $3.2 billion of additional revenues to be identified.

Beyond 2013-2014, growth in own-source revenue keeps pace with economic growth.

TABLE 23

Revenue efforts to balance the budget – Scenario 4
(millions of dollars)

	Efforts in 2013-2014
Revenue measures	**5 642**
Measures previously announced	
– 1-point rise of the Québec sales tax	1 265
– Intensification of efforts to combat tax evasion	900
– Indexing of non-indexed fees	195
Subtotal, measures previously announced	**2 360**
Additional taxes and fees to be identified	**3 282**

■ Principles and initiatives suggested earlier

The principles for improved funding identified in the second document indicate the path the government should follow.

These principles are:

- We must define an efficient tax system and thus reduce the negative impacts of any tax on economic development.
  - We absolutely must avoid raising income taxes, especially in the context of demographic changes and their effects on the labour market.
  - We must shift fiscal levies towards forms of taxation that are least damaging to economic growth, i.e. consumption taxes in particular.

  - In doing so, we must ensure that the use of consumption taxes does not fuel inequalities within society.
- We must rely more extensively on user fees.
  - In doing so, we will foster good behaviour, both by the user of the services and by the government that offers them.
  - The funding of services will thus enable more effective spending.
  - As with consumption taxes, measures must be defined to protect those in greatest need.

Two concrete initiatives were identified in the second document to give effect to these principles:

- if fiscal levies need to be raised, they should be through consumption taxes rather than income tax;
- greater application of user fees, applying the principles and the approach defined in the Policy for the Funding of Public Services.

■ Orders of magnitude

The committee has identified a number of orders of magnitude concerning potential measures that may be taken to generate additional revenue for the public treasury.

- For instance, raising the QST by an additional one point would generate $1.6 billion in extra revenue, before a $250–million increase in the QST tax credit, i.e. almost as much as by raising the fuel tax by 10 cents.
- A gradual increase of the heritage electricity pool, to reach 75% of the average residential rate elsewhere in Canada, would yield $2.2 billion, before implementation of mitigating measures for low-income households.

In all, the various measures shown here as illustrations of possible initiatives represent additional revenue of $7 billion, substantially in excess of the amounts that need to be identified by 2013-2014, under scenario 4.

TABLE 24

Examples of possible revenue measures

(millions of dollars)

	Yield 2013-2014[1]
CONSUMPTION TAXES	
Additional 1-point rise of the Québec sales tax	1 600
Increase of 10 cents per litre of the fuel tax	1 250
USER FEES	
Electricity	
– Gradual increase of the heritage electricity pool (1.5 cents/kWh) to reach 75% of the average residential rate elsewhere in Canada[2]	2 200
Health	
– Implementation of a health deductible ($25 per medical visit limited to 1% of income)[3]	670
– Self-funding of participation in the public prescription drug insurance plan[3]	200
– Higher fees for ambulance services ($15 to $100 million)[3]	100
– Contribution adjusted to income for home support services ($25 to $75 million)[3]	75
– Application of the public prescription drug insurance plan for drugs administered in health institutions	275
Education	
– Increase in university tuition fees to the Canadian average excluding Québec - from $1 968 to $5 350 per year[2]	650
Daycare services	
– Increase in daycare fees from $7 to $10 setting the share of the average daily cost of daycare covered by users at 20%	200
Other services	
– Increase in the participation of farmers in the funding of the farm income stabilization insurance plan (FISI) to 50%	130
– Increase in the share of public services funded by users[2]	n.a.

1 Annual yield before implementation of mitigating measures for low-income households.
2 Measure identical or similar to the one proposed by the Task Force on Fees for Public Services (Montmarquette Report).
3 Measure identical or similar to the one proposed by the Task Force on the Funding of the Health System (Castonguay Report).

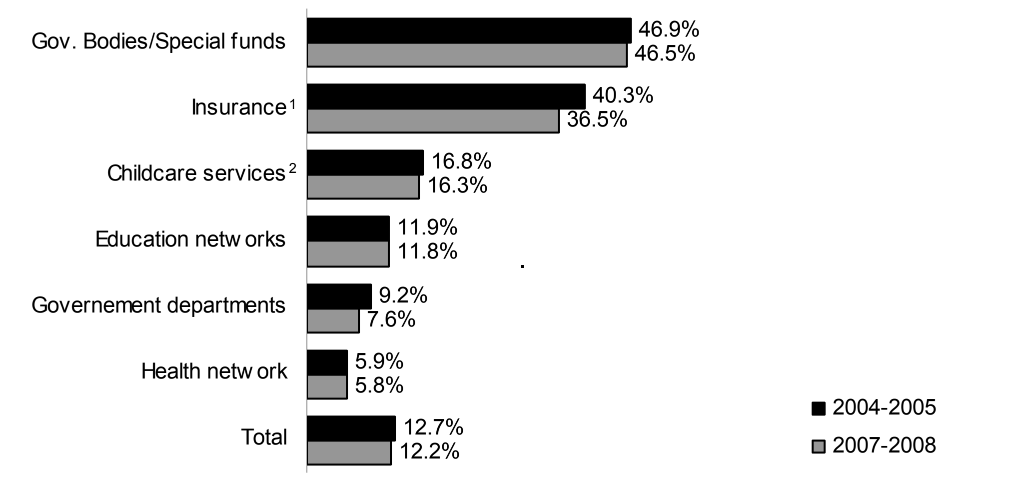
■ User fees: significant leeway available

In the committee's view, the government should give priority to studying the possibilities involving user fees: the proportion of user fee revenue according to cost is extremely low for many major public services. Contrary to the widely held view, the proportion of user fee revenue according to cost has not risen, but in fact has declined, between 2004-2005 and 2007-2008, dropping from 12.7% to 12.2%. Many fees are frozen, even as costs rise.

It should also be noted that charging fees more in line with costs has the dual advantage of costing little in terms of economic growth and encouraging good behaviour by those who make use of fee-based services.

CHART 20

Proportion of user fee revenue according to cost for all public services
(per cent)



1 Prescription drug insurance, farm income stabilization insurance and crop insurance. Excluding the SAAQ, the CSST and the Québec parental insurance plan that was not implemented until 2006.
2 Early childhood centres and family daycare facilities.
Source: Ministère des Finances du Québec, Ensure the Quality of and Funding for Public Services, Québec, 2009, page 42.

Examples of Possible Revenue Mesures

CONSUMPTION TAXES

Raise the Québec sales tax by an additional 1 point – $1.6 billion

The government could raise the Québec sales tax rate by an additional 1 point. Including the rise announced earlier, the rate would go from 8.5% to 9.5%. Such a decision can be justified by the fact that:

- the consumption tax is one of the least damaging forms of fiscal levy for the economy;
- its regressive effect can be offset by enhancing the QST credit;
- this increase would represent a recapture of the federal government's reduction of the goods and services tax (GST).

Raise the fuel tax by 10 cents per litre – $1.25 billion

To ensure long-term funding for the renewal of road and public transit infrastructures, the government could raise the fuel tax. An increase of 10 cents per litre would generate $1.25 billion annually.

USER FEES

Electricity

Gradual increase of the heritage electricity pool (1.5 cents/kWh) – $2.2 billion

Electricity rates charged in Québec are among the lowest in North America. In addition to sending the wrong price signal by encouraging waste, existing rates do not make sufficient allowance for the growing cost of new hydroelectricity projects. Accordingly, per capita electricity consumption in Québec is among the highest in the world.

To improve management and consumption of our hydroelectric resources, the government could announce a gradual increase in heritage electricity rates of 1.5 cents.

This increase would produce additional revenue of some $2.2 billion and would bring Québec's average residential rate to approximately 75% of the average residential rate in the rest of Canada.

As with the Québec sales tax, the government could limit the impact of this rate increase on low-income households by means of a tax credit.

Health

Implementation of a health contribution of $25 per medical visit – $670 million

In the wake of the recommendations of the Task Force on the Funding of the Health System, the government could implement a health contribution consisting of a $25 deductible per medical visit.

- The deductible could not exceed 1% of family income above the exemption threshold of the Québec prescription drug insurance premium.
- Just like the shift to ambulatory care designed to supply the right care at the right time by the right person and at the lowest cost, the deductible would be adjusted depending on where care is provided.

In addition to making the health system more efficient, the deductible would generate $670 million per year.

Prescription drug insurance plan: make participation self–funding – $200 million

The public prescription drug insurance plan is free for recipients of last-resort financial assistance and for low-income individuals age 65 or over, i.e. 1.5 million people. The plan also covers 1.7 million participants not covered by a private plan. But the total contribution of plan participants is less than the real cost for this group.

The government could raise premiums for participants and higher-income individuals age 65 or over to cover the $200-million shortfall, thus enabling this group to cover the full cost of their participation in the plan.

Examples of Possible Revenue Mesures (continued)

Health (continued)

Ambulance services – $15 to $100 million

The government could increase the share, currently estimated at 25%, of the cost of ambulance transportation currently paid by users. For example, the fee, which has not changed since 1997, could be indexed to the CPI, or adjusted to cover 100% of the true cost, with a minimum contribution for social assistance recipients and seniors.

In this regard, the Task Force on the Funding of the Health System assessed a variety of scenarios generating additional revenue ranging from $15 million to $100 million.

Contribution adjusted to income for home support services – $75 million

The government could introduce a user contribution depending on income (ability to pay) for everyday activities (washing oneself, eating, dressing, etc.) and domestic activities (household maintenance, meal preparation, laundry, etc.).

The Task Force on the Funding of the Health System estimated that such a contribution could generate additional revenue of $75 million.

Application of the public prescription drug insurance plan for drugs administered in health institutions – $275 million

Contrary to drugs prescribed outside a health institution, drugs administered in a health institution are free. Application of the public prescription drug insurance plan for drugs administered in health institutions would yield $275 million for the government, i.e. 40% of the costs (current division of public plan funding between the government 60% – and insured persons 40%) that would thus be borne by public plan participants and persons covered by a private plan.

According to the Task Force on the Funding of the Health System, the cost of drugs administered in health institutions amounted to $525 million in 2006-2007. By projecting the increase in these costs at the average annual growth rate of the public prescription drug insurance plan from 2004 to 2008, i.e. 7%, the potential savings available to the government from applying the public plan in health institutions amount to $275 million in 2010-2011.

Education

Increase in university tuition fees – $650 million

Tuition fees were held at $1 668 a year between 1994-1995 and 2006 2007. The government then undertook to raise these fees by $50 per session as of the 2007 2008 academic year.

Despite this increase of $500 by 2011 2012, it still costs less to study at the university level in Québec than anywhere else in Canada. By way of comparison, tuition fees for 2008-2009, which were $1 868 in Québec, were $5 643 in Ontario and $5 040 in British Columbia, while the Canadian average excluding Québec was $5 350.

To eliminate the gap between the contribution Québec university students pay and the Canadian average, and raise the proportion of universities' revenues derived from tuition fees (currently roughly 10%), the government could begin to close the gap over the coming years so that within five years, tuition fees in Québec correspond to what they currently are elsewhere in Canada.

- To set tuition fees that are more in line with the real costs of education, in addition to closing the gap with the rest of Canada, tuition fees could be set at different levels depending on the discipline.

In all, this increase would ultimately generate $650 million per year.

This increase would be accompanied by an enrichment of the loans and scholarships program.

Examples of Possible Revenue Mesures (continued)

Daycare services

Rise in daycare fees from $7 to $10 – $200 million

The government could set the share of the average daily cost it covers at 20%, thus raising the daily fee from $7 to $10.

In addition to keeping the share of the cost covered by the government constant, this increase could generate $200 million once implemented.

Other revenue

Increase in the participation of farmers in the funding of the farm income stabilization insurance plan – $130 million

The farm income stabilization insurance plan cost almost $770 million in 2008-2009. Currently, the government funds two thirds of this amount, with farmers covering the rest by means of a premium.

The government could require that henceforth, the cost of the plan be divided evenly between the state and farmers. This new allocation of funding would save the government $130 million annually.

Increase in the share of public services funded by users

Currently, users fund just over 12% of public services.

In this regard, the government could announce its intention to raise and then maintain the rate of funding of public services by users. As recommended by the Policy for the Funding of Public Services, user fees would then be indexed to the increase in real costs.

3.3 The difference between the failure to act and the results of taking action

The comparison of financial results obtained by assessing each of the scenarios shows the difference between the two series of approaches studied.

In the first two scenarios, the required efforts are very limited or non-existent. In scenarios 3 and 4, the effort is the same, i.e. $11.3 billion in 2013-2014, but the distribution between spending and revenue is different.

TABLE 25

Comparison of total efforts to balance the budget by 2013 2014 – Scenario 4
(millions of dollars)

	Scenario 1 The status quo	Scenario 2 Rollback	Scenario 3 The partial response	Scenario 4 The sustainable path
Budgetary balance with program spending growth at 4.6%	**– 11 284**	**– 11 284**	**– 11 284**	**– 11 284**
Revenue[1]	2 360	0	7 474	5 642
Spending	0	0	3 898	5 642
Efforts applied	**2 360**	**0**	**11 372**	**11 284**
Budgetary balance after efforts applied	**– 8 924**	**– 11 284**	**88**	**0**

1 Including net results of consolidated entities.

❑ "The sustainable path": public services compatible with a healthy financial situation

The results obtained show the attraction of the scenario the committee is proposing, "the sustainable path" scenario.

Under this scenario, the budget is balanced within four years and remains so thereafter, without calling into question the role and place of the state in the economy: in fact, at the end of the period, program spending as a percentage of GDP rises back to its 2009-2010 level while the share of revenue grows slightly. That is a far cry from a withdrawal or disengagement by the state.

CHART 21

Own-source revenue
(as a percentage of GDP)

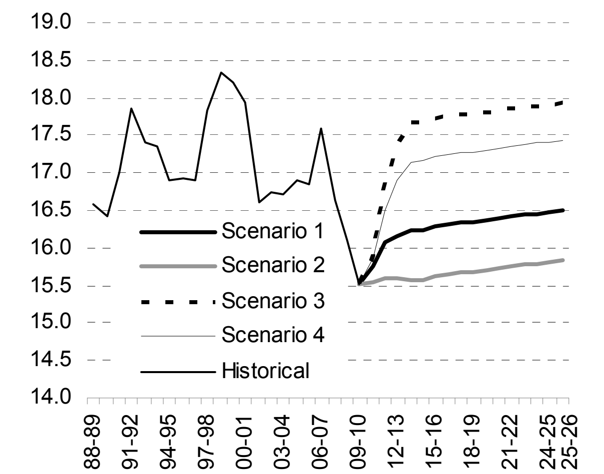


CHART 22

Program spending
(as a percentage of GDP)

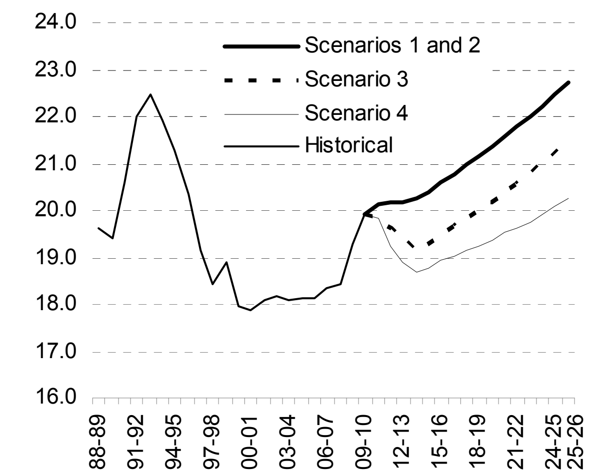


CHART 23

Debt representing accumulated deficits
(as a percentage of GDP)

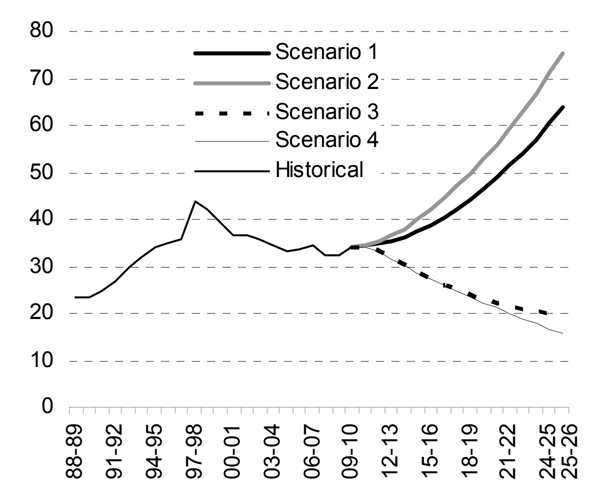
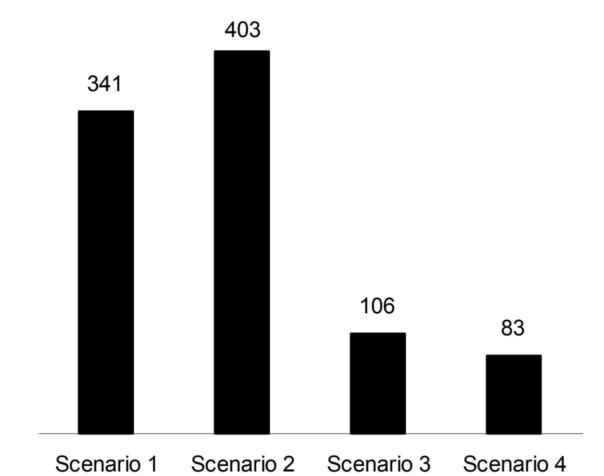


CHART 24

Debt representing accumulated deficits as at March 31, 2026
(billions of dollars)



Scenario 4 – and to a lesser degree scenario 3 – also helps limit the debt representing accumulated deficits – what is referred to as “bad debt”. This debt rises four-fold between scenarios 1 and 2 and scenarios 3 and 4.

CONCLUSION

This third document concludes the advisory committee's work begun last November at the initiative of the Minister of Finance.

In the first two documents released last December and January, the Advisory Committee on the Economy and Public Finances arrived at a number of major observations.

- We have extensive public services and we have chosen to collect more taxes and go deeper into debt than elsewhere, mostly to fund current spending, and have thus reached a limit.
- Our leeway is reduced, while new challenges are emerging, in particular the impact of demographic changes, which affect both public spending and revenue.

The committee has also arrived at possible solutions that involve spending more effectively and better funding our public services on the basis of simple principles and concrete initiatives.

In the third stage of its deliberations, the committee undertook to flesh out these observations and possible solutions by comparing a number of contrasting scenarios that correspond to positions that are part of the ongoing debate. The committee has brought something new to the discussion, by extending its analysis well beyond 2013-2014 – a necessary step to take the demographic change dimension into account.

❑ Four messages

The committee draws four essential messages from its work, directed both to the government and to all Quebecers.

- First, regarding public finances, failure to act now would be a serious mistake.

  It is imperative that the target set in the March 2009 Budget Speech be reached, and that balance be restored to public finances within four years. Postponing the date for returning to balanced budgets beyond 2013-2014 would place us in a very vulnerable position, since that is when the full effects of the aging of the population will begin to be felt.

— Second, to balance the budget, an approach that is evenly balanced between revenue and spending is required.

  The committee's proposals in this regard contrast with the easy solution that consists in raising revenue without acting on spending. Ultimately, the committee is convinced that the only way Québec's public finances can be balanced on a long-term basis is to adjust the growth of spending to that of revenue, which in turn is determined by economic growth.

— Third, it is imperative that we improve how we spend and how we fund our public services.

  The committee has placed considerable emphasis on the need to spend more effectively, based on the convincing examples provided by many advanced countries. This also applies on the revenue side. The choice of taxes and forms of levies has a direct impact on economic growth. Emphasis must be placed on indirect taxes and fees rather than on direct taxes. This option can be made compatible with a genuine concern for the situation of the most disadvantaged. An appropriate strategy in this regard could win us additional growth points, something very precious in a context of demographic changes.

— Fourth and lastly, the committee wishes to convey a message of hope.

  The scenario developed to give practical shape to the observations and proposals presented shows that it is possible to maintain balanced public finances on a long-term basis, reduce our debt load and the burden of "bad debt", despite demographic changes, while at the same time maintaining a comparable basket of public services and avoiding further increases in the tax burden.

❑ A forgotten fact

At the conclusion of its deliberations, the Advisory Committee on the Economy and Public Finances can only conclude with a fact that is all too often forgotten: whatever we do, the only sustainable way to manage public finances is to ensure that spending rises at the same rate as the revenue that funds it, i.e. the rate of economic growth.

The challenges facing Québec compel us to come to terms with this reality.

APPENDIX 1
The advisory Committee on the Economy and Public Finances

❑ Members of the Advisory Committee on the Economy and Public Finances

■ Robert Gagné (co-chairman)

With a doctorate in economics from the Université de Montréal, Robert Gagné is a professor at HEC Montréal and the director of the Centre sur la productivité et la prospérité.

Robert Gagné specializes in applied econometrics, industrial organization and public policy. In recent years, Robert Gagné chaired the Task Force on Tax Assistance for the Resource Regions and the New Economy and co-chaired the Advisory Committee on the Fiscal Imbalance of the Council of the Federation.

In 2002, Mr. Gagné was appointed a regular member of the Centre interuniversitaire sur le risque, les politiques économiques et l'emploi (CIRPÉE). Since 1999, Robert Gagné has been a fellow of the Centre interuniversitaire de recherche en analyse des organisations (CIRANO). He has focused on researching issues relating to business productivity, resource optimization and issues relating to the transportation sector.

■ Pierre Fortin (member)

Pierre Fortin holds a doctorate in economics from the University of California, Berkeley, and a master's in mathematics from the Université de Montréal.

He is professor emeritus in the economics department of the Université du Québec à Montréal (UQAM). His research focuses chiefly on economic growth, monetary and budgetary policy, social policy and the economy of Canada and Québec.

He is a member of the Royal Society of Canada, associate researcher with the Centre interuniversitaire de recherche sur le risque, la politique économique et l'emploi (CIRPÉE) and a member of the science council of the Canadian Institute for Advanced Research. He has been President of the Canadian Economics Association, a member of the panel of economic advisors of the Minister of Finance of Canada and senior economic advisor to the Premier of Québec.

Luc Godbout (member)

Luc Godbout holds a doctorate from the Université Paul-Cézanne-Aix-Marseille III. He is an associate professor at the Université de Sherbrooke.

He specializes in taxation and public finance. In recent years, he has, in particular, been a member of the Task Force on Tax Assistance for the Resource Regions and the New Economy, in addition to contributing to the Commission on the Fiscal Imbalance.

Luc Godbout is also a researcher with the Research Chair in Taxation and Public Finance of the Université de Sherbrooke. His research has focused in particular on the consequences of the aging of the population on Québec's public finances. Since 2006, Luc Godbout has co-directed four books published by the Presses de l'Université Laval. He is the author of a monthly column, "les public finances sous la loupe" published by La Tribune.

Claude Montmarquette (member)

Claude Montmarquette holds a doctorate in economics from the University of Chicago. He currently holds the Bell – Caisse de dépôt et placement du Québec chair in experimental economics at the Université de Montréal, as professor emeritus.

He is President and CEO of the Centre interuniversitaire de recherche en analyse des organisations (CIRANO), where he heads the public policy research group. Claude Montmarquette has been a guest professor at many foreign universities and is a regular participant at a large number of conferences and seminars around the world.

Ministère des Finances

Luc Monty, Secretary and Assistant Deputy Minister, budgetary policy and economics

Simon Bergeron, Director General, budgetary policy

Pierre Côté, director, policy analysis and budgetary information

Main contributors

Marc Sirois, Director General, economic analysis and forecasting

Alain Boisvert, director, budgetary information

Raymond Fournier, director, research, modelling and impact analysis

Julie Gingras, director, own-source revenue analysis and forecasting

Richard Masse, director, expenditure forecasting and analysis and fees

Luc Biron, analyst, own-source revenue analysis and forecasting division

Frédéric Chartrand, economist, own-source revenue analysis and forecasting division

Claude Dallaire, economist, own-source revenue analysis and forecasting division

Denis Guindon, economist, policy analysis and budgetary information division

Benoît Lavigne, expenditure forecasting and analysis and fees division

François Leclerc, analyst, policy analysis and budgetary information division

Alexandre Montelpare, economist, policy analysis and budgetary information division

Alain Ratté, analyst, expenditure forecasting and analysis and fees division

Éric Fournier, Director General, policies pertaining to individuals, and all his team

Éric Ducharme, Director General, policies pertaining to businesses, and all his team

Anny Gagnon, administrative assistant, Office of the Director General, Budgetary Policy

Jacynthe Létourneau, administrative assistant, Office of the Director General, Budgetary Policy

❑ Ministère du Conseil exécutif

Jean-Pierre Pellegrin, Assistant Secretary, responsible for the Direction des politiques publiques et des prospectives, Secrétariat aux priorités et aux projets stratégiques

Claude Bertrand, administrative technician with the Direction des politiques publiques et des prospectives, Secrétariat aux priorités et aux projets stratégiques

APPENDIX 2
Economic Recovey

Since the fall of 2008, the Québec government has acted a number of times to support the economy and counter the effects of the recession. The action plan injects $15.5 billion in the economy in 2009 and 2010, i.e. 5.0% of GDP.

TABLE 26

The government's action plan: cash resources injected into Québec's economy in 2009 and 2010 – Fall 2009

	2009				
	Commitment announced in the 2009-2010 Budget ($ million)	**Revised commitment[1]** ($ million)	**Proportion of funds committed** (%)	**Forecast amount in 2010** ($ million)	**Total over two years** ($ million)
1. Additional immediate actions to support businesses and workers	2 302	2 757	119.7	1 930	4 686
2. Invest in public infrastructure	4 488	4 483	99.9	3 593	8 076
3. Support households, especially families and seniors	368	360	98.0	483	844
4. Stimulate investment by reducing the corporate tax burden	330	330	100.0	729	1 059
5. Preparing Québec for economic recovery	569	300	52.8	521	822
TOTAL	**8 057**	**8 230**	**102.2**	**7 257**	**15 487**

Note: Figures have been rounded off, so they may not add up to the total indicated.
1 Amounts incurred by the government to support businesses and workers in 2009.
Source: Ministère des Finances du Québec, *Update on Québec's Economic and Financial Situation*, fall 2009.

Overall, government actions in Québec to support the economy and revive growth are equivalent to those implemented in Canada (4.8% of GDP) and the United States (4.7% of GDP).

TABLE 27

Update to government economic support actions in 2009 and 2010 – Fall 2009

	2009		2010		Total	
	($ billion)	(% of GDP)	($ billion)	(% of GDP)	($ billion)	(% of GDP)
Québec	8.2	2.7	7.3	2.3	15.5	5.0
Canada	51.7	3.4	22.5	1.4	74.2	4.8
United States[1]	274.0	2.0	401.0	2.7	675.0	4.7

Note: Includes fiscal and budgetary measures, infrastructure investments and cash resources injected to support the economy, excluding assistance to the financial sector.
1 Amounts in U.S. dollars.
Sources: Ministère des Finances du Québec, Department of Finance Canada, Congressional Budget Office and U.S. Treasury.

The actions of the Québec government together with those announced by the federal government will enable Québec's economy to get through the recession and be in better position to take advantage of the recovery.

In 2009 and 2010:

— Québec's real GDP will be 1.5 percentage points higher than it would have been without the support measures by governments;

— 60 000 jobs will be created or maintained as a result of government action.

In light of recent economic indicators, the recession appears to be over in Québec. After declining for three quarters, real GDP gained 0.2% (quarterly rate) in the third quarter of 2009.

This uptick is attributable to:

— improving consumer confidence that has stimulated consumption spending, in particular purchases of durable goods;

— the recovery in job creation;

— the actions taken by the Québec government to support economic activity.

While the recovery remains tentative so far, consumption and private investment having to step in for stimulus packages implemented by governments, the committee is of the view that the budgetary stimulus measures set up since 2008 are enough to ensure recovery. Should the recovery prove weaker than expected both in Québec and in Canada, the Bank of Canada could, for instance, decide to delay its expected rises in policy interest rates.

Québec