



ACTION

The Government's Action Plan and
Economic Policy

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2002 › 2003 BUDGET

Finances

Québec 

Foreword by the Deputy Prime Minister and Minister of State of the Economy and Finance

The events of September 11, 2001 have marked a new stage—a painful one—in the history of humanity. They have also, from an economic standpoint, resulted in a whole series of disruptions, the precise magnitude of which is still difficult to gauge. The United States, the principal power targeted, is also where the greatest impact has been felt in terms of the growth of activities. The attacks carried out on its soil magnified the risks of an economic slowdown, particularly by undermining the confidence of consumers.

Québec is experiencing directly the repercussions of these grave problems. Our economic ties with the United States have never been closer, and all manufacturing businesses are directly affected to a greater or lesser extent by the threats weighing on our exports. Several of our most dynamic sectors, such as aerospace, have already been shaken by the impact of the events of September 11. Investors themselves wonder about the current and foreseeable economic situation.

*The Québec government had to react rapidly to that shock, which no one could anticipate. The Québec economy is strong and diversified, but businesses, like individuals, must regain all the confidence that has motivated them until now, and thereby ensure a return to solid growth. The government can play a strategic role in restoring confidence, and it is for this reason that the **2002-2003 Budget Speech** is much earlier than anticipated, making it possible for a whole series of new initiatives to be implemented.*

These initiatives are three-pronged: the government is injecting funds for the benefit of consumers, by providing specific support for people with low incomes. It is accelerating major public-sector investments. It is helping small and medium-sized enterprises to navigate the current difficulties, and it is using the means at its disposal to stimulate business investment. Taken as a whole, this is a major action plan, implemented to bolster economic activity and jobs.

The action plan does not require only new money and public funds. It includes spending that was already earmarked but is being accelerated, initiatives of government corporations and private investment, concerning which certain targeted measures will produce a true leverage effect. Its

implementation does not affect the balanced budget policy, which we must maintain.

The initiatives undertaken are perfectly consistent with the government's general economic policy, which it has applied successfully since the mid-1990s. Since then, the Québec economy has been profoundly transformed, and in the right direction. The standard of living of Quebecers has improved noticeably, the unemployment rate has plummeted, while our businesses have been enjoying an enviable place on external markets. The very structure of the Québec economy has changed, with the significant breakthroughs made by advanced-knowledge sectors, which have acquired a reputation internationally.

*The **2002-2003 Budget Speech** provides an opportunity to review the government's economic policy, to assess it and to define its next stages.*

The modernization effort undertaken must be continued and stepped up. The achievement by Quebecers of the collective objectives they hold dear depends on the strengthening of their economy. It is through a strong and prosperous economy that everyone who can work will have a job, that the wealth redistribution programs among the most generous in North America will be preserved and that the public services to which we are all so deeply attached will be funded.

*While it is a response to the delicate economic situation we now find ourselves in, the action plan implemented by the government constitutes a new stage in building a more prosperous and productive Québec. With the **2002-2003 Budget Speech**, the government is mobilizing the means that Québec needs to preserve and improve the status it has acquired in an increasingly open and competitive world.*

PAULINE MAROIS

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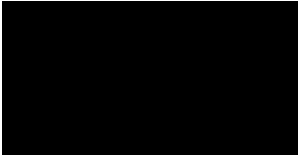
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INTRODUCTION

This publication presents and describes the action plan developed by the government as part of the **2002-2003 Budget Speech** with a view to bolstering economic activity, given the impact of the events of September 11, 2001. The action plan and the initiatives it contains are then put into perspective in order to link them with Québec's economic performance and explain the extent to which they are incorporated into the economic policy being implemented. The publication also gives the government an opportunity to emphasize the importance and nature of the resources mobilized to implement the policy.

The publication contains three sections:

- ➡ The first section is devoted to the measures defined by the government to respond to the challenge of the current economic environment.
- ➡ The second section examines the work accomplished to date in modernizing the Québec economy—work begun that must be pursued.
- ➡ The third section sets forth all the financial resources assigned to the implementation of the economic policy. They are quantified and categorized according to the nature of the instruments used.

SECTION 1

RESPONDING TO A CHALLENGING SITUATION

The attacks of September 11, 2001 profoundly changed the outlook for economic growth in Québec and the principal industrialized countries. The economic slowdown, which was perceptible before the events of September 11, expanded and accelerated—first and foremost, in the United States. The Québec economy is directly experiencing the effects of the slowdown, for its economic ties with the United States have never been closer and, in some of the sectors most affected, such as aerospace, Québec is a major player.

The government decided to respond rapidly to this unforeseen economic situation by introducing an action plan aimed, above all, at stimulating investment and helping SMEs navigate the slowdown. The government is stepping up its efforts for the resource regions. It is also defining targeted measures for consumers, of benefit mainly to people with low incomes. The government's overall objective is to maintain the achievements of recent years in terms of standard of living and productivity.

The action plan introduced as part of the **2002-2003 Budget Speech**, which is being tabled five months early for this purpose, focuses on three main elements:

- ➡ The action plan directly targets individuals through the injection of \$400 million for consumers, with a view to boosting their confidence.
- ➡ The public sector is being mobilized. The government is accelerating investments totalling nearly \$3 billion, \$2.5 billion of which are public investments, supplemented by \$500 million in investments by government corporations that are commercial in scope.
- ➡ The government is appealing to businesses through the economic levers it has already introduced to support SMEs and to spark additional investment by the private sector.

1. PROVIDE SUPPORT FOR CONSUMERS

The current economic situation requires that a positive message be sent to consumers. Accordingly, the action plan implemented by the government includes the injection of \$400 million for their benefit, \$75 million of which is for people with low incomes.

This transfer stems from the following four measures:

- ➡ The government is making an additional payment of \$250 million to bolster confidence. The payment will be in the form of an additional \$100 per adult for all beneficiaries of the QST credit. This means was chosen because it could be implemented very rapidly. The \$100 amount will be added to the second payment of the QST credit made, as each year, in December. This measure will benefit 2.5 million consumers.
- ➡ Social assistance benefits for persons with a severely limited capacity for employment will be indexed on January 1, 2002, which means a transfer of \$29 million to these recipients.
- ➡ Social assistance benefits for people who are able to work will also be indexed on January 1, 2002, which will increase them by \$46 million. This is the second increase for these Quebecers in a little over six months.
- ➡ Furthermore, the government is maintaining the indexation of the personal income tax system on January 1, 2002, and raising the indexation rate from 1.8% to 2.7%. This measure, which represents an injection of \$77 million, will benefit all taxpayers.

Full indexation of the personal income tax system

- ➡ In accordance with the commitments made in the *2001-2002 Budget Speech*, the government will index the personal income tax system beginning on January 1, 2002.
- ➡ Because of indexation, all taxpayers will see their tax burden reduced in 2002 by a total of \$232 million.

Several typical cases

The impact of the measures announced in the **2002-2003 Budget Speech**, including the full indexation of the personal income tax system, can be concretely illustrated through a number of typical cases.

- ➡ The disposable income of a couple with two children and two incomes totalling \$35 000 will increase by \$229.
- ➡ The disposable income of a couple 65 years of age or over with a total income of \$35 000 will increase by \$342.
- ➡ The disposable income of a couple with two children and an income of \$35 000 will increase by \$369.
- ➡ The disposable income of a couple that has no children and receives social assistance benefits will increase by \$460.

The impact of the income tax reductions implemented in July 2001

Moreover, bear in mind that the measures announced in the *2001-2002 Budget Speech* and implemented since July 1 are now producing their full effect. For taxpayers, the income tax reduction announced on March 29, 2001 represents an increase in disposable income of \$1 billion for the 2002 calendar year as a whole.

In all, taxpayers will thereby benefit from an increase in disposable income of \$1.6 billion in 2002, because of the personal income tax reduction measures and specific measures of support for people with low incomes, implemented in March 2001 and in the **2002-2003 Budget Speech**.

TABLE 1
Impact of support measures for households –
2001-2002 and 2002-2003 Budget Speeches
(In millions of dollars)

	Increase in disposable income in 2002
2002-2003 Budget	
One-time increase in the QST credit ¹	250
Revision of indexation rate from 1.8% to 2.7%	77
Indexation of social assistance benefits	
– For people who are able to work	46
– For people with severe employment constraints	29
Sub-total: 2002-2003 Budget	402
2001-2002 Budget	
Personal income tax reduction	1 040
Indexation of the personal income tax system in 2002	155
Indexation of social assistance benefits	36
Sub-total: 2001-2002 Budget	1 231
Total	1 633

¹ Amount paid in December 2001.

2. ACCELERATE PUBLIC-SECTOR INVESTMENTS

The second component of the government's action plan consists in accelerating a number of public-sector investments, in order to rapidly spark additional economic activity. These investments not only provide a response to the various needs of Québec society, but they also make it possible to directly support the economy and to create jobs in all Québec regions.

Investments rather than expenditures

Public-sector investments constitute a major instrument at the government's disposal for stimulating the Québec economy without jeopardizing the objective of a zero deficit. The government has chosen investments rather than budgetary expenditures for both economic and financial reasons.

- ➡ From an economic standpoint, public investments have a major leverage effect, which means that each dollar invested will create a volume of activity that is a multiple of the initial investment. In the current situation, this leverage effect is strategic, since it makes it possible to maximize the use of public funds with a view to providing support for the economic situation.
- ➡ From a financial standpoint, the decision to move up investments that were already programmed makes it possible to limit the budgetary impact of this initiative on public finances. Making public investments early has an impact on the government's budget in terms of an additional borrowing burden, but that burden is distributed over time.

Moreover, and in contrast to expenditures, public investments are non-recurrent commitments. Investments moved up therefore do not jeopardize the future budgetary balance.

It should be added that the investments in question meet major needs for the renovation and construction of infrastructure. The decision was made to accelerate public investments because of the situation, but also because it will benefit the Québec community over a long period of time. The government is implementing early useful and necessary projects that would have been implemented a little later.

Type of investments chosen

The investments chosen for the purposes of the action plan can all be made very rapidly. They are for all regions of Québec.

They fall into two categories according to their type:

- ➡ A first series consists of public investments to improve the competitiveness of the Québec economy and its productivity, and to strengthen the main public services. These investments essentially concern the road network, municipal infrastructure, research, health, education, social housing and culture.
- ➡ A second series are not public investments, but depend on the public sector. They will be made by government corporations of commercial scope. These cost-effective investments will, when fully implemented, strengthen the position of these organizations on their markets.

Nearly \$3 billion in public-sector investments

The government is accelerating public investments totalling \$2.5 billion, to which must be added \$500 million from government corporations, for a total of \$3 billion for the public sector as a whole.

The public investments that the government is accelerating are added to the \$7.1 billion in investments already provided for in the government's three year planning for fiscal years 2001-2002 to 2003-2004. Hence, the work carried out during the next three years amounts to \$9.6 billion.

- ➡ The public investment acceleration plan involves projects that will start up very rapidly and will be largely completed by July 2002. A government contribution of just over \$1 billion is set aside for projects in this category.
- ➡ The acceleration plan also includes projects totalling over \$1 billion, whose implementation will require a little more time and will be spread over the years 2002, 2003 and 2004. These are strategic investments that must be made rapidly in order to meet priority needs.

The government's action plan gets under way as soon as the **2002-2003 Budget Speech** is tabled. The main investments to be made early are given in the following table:

TABLE 2
Public-sector investment acceleration plan –
Public investments and investments by government corporations
of commercial scope
(In millions of dollars)

	Investments
Public investments	
- Health and social services	500
- Education	400
- Transport (road network)	400
- Research, science and technology	100
- Québec-Municipalités infrastructure	350
- Social housing	457
- Culture	100
- Family and child welfare	50
- Information technologies	100
Sub-total: public investments	2 457
Investments by government corporations of commercial scope	500
Total	2 957

3. SPARK INVESTMENT BY THE PRIVATE SECTOR

As part of its economic policy, the government has introduced a number of instruments to stimulate private investment. These instruments have proven their effectiveness: in recent years, Québec has experienced substantial growth in business investment, which has been supported by the government.

The action plan announced as part of the **2002-2003 Budget Speech** uses these different instruments to prompt the private sector to maintain and increase its investments in the Québec economy, with a view to maintaining jobs and economic activity. The objective of the government's initiatives is to boost the confidence of businesses and to create a climate conducive to decisions to invest, despite the uncertainty stemming from the events of September 11.

The instruments used by the government are of four types:

- ➡ The government is giving immediate assistance to SMEs by providing them with additional liquidity and facilitating their financing.
- ➡ The government is stimulating investment by businesses by improving their tax treatment and the financing of large-scale projects.
- ➡ The government is expanding and accelerating its efforts in regard to the resource regions by strengthening the existing assistance provided for investments.
- ➡ The government is lending its support for investments in two specific sectors of activity: agri-food and the social economy.

IMMEDIATE ASSISTANCE FOR SMEs

The current situation is directly affecting SMEs, which may face liquidity problems. Furthermore, their access to financing has been made even more difficult.

Support for SME working capital

In the days following the events of September 11, the Québec government gave SMEs initial assistance in the form of an additional six-month period in which to pay income tax instalments and instalments of the tax on capital that were to be remitted in October. That measure provided SMEs with additional liquidity of \$175 million.

The **2002-2003 Budget Speech** announces that that measure will also apply to instalments to be remitted in November and December. The businesses concerned will thereby benefit from a total of \$525 million in assistance for their working capital.

In addition, SMEs will no longer be obliged to remit source deductions every month if their average monthly remittance does not exceed \$1 000. They will be allowed to make remittances quarterly, which will improve their cash flow while relieving their administrative burden. It is estimated that annually there are more than 800 000 forms that small employers will no longer have to file.

La Financière du Québec: a powerful tool for SMEs

SMEs are already facing a tighter supply of financing on the market. The problem mainly affects young businesses, businesses in the regions and businesses in the new economy.

The government is setting up La Financière du Québec to help SMEs find financing. This new organization is part of Investissement Québec, and it replaces Garantie Québec.

The creation of La Financière du Québec will be accompanied by a complete re-engineering of Investissement Québec's current supply of financing for SMEs, in order to provide them with customized financial solutions and to adapt rapidly to their changing financial needs.

La Financière du Québec will serve as an adjunct to financial institutions, while respecting their normal fields of intervention.

- ➡ La Financière du Québec will be able to extend loans to businesses. It will no longer essentially provide loan loss guarantees, as Garantie Québec did.
- ➡ La Financière du Québec will have the important mandate of providing assistance for the working capital of businesses facing temporary difficulties. The assistance may take the form of a loan or a loan guarantee not exceeding 80% of the net loss.

La Financière du Québec will intervene in those ways in order to maintain the activities and jobs of businesses that have liquidity problems owing to the situation—the impact of the events of September 11, for example. The objective is to grant a total of \$100 million in loans or loan guarantees by March 31, 2003.

- ➡ La Financière du Québec will use innovative financing formulas, established on a business basis, in order to respond in a flexible and versatile manner to the increasingly diversified needs of SMEs. In particular, the corporation will intervene to provide businesses with “quasi-equity” financing.

“Quasi-equity” financing

“Quasi-equity” financing is a hybrid form of financing, between venture capital financing and the traditional financing available from financial institutions.

“Quasi-equity” financing consists essentially of a loan—a risk-sharing loan, a subordinated loan or a venture loan—but it has certain features akin to venture capital, such as a moratorium on the repayment of principal or a risk premium.

- ➡ La Financière du Québec will be able to lend immediately to fledgling businesses that are unable to finance themselves because of the economic situation. A \$25-million loan envelope has been set aside for that purpose, until March 31, 2003.
- ➡ La Financière du Québec can provide cooperatives and businesses in the social economy with capitalization loans and other quasi-equity financial products. A \$15-million financial intervention envelope has been placed at the disposal of these businesses. In addition, partial interest payment holidays may be granted, up to a maximum of \$1.2 million. These envelopes will be managed jointly with the business clientele contemplated by this measure.

Because of its expertise, La Financière du Québec will be responsible for managing the FAIRE program.¹

La Financière du Québec will be operational very quickly, since it is replacing an existing organization, Garantie Québec.

Thanks to its new opportunities for intervention, La Financière du Québec can actually play the role of an investment bank for SMEs, as an adjunct to commercial financial institutions.

1 FAIRE is an acronym for the Fonds pour l'accroissement de l'investissement privé et la relance de l'emploi, the Private Investment and Job Creation Promotion Fund.

STIMULATING PRIVATE INVESTMENT

Québec has gradually introduced a broad range of programs to support businesses in their investment efforts, while encouraging foreign businesses to move to Québec.

These programs stem from a basic observation: businesses constitute, through their investments, the principal engine for job and wealth creation. By encouraging private investment, Québec has chosen the most effective and sustainable way to modernize its economy and enhance its competitiveness.

In the current setting, where investment decisions may be jeopardized by the waning confidence of decision-makers, the government has chosen to intervene in two ways as a priority:

- ➡ The government is introducing major tax relief for businesses, in order to preserve the competitiveness of the Québec tax system.
- ➡ The government is improving the FAIRE program, in order to accelerate the start-up of large-scale projects.

By January 1, 2003, 60% of businesses will no longer pay the tax on capital

The competitiveness of the tax system is one of the decisive factors that businesses consider in making their investment decisions. It is not the only factor considered, but it is a major one in the final decision: the size and nature of the tax burden to which businesses are subject determine in part the relative competitiveness of the economic environment in which the business plans to invest.

At the current time, the tax system for businesses established in Québec is competitive over all, particularly because of the rate of taxation of corporate income, the refund of the sales tax paid on inputs under the QST system and the reduced property taxes levied.

However, the current tax system poses a number of major problems:

- ➡ Fixed charges are considerable. The tax on capital in Québec is the highest in North America, and the payroll tax burden is the heaviest among Canadian provinces.
- ➡ The overall competitiveness of the system is greatly threatened. The main industrialized countries have embarked on a major shift toward reducing business taxes. The same phenomenon is observed in Ontario, Alberta and British Columbia.

In the current circumstances, that threat affects business confidence. Furthermore, the burden of fixed charges, particularly the tax on capital, has already been detrimental: some businesses may be prompted to move their activities, transferring part of their tax base outside Québec. Québec's SMEs suffer from an even greater disparity, as a number of jurisdictions already exempt their competitors from all fixed charges.

The action plan that the government has introduced provides an opportunity to respond to that situation, and to send a clear message concerning business taxation. The government is attacking head on the problem of the heavy fixed charge burden of businesses, by taking two major decisions.

Reduction of over 50% in the tax on capital

- ➡ The government is embarking on a plan to reduce the tax on capital. The general rate of that tax will be gradually cut by more than half, from 0.64% to 0.30%, between now and 2007. The first reduction will come into effect on January 1, 2003.

A reduction of the same magnitude and according to the same schedule will be applied to the rate for financial institutions, which has been twice as high as the general rate, since their tax base is more limited than that of other corporations.

TABLE 3
Rates of the tax on capital in Québec
(In percent)

	Current	2003	2004	2005	2006	2007
General	0.64	0.60	0.525	0.45	0.375	0.30
Financial institutions	1.28	1.20	1.05	0.90	0.75	0.60

Note: The rate reduction will come into effect on January 1 of each year.

\$1-million exemption to benefit SMEs

- ➡ The government is going a step further in regard to SMEs, by gradually exempting them by January 2006 from the tax on capital on the first \$1 million in paid-up capital. Through this measure, nearly 60% of all Québec businesses will no longer pay the tax on capital as of January 1, 2003. When the measure is fully implemented, nearly 210 000 Québec SMEs, or 75% of all businesses established in Québec, will no longer pay the tax on capital.
- ➡ During the transition period, i.e. 2003 to 2005, only SMEs will have access to the exemption. In 2006, the exemption will be accessible to all Québec businesses.

TABLE 4
Exemption regarding the tax on capital,
and number of fully exempt businesses

	Currently	2003	2004	2005	2006
Exemption (in dollars) ¹	-	250 000	500 000	750 000	1 000 000
Number of exempt businesses	-	162 000	198 000	203 000	210 000
As a percentage of total businesses	-	58.1	67.8	72.6	75.1

1 For the years 2003 to 2005, a complete exemption will apply to SMEs whose paid-up capital is below these amounts. The value of the exemption will be gradually reduced for SMEs whose paid-up capital is above the exemption and below \$1 million in 2003, \$2 million in 2004 and \$3 million in 2005.

Source: Ministère des Finances du Québec estimate.

Significant relief, with an immediate impact

In all, the relief provided by the government in regard to the tax on capital is significant, and it will have an immediate impact.

- ➡ There is already a two-year tax holiday in regard to the tax on capital, for businesses that invest particularly in manufacturing or processing equipment—including the buildings used in such activities—and computer equipment. The combination of that measure and future relief will especially stimulate new investment.
- ➡ For all investments, the relief in regard to the tax on capital means an immediate reduction in anticipated costs, since the investor will discount the tax cuts announced.
- ➡ According to the tax reduction schedule, all businesses with a paid-up capital of \$1 million or less will be fully exempt from the tax on capital as of 2006.
- ➡ The reduction is also significant for other businesses. In 2007, a business with paid-up capital of \$2 million will benefit from a reduction in the tax on capital of 77%, compared with what it now pays, if one factors in the exemption and the rate reduction.

TABLE 5
Illustration of the reduction in the tax on capital, 2003 to 2007

Paid-up capital	2003	2004	2005	2006	2007
\$250 000 or less	-100%	-100%	-100%	-100%	-100%
\$500 000	-38%	-100%	-100%	-100%	-100%
\$750 000	-17%	-64%	-100%	-100%	-100%
\$1 000 000	-6%	-45%	-77%	-100%	-100%
\$2 000 000	-6%	-18%	-41%	-71%	-77%
\$10 000 000	-6%	-18%	-30%	-41%	-58%

Fiscal measures in the 2002-2003 Budget Speech for Québec's SMEs

More than 50% reduction in the tax on capital

- ➡ The general rate will be cut by more than half, from 0.64% to 0.30%, between now and 2007.
- ➡ An exemption will be gradually implemented for the first \$1 million in paid-up capital.
- ➡ When the measure is fully implemented, nearly 210 000 SMEs, i.e. 75% of all businesses operating in Québec, will no longer pay the tax on capital.

Deferment of tax instalments

- ➡ The government has already announced a no-interest deferment of October 2001 tax instalments. These instalments may be paid in April 2002.
- ➡ The deferment will also apply to instalments due for November and December 2001, which may be paid in May and June 2002.
- ➡ This will provide SMEs with additional liquidity of \$525 million, i.e. substantial assistance for their working capital.

Reduction in the number of payments

- ➡ Employers whose average monthly source deduction remittances do not exceed \$1 000 may now make these remittances quarterly.
- ➡ This will enable the employers contemplated to increase their short-term liquidity.
- ➡ The measure will dispense more than 100 000 employers from the obligation to make eight payments a year, and will make it possible for them to submit over 800 000 fewer forms.

Resource regions

- ➡ Refundable tax credits for the processing of various resources are improved: the calculation of the tax credit related to new jobs is made more flexible in order to take into consideration the current economic situation, and the formula for determining tax credits is changed so that businesses receive this tax assistance for 10% of their existing jobs for two years.
- ➡ The scope of the 10-year tax holiday for manufacturing SMEs in remote regions is broadened: the size of businesses that can take advantage of the tax holiday is doubled.

Improvement of tax measures for the new economy

The action plan adopted to bolster the confidence of investors includes a specific component for the new economy.

Even before September 11, the situation in sectors of the new economy, particularly businesses involved in e-commerce, had deteriorated because of the worldwide slowdown and particular problems stemming from the decline in their stock market valuation.

The government is taking a number of steps to ensure that the achievements of recent years are not in jeopardy: Québec had succeeded in carving out a significant place for itself internationally in the new economy, and that place must be preserved.

Extension of existing programs

The action plan introduced by the government provides for the extension of the various fiscal programs for the new economy. The date on which the programs end is extended from December 31, 2010 to December 31, 2013, in order to preserve their incentives.

The duration of the program for a given business is still 10 years. Businesses can benefit from the program in its entirety provided they decide to set up shop in the designated sites by January 1, 2004, whereas, beginning on January 1, 2001, tax benefits were no longer applicable to new investments for the full 10-year period. The measure should therefore have an immediate impact on investment in the new economy.

The measure concerns all regions of Québec, and applies particularly to the Cité du multimédia in Montréal, the Centre national des nouvelles technologies de Québec (CNNTQ), information technology development centres (CDTIs) and new economy centres (CNEs).

Increase in the floor space of new economy centres (CNEs)

Measures regarding CNEs were introduced in the *1999-2000 Budget Speech*. At the present time, the floor space allotted to the various Québec regions under this program totals 100 000 m².

Given the appeal of CNEs in terms of the development of the various Québec regions, the government is increasing the available floor space to 125 000 m². Investissement Québec will continue to manage the allocation of the new floor space and will give priority to expanding and consolidating the CNEs currently set up in the various Québec regions, rather than to increasing their number.

A revision of the tax incentives for e-commerce

In May 2000, the government introduced the E-Commerce Place program with a view to positioning Montréal in a particularly promising sector of activity. Government support for businesses specializing in e-commerce is more relevant than ever: even though the economic slowdown has made businesses specializing in this type of activity more vulnerable, the deployment of this new form of transaction is inevitable.

However, the existing program must be adjusted so as to respond to the current situation, and take better account of the realities of the real-estate market in downtown Montréal. The government is therefore making the following changes:

- ➡ First, a new tax credit is introduced for the territory of downtown Montréal.
 - This territory, surrounding E-Commerce Place, will contain a total of 186 000 m² of new floor space for businesses that want to take advantage of the new measure.
 - Businesses that move into the perimeter formed by the river and Sherbrooke, Atwater and Du Havre streets can avail themselves of a tax credit of 35% calculated on the salaries of new employees.
 - The tax credit will apply to labour expenditures directly associated with e-business and to the operation of a customer-contact centre. The new tax credit will have a maximum duration of five years.
 - The owners of immovables within this perimeter will be able to take advantage of a number of financial assistance programs set up by the City of Montréal to encourage the renovation and revitalization of industrial immovables and buildings.

Furthermore, the new tax credit will also be available to businesses established in the perimeter of the Centre national des nouvelles technologies de Québec (CNNTQ).

- ➡ Second, the size of the project initially planned for E-Commerce Place is significantly reduced; the maximum floor space of E-Commerce Place is cut from nearly 290 000 m² to just under 140 000 m².

The tax incentive under the E-Commerce Place program is otherwise improved, in order to ensure consistency with the new tax credit applicable to the downtown area as a whole. The tax credit is increased from 25% to 35%, and the maximum tax credit per job rises from \$10 000 to \$12 500.

These adjustments to the E-Commerce Place program mean no additional cost for public finances: creation of the new tax credit and improvement of the existing program will be funded through savings realized by reducing the floor space of the site designated for E-Commerce Place.

Furthermore, these adjustments correspond to the government's objectives in introducing its action plan to deal with the current economic conditions: the new formula is more flexible for businesses.

TABLE 6
Summary table of improvements in tax measures for businesses in the new economy

Measure	Objective	Change
Extension of existing programs until 2013	Maintain the appeal and the incentive with a view to ensuring the success of the measures	Duration: 10 years for corporations that sign a lease before January 1, 2004 The measures are: ▪ Cité du multimédia ▪ Information technology development centres (CDTIs) ▪ New economy centres (CNEs) ▪ Centre de développement des biotechnologies de Laval ▪ Centre national des nouvelles technologies de Québec (CNNTQ)
Measure	Objective	Change
New economy centres	Ensure the development of the regions and consolidate existing CNEs	Increase in the rental floor space from 100 000 m ² to 125 000 m ²
Measure	Objective	Parameter
New tax credit for e-business	Stimulate the development of more e-business-related firms	Tax credit rate: 35% Duration: 5 years Assistance calculated according to payroll growth (contemplates new jobs) End of program: December 31, 2013 Downtown Montréal: Maximum of 186 000 m² CNNTQ: rental floor space integrated into the current perimeter
Measure	Objective	Change
E-Commerce Place	Adapt the program to the economic situation	Rate of the tax credit: 35% Maximum per job: \$12 500 Duration: 10 years for corporations that sign a lease before January 1, 2004 End of program: December 31, 2013 Reduction in the project's rental floor space from 288 300 m² to 139 500 m²

***Accelerate the start-up of large-scale projects:
improvement of the FAIRE program***

In stimulating private investment, the government is not limiting itself to relieving the tax burden on businesses. It is also improving the FAIRE program in order to spark large-scale projects.

The FAIRE program, administered by Investissement Québec, is the chief budgetary instrument used by the Québec government to encourage major investment projects. The program, which was slated to end on March 31, 2003, particularly made it possible for Québec to compete with other jurisdictions in attracting large-scale investment. In recent years, Québec's performance in terms of private investment is, in fact, partly attributable to the implementation of large-scale private investment projects.

The rapid start-up of major new investments is one response to the current economic situation. The government is using the FAIRE program for that purpose and is improving its terms so that government action is even more effective. Three changes are made to the current program:

- ➡ The envelope for the FAIRE program is increased and its application period is extended until 2004-2005, representing additional financial commitments by the government of \$150 million for the fiscal year under way and of \$200 million for fiscal 2002-2003. Hence, the total envelope for the program is increased to \$400 million for 2001-2002 and to \$300 million for 2002-2003.

TABLE 7
FAIRE program commitment envelope
(In million of dollars)

	2001-2002	2002-2003
Basic envelope	250	100
Increase	150	200
Total envelope	400	300

- ➡ The minimum threshold for investment projects eligible for the program is reduced from \$10 million to \$5 million until March 31, 2003, in order to broaden application possibilities. The minimum threshold for job creation projects will also be reduced from 100 to 50 jobs.
- ➡ The terms of the program are adjusted so that a business qualifying for a 10-year tax holiday for major investment projects can, at the same time, avail itself of the FAIRE program.

The same rule will apply to businesses that receive the tax credits introduced in the *Resource Regions Economic Development Strategy*.

Making budgetary support more consistent with fiscal support will strengthen incentives in measures aimed at major investments. Rules will be developed with a view to maintaining government contributions at reasonable levels.

Expansion of private high technology corporations

- ➡ Growing private high technology firms, particularly those in the biotechnology sector, have difficulty finding sufficient capital to support their development. Their financial needs exceed the capacity of Québec's venture capital companies to intervene. These firms find themselves compelled to move their activities outside Québec or to transfer their ownership to non-Québec interests, in order to market their products.

The government therefore intends to examine the problem of the expansion of private high technology firms, especially those in the biotechnology sector, to ensure that the benefits generated by the government's efforts in encouraging the start-up of these businesses remain in Québec. Innovative financial methods will be examined and, if need be, changes will be made to the FAIRE program.

PURSUING AND STEPPING UP EFFORTS FOR THE BENEFIT OF RESOURCE REGIONS

The *Resource Regions Economic Development Strategy*, introduced in the *2001-2002 Budget Speech*, has substantial means at its disposal: the government mobilized \$800 million for this purpose.

The situation resulting from the events of September 11 has also affected regional economies, justifying improvements to the measures implemented.

The **2002-2003 Budget Speech** includes the following four measures:

- ➡ The 10-year tax holiday for manufacturing SMEs in remote resource regions is broadened, as the size of businesses that can take advantage of the tax holiday is doubled, from \$15 million to \$30 million in paid-up capital. Consideration of activities carried on outside the resource regions is also made more flexible.
- ➡ Changes are made to the refundable tax credits aimed at job creation in processing activities in the resource regions, for Gaspésie and certain maritime regions, and for the Vallée de l'aluminium.
 - Businesses can choose a reference year other than 1999 or 2000, so as not to be penalized by an eventual payroll reduction.
 - The formula for determining the tax credit is temporarily modified, so that businesses can avail themselves of this tax assistance for 10% of their existing jobs. This additional help is aimed at supporting businesses that preserve their jobs, despite the current difficulties.
- ➡ The refundable tax credit for exploration activity is broadened to encompass the cut stone sector, so as to support the diversification of an industry geared toward export markets. This measure should have a direct impact on the level of exploration activities in the Côte-Nord, Gaspésie and Haute-Gatineau regions.

- ➡ The envelope of the Programme de soutien aux projets économiques (PSPE) is increased by \$2.2 million for the year in progress. This program is for investment projects of between \$500 000 and \$2 million. The improvement will provide additional support for the investment projects of businesses in the resource regions and in the 20 less affluent RCMs in the central regions, identified in the *2001-2002 Budget Speech*.
- ➡ SOQUEM will invest \$12 million in the next two years to support mining exploration and development activities. SOQUEM and its partners will thereby carry out additional work worth more than \$20 million in the various Québec regions.

Special support for rural regions

The **2002-2003 Budget Speech** announces accelerated investments specifically for the rural regions.

- ➡ A new program entitled Villages branchés du Québec will connect Québec school boards through a broadband telecommunications network. A budgetary envelope of \$75 million has been set aside for this purpose.
- ➡ Under a village beautification program, work totalling \$36 million will be carried out in the next two years.
- ➡ The government will inject \$16 million into the RénoVillage program, under which \$45 million in work will be performed in the next two years.

Furthermore, the rurality policy will be tabled shortly. A total of \$10 million will be devoted to it.

Modernization of the pulp and paper sector

INNO-PAP, an organization responsible for contributing to pulp and paper plant modernization projects, was given a financial envelope of \$100 million in the *2000-2001 Budget Speech*.

The organization has fully committed the amounts mobilized, which will be used in the coming months to renovate some of the less productive plants in Québec and to preserve the jobs that depend on them in the regions.

To enable INNO-PAP to pursue its mandate and to participate in the investment efforts undertaken, the government is providing it with an additional grant totalling \$30 million. The organization will receive this additional amount by 2004-2005. It confirms the government's support for the pulp and paper industry, while improving the industry's productivity in the medium term, in keeping with the objectives pursued in introducing the action plan set out in the **2002-2003 Budget Speech**.

SUPPORT FOR INVESTMENTS IN THE SOCIAL ECONOMY AND AGRI-FOOD INFRASTRUCTURE

The social economy

The social economy sector in Québec encompasses nearly 5 000 businesses and some 50 000 jobs. The sector contributes to the development of the Québec economy while meeting social needs.

Since the Summit on the Economy and Employment in 1996, more than 15 000 jobs and about 1 000 new social economy businesses have been created.

The **2002-2003 Budget Speech** confirms the government's support for businesses in the social economy. As indicated earlier, new financing opportunities are open to them with the creation of La Financière du Québec in order to meet their capitalization needs.

Three other initiatives have been announced:

- Local development centres (CLDs), which administer the Fonds de développement des entreprises d'économie sociale, will receive additional funding of \$12 million.
- The annual envelope of the financial exemption program for domestic help services is increased from \$32 million to \$36 million. This improvement is in keeping with one of the commitments made in June.
- The Office des personnes handicapées du Québec will receive \$2.9 million a year to fund adapted work centres.

The agri-food industry

Following the *Rendez-vous de mi-parcours* of the Forum sur l'agriculture et l'agroalimentaire québécois, nearly \$200 million was set aside to support the development of the agri-food industry.

Furthermore, the government is providing an additional \$5 million to fund the implementation, in all Québec regions, of quality control systems based on HACCP (Hazard Analysis Critical Control Point Concept for Food Safety) principles.

HACCP standards: quality control in the bio-food industry

HACCP standards are a concept for the analysis of hazards and the control of critical points with a view to ensuring food safety.

These systems are aimed at improving food safety through the introduction of internal controls in businesses in the food production, processing and retail sectors, and the restaurant sector.

SECTION 2

CONTINUING THE WORK BEGUN

The action plan introduced by the government as part of the **2002-2003 Budget Speech** is aimed at bolstering economic activity and employment in order to overcome the problems resulting from the events of September 11.

The various initiatives that the government is undertaking will also meet the main challenges confronting Québec in ensuring the strength and growth of its economy in the medium term.

In order to clearly identify and gauge these challenges, as well as the progress made in meeting them, it is essential to illustrate briefly the undeniable modernization and strengthening of the Québec economy in recent years.

It will then be possible to discuss two conditions for which an economic policy must lay the groundwork, i.e. the growth of investment and the intensification of research and innovation, which are the requirements for growth and employment. Québec is already well positioned from these two standpoints, and the new initiatives implemented by the government should permit additional strides to be made.

The second section of the publication on the government's action plan and economic policy consists of three parts:

- ➡ The first part describes the modernization and strengthening of the Québec economy, as illustrated by analysing the main indicators of economic activity, and it identifies the factors that determine standard of living and productivity.
- ➡ The second part is devoted to investment growth, an essential condition of increased productivity and therefore of higher standard of living, and to the government initiatives implemented in this regard in recent years.
- ➡ The third part discusses the principal government initiatives to accelerate research and innovation, another factor that determines productivity, and a just as essential condition of economic growth.

1. MODERNIZE AND STRENGTHEN THE QUÉBEC ECONOMY

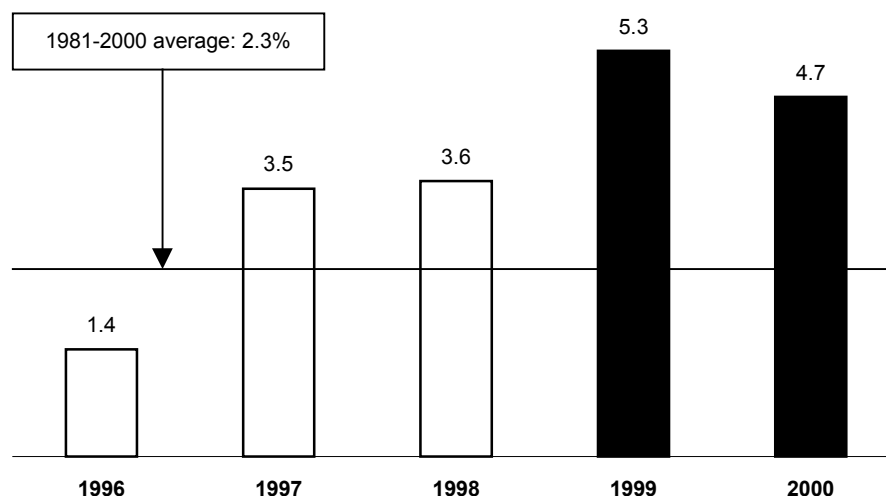
Since the mid-1990s, the Québec economy has been significantly modernized and strengthened.

CONVINCING ILLUSTRATIONS

The modernization and strengthening of the Québec economy may be illustrated in different ways.

- ➡ In the last four years, Québec has experienced growth in its real gross domestic product far beyond the average for the period from 1981 to 2000. In 1999 and 2000, its growth reached record levels, i.e. 5.3% and 4.7% respectively.

GRAPH 1
Growth in real gross domestic product – Québec, 1996-2000
 (Annual change in percent)

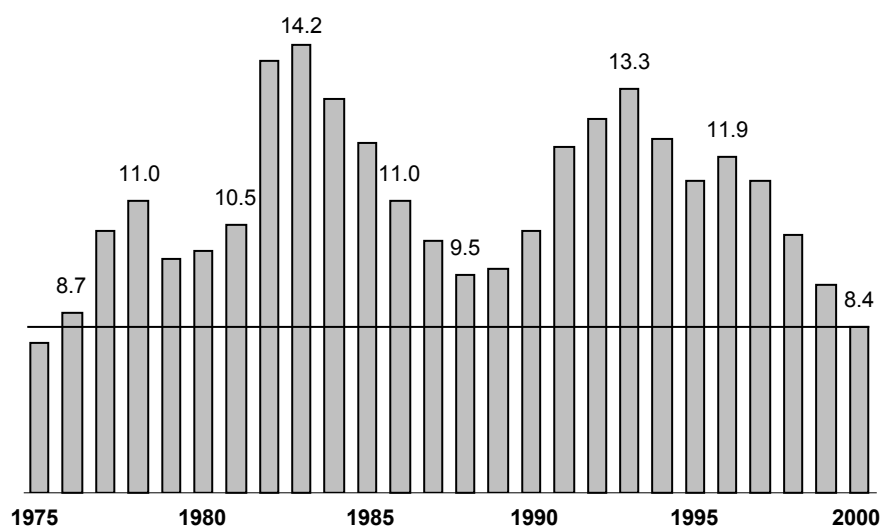


Sources: Institut de la statistique du Québec and ministère des Finances du Québec.

- ➡ From 1997 to 2000, the Québec economy created nearly 300 000 jobs, i.e. more than 70 000 jobs a year, compared with an average of 34 000 jobs annually since 1981.

There has been a significant reduction in the unemployment rate, which reached a record low compared with the last 25 years.

GRAPH 2
Unemployment rate – Québec, 1975 to 2000
 (In percent)

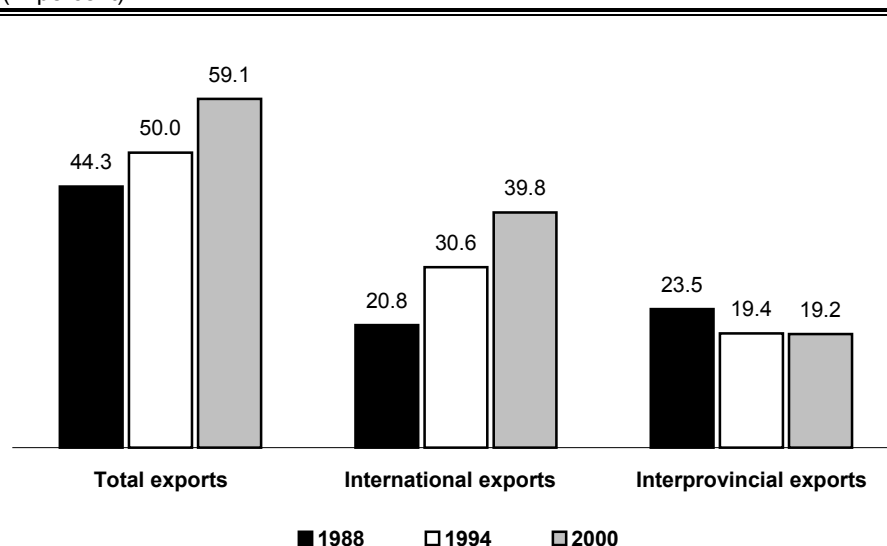


Source: Statistics Canada.

- ➡ A third illustration of the progress achieved is the significant increase in exports. International exports actually doubled as a percentage of GDP, from 21% to 40%, between 1988 and 2000.

The United States, where 86% of our international exports are sent, became Québec's chief economic partner, replacing the Canadian provinces. Québec is now the seventh exporter to the U.S. market, ranking ahead of Taiwan and France.

GRAPH 3
Share of exports in gross domestic product – Québec,
1988, 1994 and 2000
(In percent)

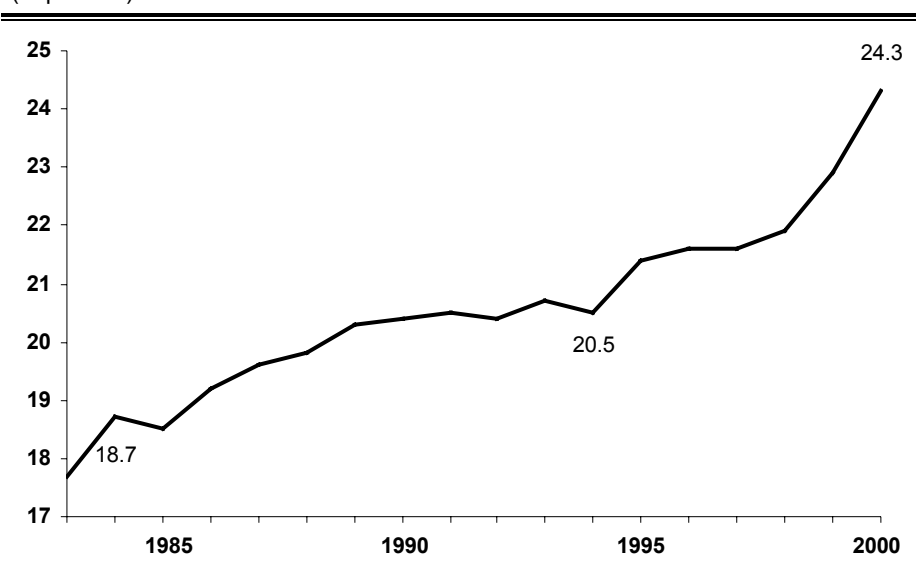


Sources: Statistics Canada and Institut de la statistique du Québec.

- ➡ The structure of the Québec economy rapidly shifted toward advanced-knowledge activities.

Between 1983 and 2000, the share of these activities in the creation of business wealth rose from less than 18% to more than 24%.

GRAPH 4
Share of advanced-knowledge industries¹ in private-sector real gross domestic product – Québec, 1983-2000
(In percent)



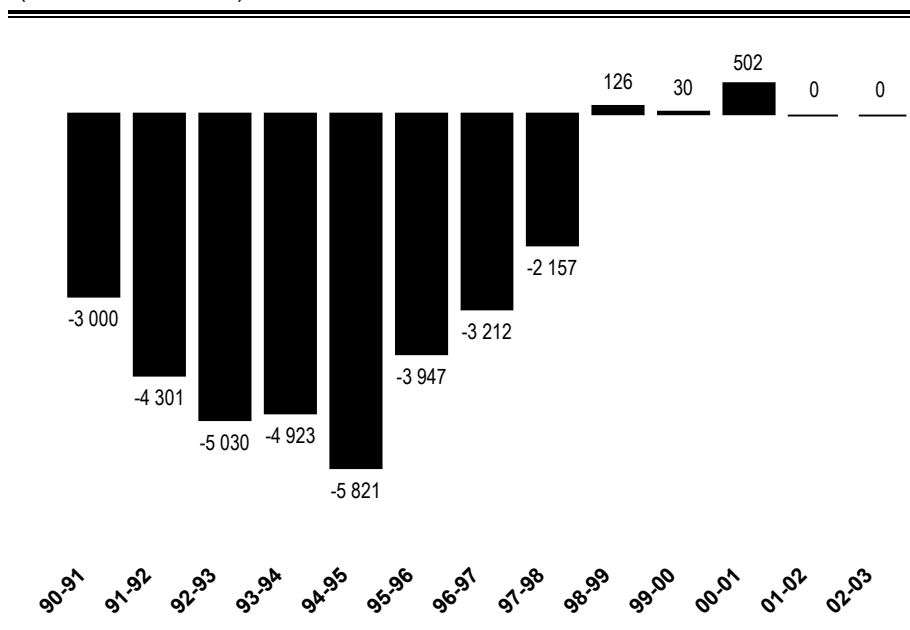
1 Advanced-knowledge industries: aircraft, chemicals (including pharmaceuticals), electronic products, industrial machines, pipeline transport, telecommunications, electricity and business services (including computer services).

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

- ➡ These major changes in the Québec economy took place during the same period that Québec was restoring its budget balance.

It achieved a balanced budget in a relatively short period of time: in 1994-1995, the budget of the Québec government had a deficit of nearly \$6 billion. Since 1998-1999, Québec has tabled five budgets with no deficit, including that in the **2002-2003 Budget Speech**.

GRAPH 5
Budget balance of the Québec government,
1990-1991 to 2002-2003
(In millions of dollars)



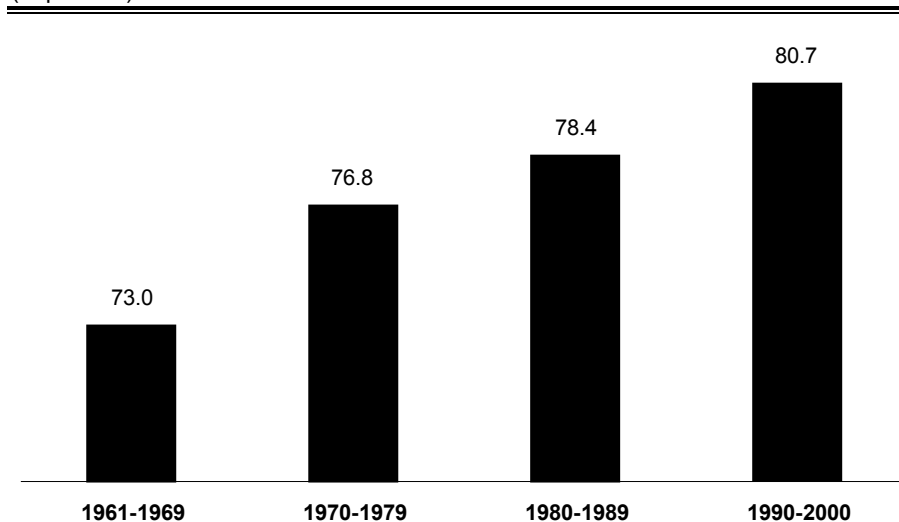
Source: Ministère des Finances du Québec.

STANDARD OF LIVING AND PRODUCTIVITY

The Québec economy is undeniably more modern and stronger. Québec's progress is gauged in terms of standard of living: the real per capita gross domestic product of Québec increased by an average by 0.1% a year from 1990 to 1994, and by 3.0% a year from 1995 to 2000.

It has been noted, over a long period of time, that Québec has done better than Ontario in this regard. Since 1961, the disparity in standard of living between Québec and Ontario narrowed regularly, the standard of living of Quebecers rising in 40 years from 73% of that of Ontarians to 81%.

GRAPH 6
Québec-Ontario real per capita gross domestic product ratio,
1961 to 2000
(In percent)



Sources: Statistics Canada, Institut de la statistique du Québec, Conference Board du Canada, Ontario Ministry of Finance and ministère des Finances du Québec.

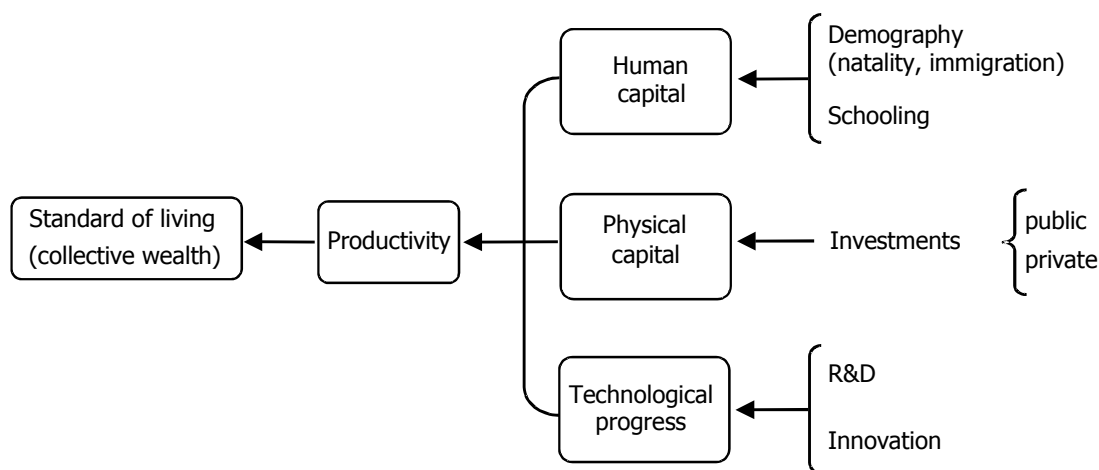
THE MAIN FACTORS THAT DETERMINE PRODUCTIVITY

The standard of living of a community is, in fact, strongly linked to the productivity of its economy, i.e. to the production of wealth by each of its workers.

That productivity is itself dependent on human capital, physical capital and technological progress.

- ➡ The government's economic policy is aimed, first and foremost, at strengthening physical capital—through investment—and ensuring technological progress—through R&D and innovation.
- ➡ However, it is obvious that the quality and vitality of human capital form the basis for high productivity, and hence, an improved standard of living.

DIAGRAM 1
The main factors that determine productivity



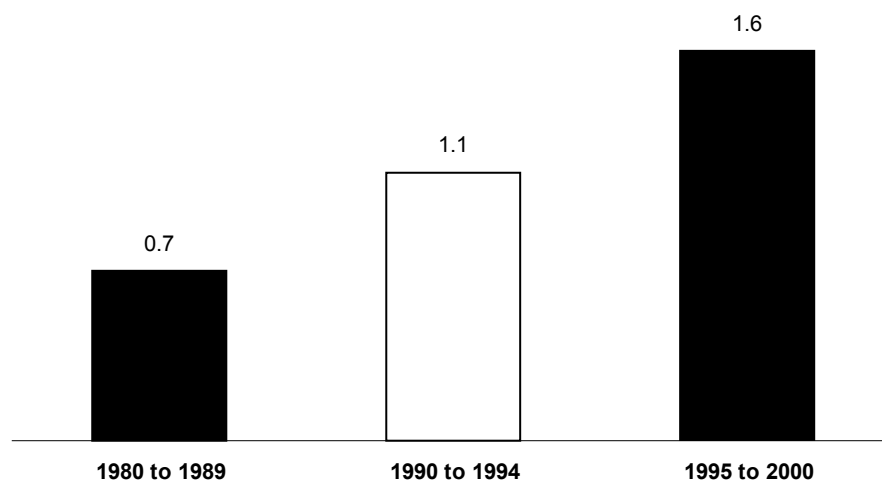
Source: Inspired by a publication of the Centre d'étude de niveau de vie, *La productivité: secret de la réussite économique*, March 1998.

THE PRODUCTIVITY CHALLENGE

Thanks to performances achieved in terms of human capital, physical capital and technological progress, productivity in Québec has grown at a good pace over the past 20 years.

Measured in terms of real GDP per worker, productivity has increased annually by 1.6% from 1995 to 2000, compared with 0.7% during the 1980s, and 1.1% from 1990 to 1994.

GRAPH 7
Productivity growth in Québec
Real gross domestic product per worker
(Average annual change in percent)



Sources: Statistics Canada, Institut de la statistique du Québec, Conference Board du Canada and ministère des Finances du Québec.

Despite this progress, Québec's productivity has been insufficient when compared with the performance of a number of industrialized countries. In 2000, labour productivity was 11% higher in Ontario and 27% higher in the United States.

TABLE 8
Comparison of productivity levels – Québec, Ontario and certain industrialized countries, 2000
 (Québec = 100)

	Productivity
Québec	100
Australia	103
France	110
Ontario	111
Ireland	118
Belgium	125
United States	127

Sources: Institut de la statistique du Québec, OECD, Statistics Canada, Ontario Ministry of Finance and ministère des Finances du Québec.

If the productivity disparities between Québec and Ontario are examined more closely, it can be seen that they affect all the main sectors of economic activity.

TABLE 9
Productivity comparison of Québec and Ontario by sector of activity – annual average, 1996 and 1997
 (In current dollars)

	Québec	Ontario	Disparity
Primary	41 632	43 392	- 1 760
Secondary	59 833	66 326	- 6 493
Tertiary	42 945	51 220	- 8 276
Sectors as a whole	48 129	55 694	- 7 565

Sources: Statistics Canada and ministère des Finances du Québec.

This means that, despite lower productivity, Québec businesses had other comparative advantages, particularly lower production costs, that enabled them to be competitive.

It also means that Québec has leeway in which to increase its productivity. This is real strategic potential that it is not fully using at the present time.

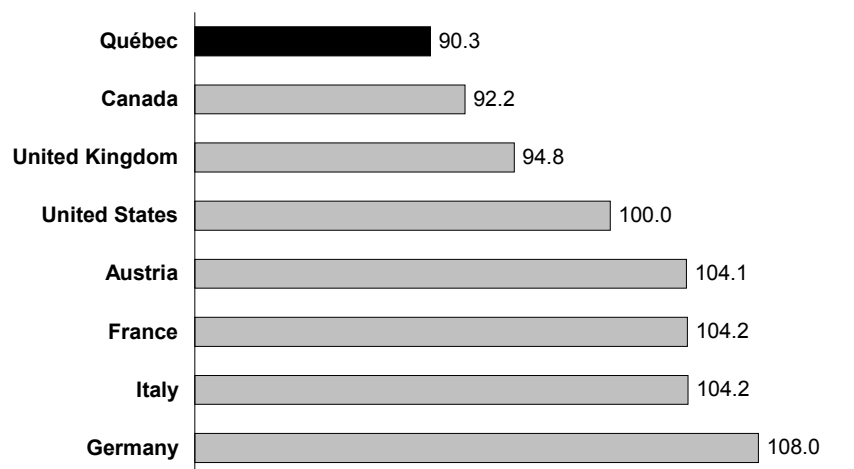
KPMG study of the costs of setting up and operating businesses

The study conducted in 1999 by KPMG convincingly quantified the nature and scope of the comparative advantage that businesses can have when they decide to invest in Québec: according to the study, businesses established in Québec have business location costs and operating costs that are the lowest among the main industrialized countries.

GRAPH 8

Business location and operating costs – average for nine industries¹ – Québec and seven countries, 1999

(United States = 100)



¹ These industries are identified in the following publication: *The Competitive Alternatives – A comparison of business costs in North America and Europe – Focus on Québec*, KPMG, 1999. Source: KPMG.

A three-pronged thrust

To increase its productivity, Québec must act from an economic standpoint through a three-pronged thrust to:

- ➡ improve its human capital, both quantitatively and qualitatively;
- ➡ increase its investments, a condition for increasing its physical capital;
- ➡ and, at the same time, capitalize fully on technological progress, which involves, in this case, investment in R&D and innovation.

These three thrusts are, in fact, challenges that the Québec economy must meet in the coming years. The government's action since the mid-1990s has consisted in making progress in these three areas.

The economic policy, as examined in this publication, essentially targeted increased investment and intensified R&D and innovation, while the initiatives regarding human capital were covered by other government policies.

The action plan defined in the **2002-2003 Budget Speech** pursues the same objectives, and creates additional tools that will make it possible to accelerate investment and intensify innovation, i.e. increase physical capital and disseminate technological progress.

Before discussing the results obtained in regard to physical capital and technological progress—and highlighting the rationale for the government intervention that contributed to them—certain challenges related to the strengthening of human capital must be mentioned.

HUMAN CAPITAL

Human capital is a determinant of productivity. It depends on factors that are most often within the scope of government policies other than economic ones, be they in regard to birth rate, immigration or education.

However, three specific elements must be discussed here that are directly linked to the growth and development of a population that is able to meet the challenges of a modern economy, i.e.:

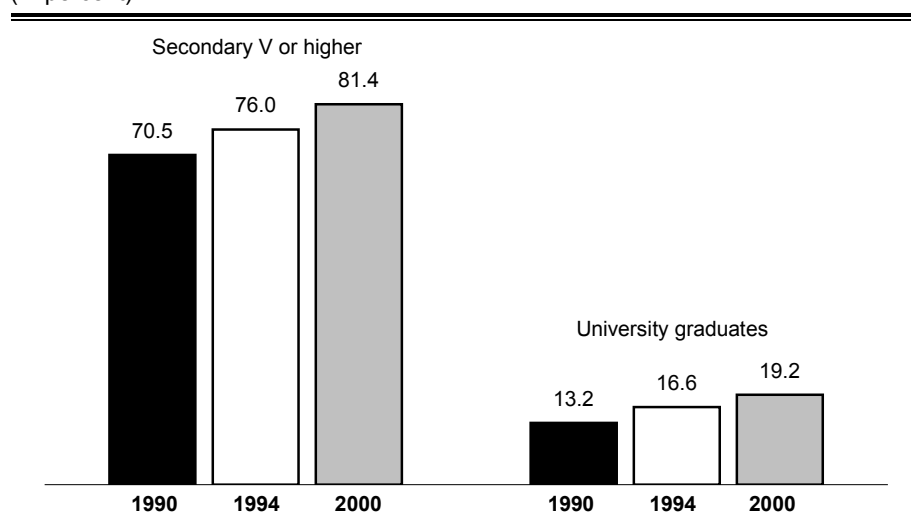
- ➡ schooling of the workforce;
- ➡ training of the workforce;
- ➡ level of personal income tax.

Schooling of the workforce

The first element is the schooling of the workforce, by which the results of the educational efforts made by the community are measured.

It can be seen that, in Québec, major progress has been made in this regard. The Québec population has one of the highest rates of schooling in the world. In 2000, more than 81% of workers had a secondary school diploma and nearly 20%, a university diploma.

GRAPH 9
Rate of schooling of workers – Québec, 1990, 1994 and 2000
 (In percent)



Source: Statistics Canada.

In fact, among people 20 to 29 years of age, Québec has the highest rate of school attendance of the 24 OECD countries for which data are available.

The high rate of schooling in Québec is reflected in the outstanding position of the City of Montréal in North America. In 1996, Montréal ranked first in North America for the number of students per capita, before Boston and Toronto. In absolute terms, with nearly 150 000 students, Montréal ranked after only New York, Boston, Washington and Chicago, cities whose populations are much larger.

Training of the workforce

The second element, which is a direct extension of the first, is the training of the workforce.

With the creation of Emploi-Québec, in 1998, all employment services in Québec were streamlined. Emploi-Québec is an integral part of the ministère de l'Emploi et de la Solidarité sociale, which, in particular, provides major support for manpower training.

Level of personal income tax

The third element concerns the level of personal income tax.

The human capital of a community depends directly on the presence and availability of a qualified workforce, which must be retained and given an incentive to work. It is here that personal income tax comes into play: it has an impact on the retention of the workforce on a given territory, and is an important factor in the quantity of work that the workforce is prepared to carry out.

In this regard, Québec's personal income tax is too high, even though major progress has been made over the last two years to narrow the disparity in tax burden between Québec and neighbouring jurisdictions.

Compared with Ontario, for example, the disparity in tax burden is now \$4.2 billion. That means that Quebecers would pay \$4.2 billion less in income tax if the Ontario government's current tax structure were applied in Québec.

TABLE 10
Disparity in the tax burden between Québec and the other provinces
when the tax structures of the other provinces are applied to Québec
Personal income tax
(In millions of dollars)

	1999	2002 ¹	Change in disparity (percent)
Disparity between Québec and the other provinces²			
Ontario	5 779 ³	4 164	- 28
Alberta	4 828	4 852	0
British Columbia	4 046	4 628	14
Nova Scotia	3 300	1 466	- 56
Prince Edward Island	2 676	998	- 63
New Brunswick	2 599	1 068	- 59
Manitoba	1 911	587	- 69
Saskatchewan ⁴	1 584	1 113	- 30
Newfoundland ⁵	1 321	1 761	33
Average disparity	3 116	2 293	- 26
<i>As a percentage of Québec income tax</i>	20	15	—

1 The estimates take into consideration the federal tax measures and the measures of the other provinces announced on October 24, 2001.

2 The Québec tax abatement of 16.5% is subtracted from the disparity in the tax burden.

3 Excluding the tax dividend paid for the 1999 taxation year.

4 Including the Saskatchewan tax reduction, which will apply only in 2003.

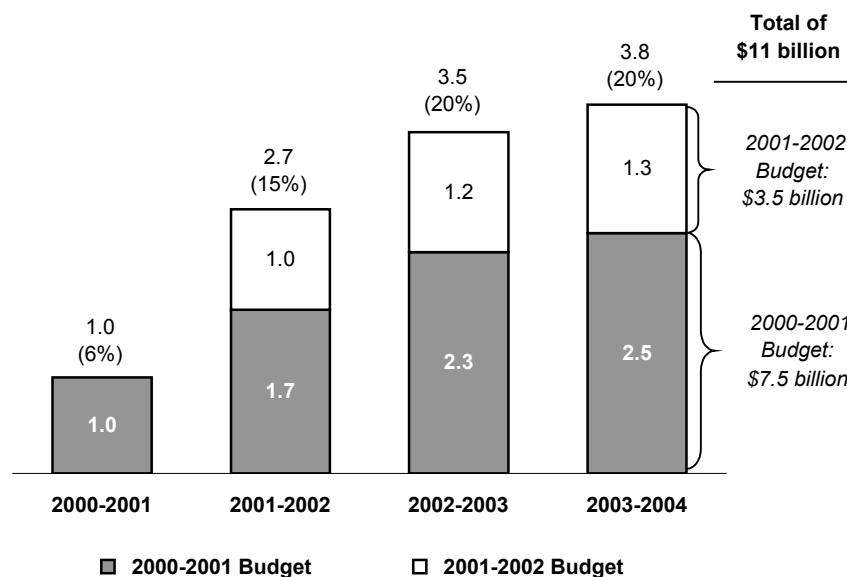
5 Including the income tax reduction planned for 2002, which was recently deferred.

Source: Ministère des Finances du Québec.

The disparity between Québec and Ontario has declined by 28% over the last two years, and has been reduced by 26% compared with the average for the other Canadian provinces. Québec introduced major reductions in the personal income tax burden in 2000 and 2001, and a number of reforms were implemented to improve the incentive to work.

These reductions are, however, insufficient if personal taxation is to be competitive with the other jurisdictions, thereby ensuring favourable conditions for workers, who constitute Québec's human capital.

GRAPH 10
Cumulative reductions in personal income tax,
2000-2001 to 2003-2004
 (In billions of dollars)



Source: Ministère des Finances du Québec.

Strengthening human capital: one of the priorities of government policies

Strengthening human capital is obviously a priority of all government policies. The emphasis placed on education and the support provided to the various networks that disseminate knowledge have been apparent in the massive reinvestments under the latest budgets, while ambitious reforms regarding training were implemented.

From a strictly fiscal standpoint, the income tax reductions over the past two years also illustrate the government's determination to improve Québec's competitiveness in that regard. The action plan announced as part of the **2002-2003 Budget Speech** includes the maintenance and upward revision of the indexation of the tax system, thereby confirming the commitments made by the government to reduce income taxes.

Priorities of economic policy: increase investment and disseminate technological progress

In addition to taking action in regard to human capital, the government is intervening in regard to two other determinants of productivity: investment, and R&D and innovation, two business-driven elements.

The government's initiatives since the mid-1990s to increase investment and disseminate technological progress are, in fact, crucial elements of economic policy, defined in the strict sense, that the government has gradually implemented.

The following two sections discuss the strategy developed to support businesses in these two areas.

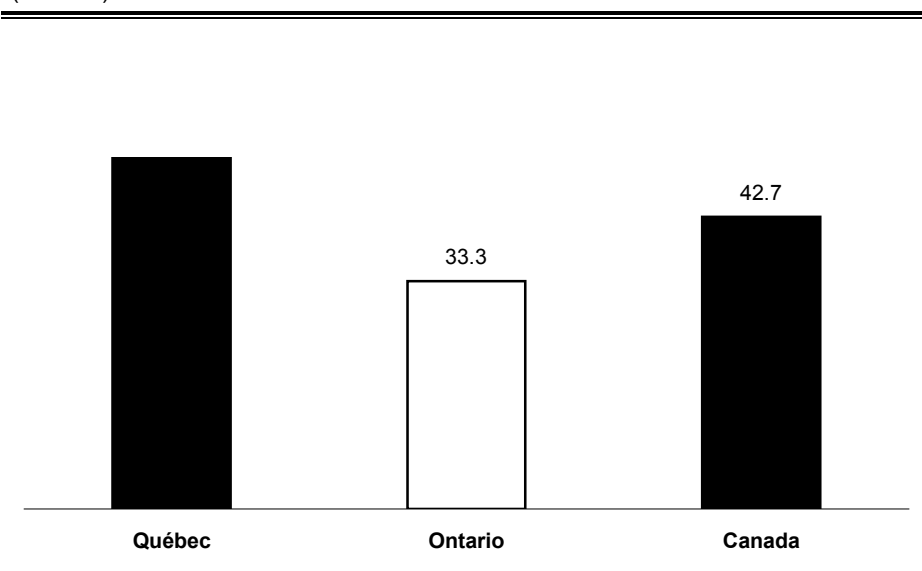
2. INCREASE INVESTMENT TO BOLSTER PHYSICAL CAPITAL

INVESTMENT GROWTH

As has been pointed out previously, investment growth depends primarily on businesses. Private investment is the most stable and lasting source of growth and employment, which is why the government's economic policy places businesses at the centre of most of the strategies designed to increase investment.

Since 1995, Québec has experienced strong growth in private non-residential investment, which provides a good indication of an economy's investment effort. Private non-residential investment has grown by 61%, compared with increases of 33% in Ontario and 43% in Canada as a whole.

GRAPH 11
Growth in private non-residential investment – Québec, Ontario and Canada, 1995-2000
(Percent)

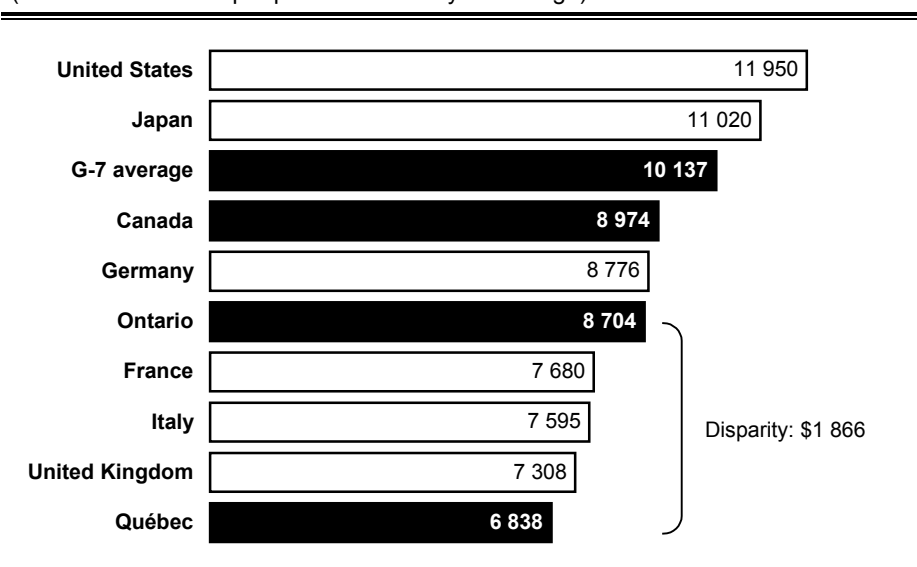


Source: Statistics Canada.

However, these results should not be allowed to obscure a worrisome reality: despite significant progress since 1995, Québec is still behind major western economies as far as investment by businesses is concerned. In 1999, per capita investment in Québec stood at \$6 838 compared with \$8 704 in Ontario, a difference of \$1 866 per capita or some \$9.5 billion overall.

The disparity compared to major industrialized economies is even greater: in 1999, per capita investment was almost twice as high in the United States and Japan than in Québec, and exceeded \$10 000 for G-7 member countries as a whole.

GRAPH 12
Per capita investment – Québec, Ontario
and G-7 member countries, 1999
(In Canadian dollars per person 15 to 64 years of age)



Sources: Statistics Canada, Institut de la statistique du Québec, OECD and ministère des Finances du Québec.

KEEPING THE CORPORATE TAX SYSTEM COMPETITIVE

To bolster the economy's physical capital by increasing investment, the government began by keeping the tax system as it pertains to businesses competitive.

For many years now, Québec's tax system applicable to business has been, on the whole, competitive and more favourable than in the rest of Canada. Accordingly, in 2001, Québec businesses bore a tax burden that was \$1.4 billion lower than what they would have paid under Ontario's tax system.

TABLE 11
Québec-Ontario tax burden differential: corporate taxes, 2001

	Millions of dollars	Percent
Income tax	-1 100.9	-38.8
Tax on capital	999.4	118.3
Payroll tax ¹	1 865.4	173.2
Sub-total	1 763.9	37.0
Consumption taxes	-1 221.5	-35.2
Fees	-326.3	-30.4
Local and school taxes	-1 648.6	-37.9
Total	-1 432.5	-10.5

¹ In Québec, the employer contribution to the Health Services Fund.
Source: Ministère des Finances du Québec.

There are essentially three reasons for this favourable difference:

- ➡ Québec's tax system has one of the lowest corporate income tax rates in North America. Compared with Ontario, the difference in tax burden for this component amounts to \$1.1 billion in favour of businesses in Québec.
- ➡ Another reason for the competitiveness of Québec's tax system is the refund of sales tax on inputs, which represents an advantage of \$1.2 billion for businesses in Québec compared with their competitors in Ontario.
- ➡ Lower local and school taxes provide Québec businesses with a further advantage of \$1.6 billion, compared with businesses in Ontario.

As was pointed out in the first section of this publication, Québec's tax system applied to businesses does suffer from one weakness, i.e. significant fixed charges.

In the recent reform of the tax system applied to businesses, in 1999, the government began to correct this situation by substantially reducing the payroll tax on SMEs.

TABLE 12
Illustration of reductions to the rate of contribution of the Québec Health Services Fund (HSF), 1999 to 2001

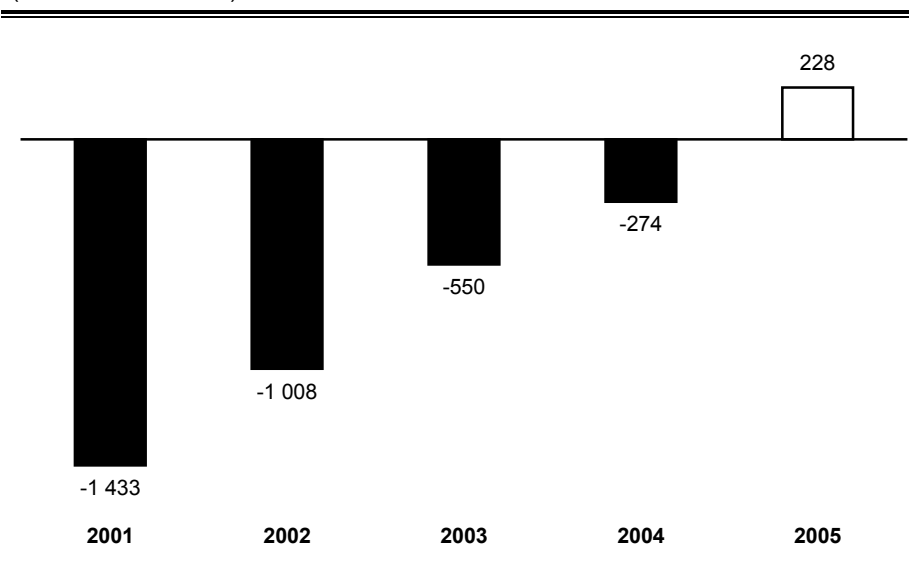
Payroll	Rate before reduction	1999	2000	2001	Total reduction
Under \$1 million	4.26%	4.00%	3.22%	2.70%	-36.6%
\$2 million	4.26%	4.07%	3.48%	3.09%	-27.5%
\$3 million	4.26%	4.13%	3.74%	3.48%	-18.3%
\$4 million	4.26%	4.19%	4.00%	3.87%	-9.2%
\$5 million or more	4.26%	4.26%	4.26%	4.26%	-

Note: The rate of contribution to the HSF rises linearly for businesses whose payroll lies between \$1 million and \$5 million. The rate reductions become effective January 1 of each year.

In the **2002-2003 Budget Speech**, the government is taking a major step in reducing fixed charges on businesses, this time by targeting the tax on capital.

This was a necessary initiative: recent announcements by a number of provinces pointed to an erosion of Québec's competitive advantage. For instance, by 2005, had nothing been done, businesses in Québec would have lost the advantage of close to \$1.7 billion they currently enjoy over their Ontario competitors.

GRAPH 13
Québec-Ontario tax differential: corporate income tax, 2001-2005
Situation prior to the reduction of the tax on capital
(In millions of dollars)



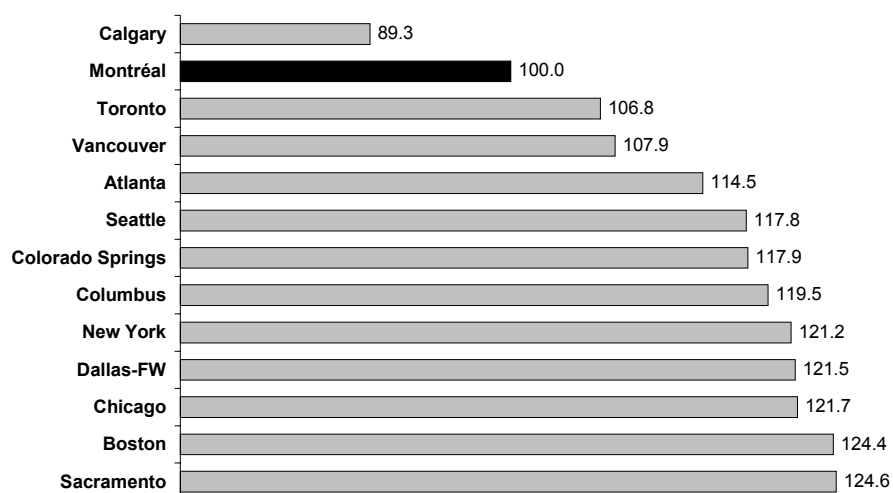
Source: Ministère des Finances du Québec.

The plan to reduce the tax on capital, announced in the **2002-2003 Budget Speech** and whose main components have already been described, will enable Québec to remain tax competitive.

GRAPH 14

Index of tax competitiveness – KPMG simulation model,¹ 2007

(Index: Montréal = 100)



1 Reflects all announcements made to date in Canadian jurisdictions. Based on business location and operating costs in Montréal, average of 18 industries. These industries are identified in: *A Comparison of Business Costs in Major North American Cities*, KPMG, 1999.

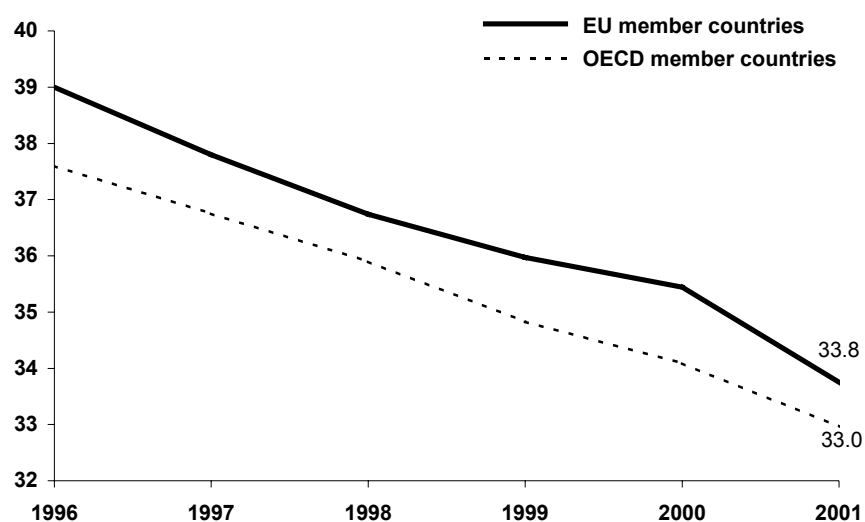
Sources: KPMG and ministère des Finances du Québec.

By implementing a plan to reduce the tax on capital, together with an exemption for SMEs, the government is sending a very clear signal that should have a positive influence on the investment decisions of businesses.

Lower corporate income taxes: a global trend

While it responds to a delicate economic situation, the government is in line with a general trend in major industrialized countries: in response to the growing mobility of capital, many of these countries have already begun to make significant cuts in business taxes.

GRAPH 15
Average tax rate on businesses – OECD and European Union (EU)
countries, 1996 to 2001
 (Percent)



Source: KPMG.

GOVERNMENT SUPPORT FOR BUSINESS FINANCING AND CAPITALIZATION

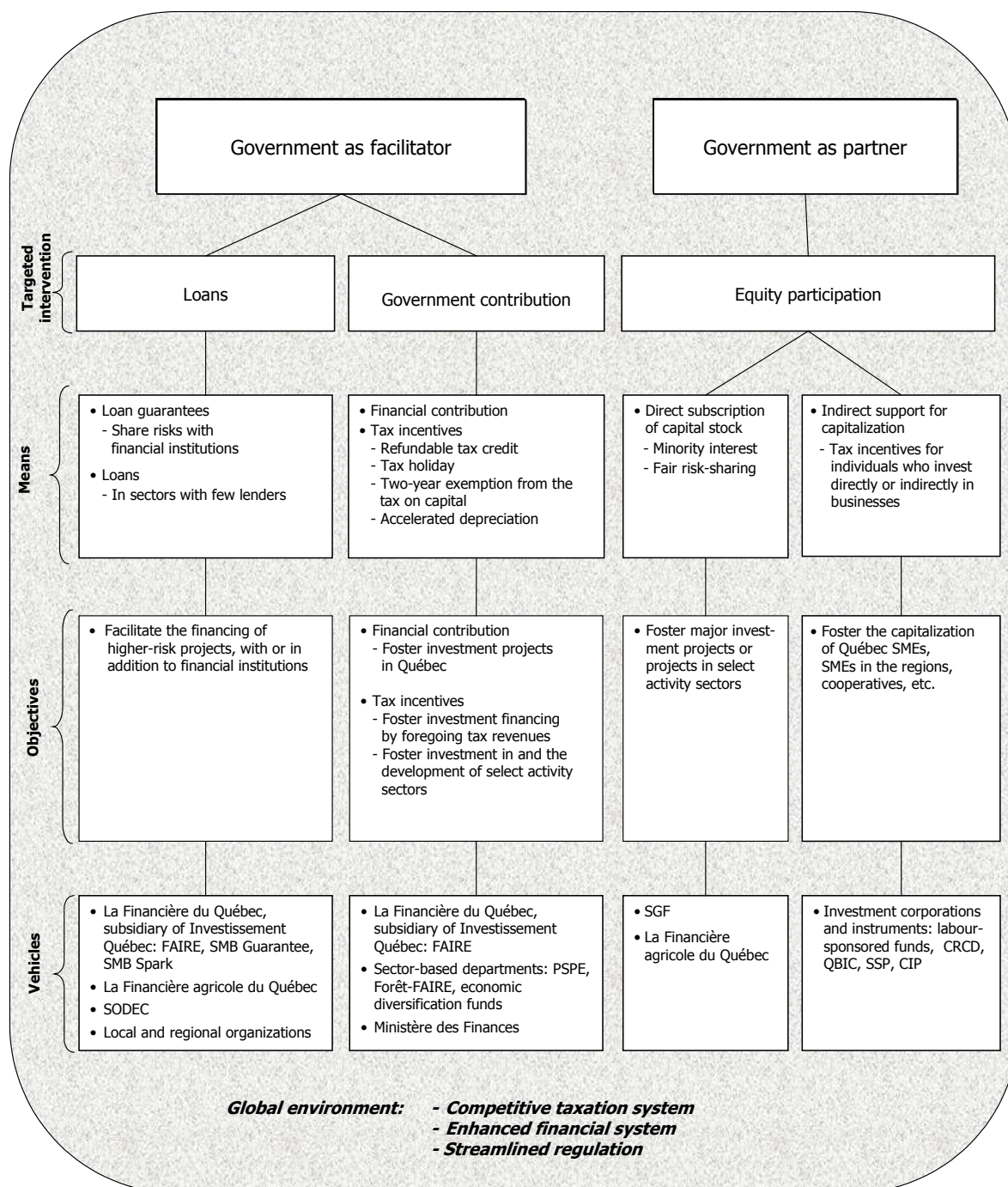
While keeping its tax system competitive, the government has acted on two fronts to facilitate the financing of private investment:

- ➡ The Québec government facilitates the efforts of businesses in obtaining such financing.
- ➡ In some cases, it even plays a partnership role, by facilitating their capitalization.

The following diagram summarizes the mechanisms implemented for each of these two approaches.

DIAGRAM 2

Québec's financial instruments for increasing private business investment



Government as facilitator

To encourage businesses to increase their investments, and thus create jobs, the government acts initially as a facilitator, i.e. it helps businesses to finance the investments they want to make.

The government does so in two ways:

- ➡ It makes loans to businesses or helps them obtain loans.
- ➡ It contributes directly to their investments.

Loans and loan guarantees

Mechanisms have been put in place as part of the government's economic policy to enable businesses to borrow the funds they need for their investment.

- ➡ The main supplier of loan guarantees is La Financière du Québec, a subsidiary of Investissement Québec. This government corporation guarantees loans to businesses of any size, large or small. The vehicle used in the first case is the Private Investment and Job Creation Promotion Fund (FAIRE) program. For SMEs, guarantees to sustain business start-ups are provided through the SMB Spark program, while guarantees to sustain business growth and development are provided through the SMB Guarantee program.

Local organizations, such as the local development centres (CLD), also guarantee loans contracted by SMEs.

In the agricultural sector, this assistance is provided by La Financière agricole du Québec. And in the cultural sector, SODEC provides financial support for cultural enterprises.

Loan guarantees

In the event of a loss, part of the shortfall is covered by the organization that provided the guarantee, according to the terms of the guarantee. This guarantee encourages financial institutions to take a greater risk with a given business.

- ➡ Loans in the strict sense are provided by these same government organizations, when businesses are unable to find the financing necessary for their investment from financial institutions.

There is no need to review the broadened and improved financial support for businesses introduced by the **2002-2003 Budget Speech**, or the creation of La Financière du Québec. In every case, the purpose is to make use of existing mechanisms to accelerate the initiation of private investments, and in so doing respond to the delicate economic situation.

These mechanisms are very effective in financing businesses. In 2000-2001, financing consisting of loans and loan guarantees for Québec businesses amounted to \$491 million and contributed to the financing of 546 projects.

TABLE 13
Financing programs and investment projects financed, 2000-2001

Loans and loan guarantees	Amount of financing provided (millions of \$)	Number of projects financed
FAIRE	322.0	34
SMB Guarantee ¹	158.4	374
SMB Spark	10.5	138
Total	490.9	546

¹ Including guarantees to cooperatives and businesses in the social economy.
Source: Ministère des Finances du Québec.

Direct contribution

The second way the government as facilitator helps businesses to finance their investments is to provide them with a direct contribution. As part of its economic policy, the government has set up four types of direct contributions.

- ➡ Financial contributions are essentially allocated under the FAIRE program and are administered by La Financière du Québec. Such contributions are an essential tool to enable Québec to compete with other jurisdictions also working to attract investments.

These financial contributions can take a variety of forms, from non-repayable contributions to contributions whose repayment depends on the financial results obtained.

In principle, the FAIRE program is reserved for major investment projects. For contributions to smaller projects, the government has created other programs, such as the Programme de soutien aux projets économiques (PSPE), Forêt-FAIRE and economic diversification funds.

➡ The refundable tax credit is similar to a direct financial contribution. This form of support is used mainly for research and innovation, as will be seen later. For investments in physical capital, the refundable tax credit is used for businesses located in particular in the Montréal Foreign Trade Zone at Mirabel.

➡ Tax holidays are the third form of direct contribution used by the government in its economic policy.

- The tax holiday for major investment projects, introduced in the *2000-2001 Budget Speech*, applies, for ten years, to income tax, the tax on capital and the employer contribution to the Health Services Fund. It is offered to business that reach a certain investment or job creation threshold.

This mechanism is useful in approaching multinational corporations for whom taxation is a particularly important component in the investment decision. Québec thus has a flexible tool for presenting competitive offers to obtain such investment projects.

- Another type of tax holiday is geared particularly to new business start-ups. New SMEs can benefit from a tax holiday for their first five years of operation, which is a major boost to their long-term viability.
- Lastly, in March 2001, a tax holiday was implemented for SMEs in the manufacturing sector located in remote resource regions.

- ➡ The fourth type of direct contribution is also fiscal in nature: the 125% accelerated depreciation deduction, available until March 31, 2005, for manufacturing or processing equipment and computer hardware, in particular.

This measure completes a two-year tax holiday applicable following the acquisition of the same type of assets and buildings used in manufacturing or processing. These are major tax incentives for the acquisition of advanced equipment necessary to improve productivity and cut costs.

TABLE 14
Major government contributions for investment projects, 2000-2001

	Total contributions (millions of \$)	Number of recipient businesses or projects
Financial contributions		
FAIRE	206.1	56
PSPE	0.9	7
Forêt-FAIRE	2.0	3
Sub-total: financial contributions	209.0	66
Fiscal measures¹		
General measures		
– Accelerated depreciation	144.0	41 000
– Exemption from the tax on capital regarding new investments in certain sectors	74.9	35 000
Regions		
– Shipbuilding or conversion	15.0	8
– Processing activities	–	–
– Vallée de l'aluminium	1.0	20
– Gaspésie and certain maritime regions	–	–
– Tax credit for resources	–	–
Sectoral		
– Montréal Foreign Trade Zone at Mirabel	–	–
– Financial sector	27.4	182
– Other	21.9	184
Tax holidays		
– Five-year tax holiday for new corporations	47.7	7 000
– Ten-year tax holiday for manufacturing SMEs in the resource regions	–	–
– Major investment projects	–	–
Other	26.3	n/a
Sub-total: fiscal measures	358.2	83 394
Total	567.2	83 460

1 Fiscal measures are those in effect in 2001 and calendar year 2000 is the reference for the financial impact.

The government as partner

The government can do more to provide support for private investment and participate as a partner in the transaction carried out by the business. The economic policy has two tools for this purpose:

- ➡ Direct subscription of capital stock.
- ➡ Indirect support for capitalization.

Direct subscription of capital stock

The government has various government corporations that participate directly in the capital stock of businesses. They act when a capital stock contribution is needed to balance a project's financial structure. Of these, the Société générale de financement du Québec (SGF) is the preferred organization for generating major investment projects in Québec. It intervenes according to the following principles:

- ➡ It holds a minority participation, so that decisions are taken on a business basis.
- ➡ Its intervention is temporary, until the project reaches maturity.
- ➡ Its participation is on a business basis, at conditions and a level of risk equivalent to those of the private partner.

Indirect support for capitalization

This category comprises the various tax incentives set up by the government to encourage individuals to finance investments by businesses.

These incentives – tax credits and tax deductions – gave rise to the creation and rapid development of the Stock Savings Plan (SSP), the Cooperative Investment Plan (CIP), Québec Business Investment Companies (QBICs), the flow-through share regime, labour-sponsored funds (Fonds de solidarité FTQ, Fondaction), and more recently, Capital régional et coopératif Desjardins (CRCD).

As the following table indicates, the Québec government becomes involved with businesses to carry out investments mainly through direct subscriptions of capital stock, the SGF being the chief instrument used for this purpose.

TABLE 15
Major state equity participations to support investment projects,
2000-2001

	Total participations (millions of \$)	Number of projects or capitalized businesses
Direct subscription of capital stock		
SGF	420.0	35
Indirect capitalization support¹		
Labour-sponsored funds	113.0	258
SSP	17.1	20
CIP	6.3	40
QBIC	8.0	40
Flow-through shares	3.0	24
CRCD	—	—
Sub-total indirect capitalization support	147.4	382
Total	567.4	417

1 For indirect capitalization support, the figures shown refer to measures in effect in 2001 and calendar year 2000 is the reference for the financial impact.

An enhanced financial system

Increased investment also requires a strong financial sector ensuring the presence in Québec of strategic decision-making vehicles able to offer Québec businesses financial products adapted to their needs.

The economic policy encourages the development of Québec's financial sector. Specific initiatives have been taken to support certain strategic players – namely the Montréal Exchange and the Nasdaq Stock Market.

- The government has supported the development of the financial sector by creating international financial centres (IFCs) in Montréal, and by encouraging the creation of mutual funds administered and managed in Québec. Montréal now has 100 IFCs. In addition, tax incentives have contributed to the creation of 130 mutual funds.
- The Québec government helped the Montréal Exchange to specialize in exchanged-traded financial derivatives, for which the ME has exclusive rights in Canada, and the development of its expertise in B2B e-commerce.
- A major step in the development of the financial system was taken in November 2000 with the arrival of the Nasdaq Stock Market in Montréal. As a result of Nasdaq's arrival, Québec corporations will be able to be listed on this electronic stock market as of 2002.

Regulatory streamlining

The degree of regulation is an integral part of the environment in which businesses operate and accordingly plays a direct role in initiating and carrying out investments.

In 1996, the Summit on the Economy and Employment provided an opportunity to spotlight the administrative burden imposed by Québec's regulatory system and how it can slow private investment growth. An advisory group on regulatory streamlining was then set up to suggest appropriate improvements.

Many steps have been taken to reduce the burden of Québec's regulatory system:

- ➡ Following the advisory group's work, the government reduced the regulatory burden of forms and permits on businesses. Close to two million forms were either simplified or eliminated.
- ➡ Deregulation initiatives were undertaken, in the agri-food sector in particular.

TABLE 16
Major deregulation initiatives in Québec

Regulatory streamlining

Taxation of businesses	Over 700 000 permits and authorizations eliminated Simplification of the QST and harmonization with the GST
Transportation	Over 300 000 permits and certificates eliminated
Forwarding of reports	Over 800 000 reports forwarded electronically

Deregulation

Agri-food sector	Merger of nine stabilization insurance plans Repeal of four laws
Transportation	Elimination of driving school permits

Source: Secrétariat à l'allègement réglementaire.

- ➡ In addition, the **2002-2003 Budget Speech** is introducing a measure to allow over 100 000 employers to make quarterly, rather than monthly, remittances. This measure will eliminate the filing of over 800 000 forms.

TARGETED INVESTMENT SUPPORT POLICIES

In recent years, and as part of its economic policy, the Québec government has taken specific action targeting the resource regions and the social economy. In both cases, a set of structured initiatives was set up and major financial resources were mobilized for this purpose, to stimulate investment.

Measures concerning the resource regions

Starting in the mid-1990s, the government made a substantial effort to provide the resource regions with appropriate development tools. The *2001-2002 Budget Speech* provided an opportunity to bolster them substantially and incorporate them into a comprehensive strategy.

The regions concerned are Gaspésie–Îles-de-la-Madeleine, Bas-Saint-Laurent, Côte-Nord, Nord-du-Québec, Saguenay–Lac-Saint-Jean, Abitibi-Témiscamingue and Mauricie. These regions have common geographic and economic features and problems, and are all characterized by disparities in income and unemployment rate compared to the rest of Québec.

The same is also true of the Antoine-Labelle, Vallée-de-La-Gatineau and Pontiac RCMs, which prompted the government to provide them with advantages comparable to those of the resource regions.

The actions taken by the government are driven by three main focuses:

- ➡ Increasing value-added and accelerating economic diversification.
- ➡ Growth of the resource sector.
- ➡ Financing of SMEs and business creation.

In all, the fiscal and budgetary measures implemented by the government provide close to \$800 million of support over three years.

TABLE 17
Financial impact of the fiscal and budgetary measures for the resource regions, 2001-2002 to 2003-2004
(In millions of dollars)

Measures	2001-02	2002-03	2003-04	Total
Value-added and economic diversification				
Zero income tax for manufacturing SMEs	41	52	54	147
Tax credit for secondary and tertiary processing	7	21	37	65
Economic diversification and niches of excellence	41	64	38	142
Growth in the natural resources sector				
Support for forest resource development	61	33	33	126
Support for mining exploration	36	51	51	138
Facilitate the financing of SMEs and the creation of businesses	51	64	55	170
Total	237	284	267	788

Note: Measures announced in the 2001-2002 Budget Speech. Does not reflect initiatives announced in this Budget Speech.

Some of the actions taken by the government have been extended to about 20 RCMs in central regions that suffered from income and unemployment disparities similar to those of the resource regions. These actions total \$23 million over three years.

The ministère des Régions

To structure and coordinate its initiatives in Québec's regions, the government created the ministère des Régions in 1998.

The mission of this department is to:

- ➡ Consolidate partnership with local and regional communities in taking charge of their development;
- ➡ secure the cooperation of government departments and organizations to ensure that government action is harmonized and consistent;
- ➡ design and implement follow-up and assessment measures for local and regional development and develop expertise in research and future planning.

Support for the social economy

At the 1996 Summit on the Economy and Employment, the government undertook to support the development of the social economy in Québec. Today, the social economy has close to 5 000 businesses, about 50 000 jobs and sales of over \$4 billion.

In addition to the new measures announced in this Budget Speech, an array of measures supporting businesses in the social economy, representing over \$175 million, has been put in place since 1996:

- ➡ Targeted sectors are the environment, domestic help services, job-entry enterprises and early childhood centres.
- ➡ The measures taken by the government have helped support 1 000 businesses and fostered the creation and maintenance of 15 000 jobs.
- ➡ Favourable impacts of the support provided for the social economy include entry into the labour market, a decline in unreported work and solutions to certain social needs.

TABLE 18
Measures supporting social economy businesses, 1996 to 2001
(In millions of dollars)

Measures	Total amount
Réseau d'investissement social du Québec	6.6
Fonds de développement des entreprises d'économie sociale (CLD) ¹	4.0
➡ CLD de Laval et Montréal ²	8.0
➡ CLD des autres régions ²	18.1
➡ Business consolidation ³	6.0
NPO Guarantee – Investissement Québec ²	48.0
CO-OP Guarantee – Investissement Québec ²	62.2
Assistance program for waste management businesses	9.2
Filaction	1.5
Program supporting sectoral groups in the social economy	6.0
Fonds de consolidation des entreprises d'aide domestique	7.0
Total	176.6

1 Additional funding announced June 6, 2001 (CLD social economy enveloped).

2 Funding provided.

3 Additional funding provided for CLDs in the 2000-2001 Budget Speech.

Financial tools designed specifically for cooperative businesses

- ➡ Co-op Guarantee (Investissement Québec)
 - Loans and loan guarantees for cooperatives' investment projects.
 - 156 projects financed over the period 1998-2001. Financing of \$62.2 million provided over this period.
 - Improvement announced in the **2002-2003 Budget Speech**: capitalization loan and other quasi-equity financing.
- ➡ Cooperative Investment Plan (CIP)
 - Deduction of the cost of acquisition of part of a cooperative by a member or worker of the cooperative.
 - Improvement in 2001-2002:
 - ⇒ Maximum annual deduction raised from 10% to 30% of the individual's total income.
 - Estimated cost of the plan for calendar year 2001: \$8.3 million.
- ➡ Capital régional et coopératif Desjardins (CRCD)
 - Formed in 2001-2002.
 - Will marshal a minimum of \$900 million of venture capital by 2010 for businesses and cooperatives located mainly in the resource regions.

As part of its economic policy, the Québec government has made substantial efforts to develop private investment, an essential condition for the modernization of physical capital that is the basis of productive activity.

The measures announced in the **2002-2003 Budget Speech** maintain the same course by announcing that the tax system pertaining to business will remain competitive and by improving financial support programs.

The government's economic policy also seeks to accelerate the spread of advances in technology by acting on R&D and innovation. Here again, encouraging results have been obtained and new measures are introduced in the **2002-2003 Budget Speech**, specifically targeting the new economy.

3. BENEFIT FROM TECHNOLOGICAL ADVANCES: INTENSIFYING INNOVATION EFFORTS

In addition to investments in physical capital, innovation efforts—taken in the broad sense, i.e. including research and development (R&D)—enable a community to benefit from technological advances and, thereby, increase its productivity and standard of living.

Québec's economic policy stresses R&D and innovation, and the results have been significant in this regard.

R&D SPENDING

Québec enterprises have invested heavily in research and development over the past ten years. Thanks to these investments, Québec has significantly closed the gap between it and the major industrialized countries.

Between 1989 and 1998, the average annual growth in R&D spending by businesses was higher in Québec than in Ontario and in Canada as a whole. It grew 8.4% in Québec, compared with 7.4% in Ontario and in Canada as a whole.

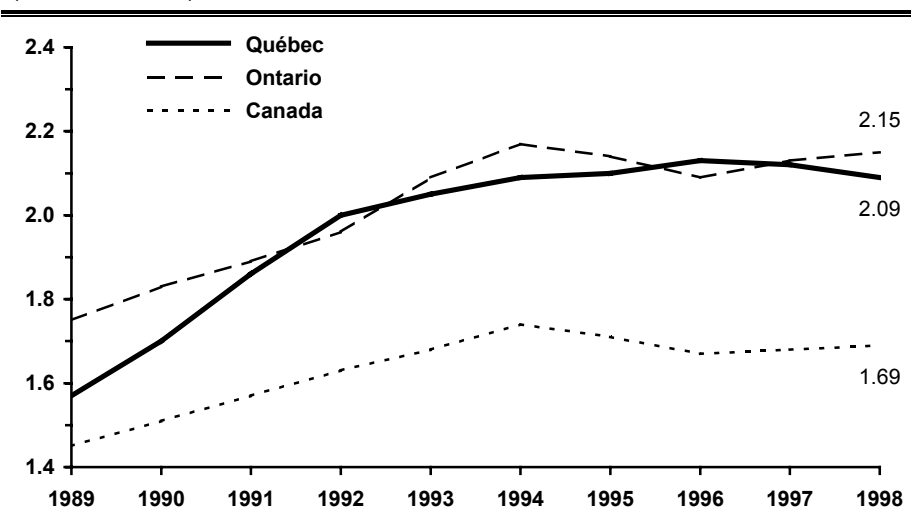
TABLE 19
R&D spending by business firms – Québec, Ontario and Canada,
1989 to 1998
(In millions of dollars)

Jurisdictions	1989	1991	1993	1995	1997	1998	Average annual growth (Percent)
Québec	1 245	1 520	1 802	2 277	2 500	2 584	8.4
Ontario	2 729	2 952	3 507	4 341	4 823	5 181	7.4
Canada	4 779	5 355	6 424	8 013	8 709	9 111	7.4

Source: Institut de la statistique du Québec.

As a percentage of GDP, Québec invests more in research and development than Canada as a whole. It has even been on a par with Ontario since the early 1990s.

GRAPH 16
Domestic R&D spending – Québec, Ontario and Canada,
1989 to 1998
(Percent of GDP)

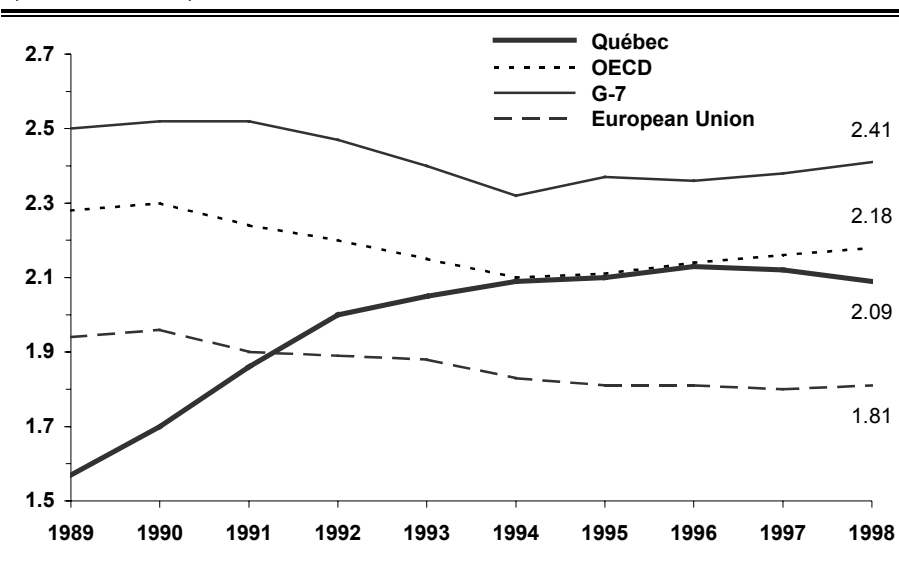


Source: Institut de la statistique du Québec.

The same comparison holds in relation to the European Union. Since 1991, Québec has spent more on R&D, as a percentage of GDP, than all member nations of the European Union.

Although there is still a gap between Québec and the OECD member countries and G-7 economies, it has been significantly narrowed.

GRAPH 17
Domestic R&D spending – Québec and other jurisdictions,
1989 to 1998
 (Percent of GDP)



Source: Institut de la statistique du Québec.

Note that Québec's R&D performance could have been even better if not for the federal government's underinvestment in this area: federal R&D investment in Québec is well below that in Ontario. In fact, in the past ten years, per-capita spending on R&D by the federal government has been nearly three times higher in Ontario than in Québec.

TABLE 20
Federal R&D spending in
Québec and Ontario, 1989 to 1998
 (Dollars per capita)

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Québec	23	25	26	27	29	30	29	28	26	30
Ontario	66	70	71	74	76	73	79	83	78	80
Discrepancy	-43	-45	-45	-47	-47	-43	-50	-55	-52	-50

Source: Institut de la statistique du Québec.

Federal underinvestment in R&D in Québec

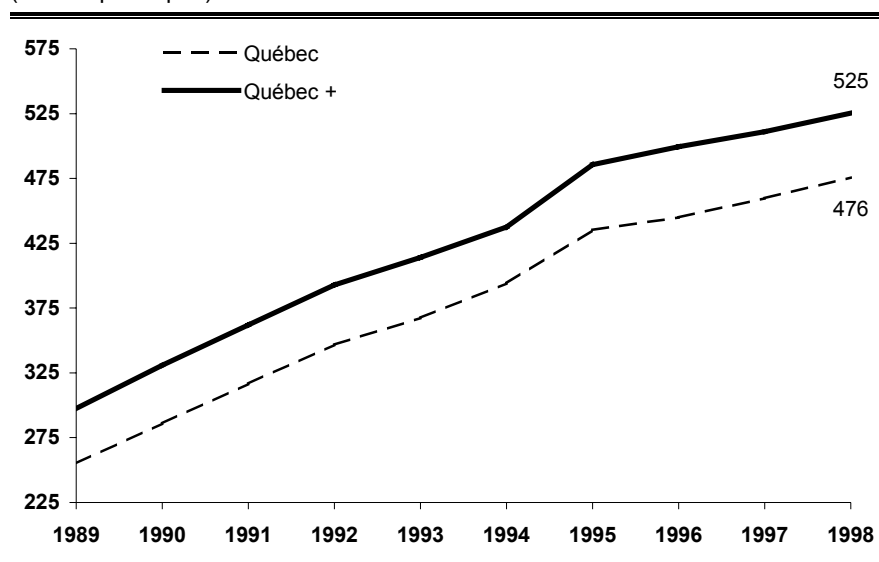
Federal underinvestment in R&D deprives Québec of strategic spending, which is critical to the dissemination of technological advances.

Consequently, if Québec had benefited from the same level of federal R&D spending per capita as Ontario, its overall performance in this area would have been substantially better. It would have meant roughly \$350 million more in R&D spending in Québec in 1998.

GRAPH 18

Comparison of total R&D spending if Québec had benefited from the same level of federal spending as Ontario, 1989 to 1998

(Dollars per capita)



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

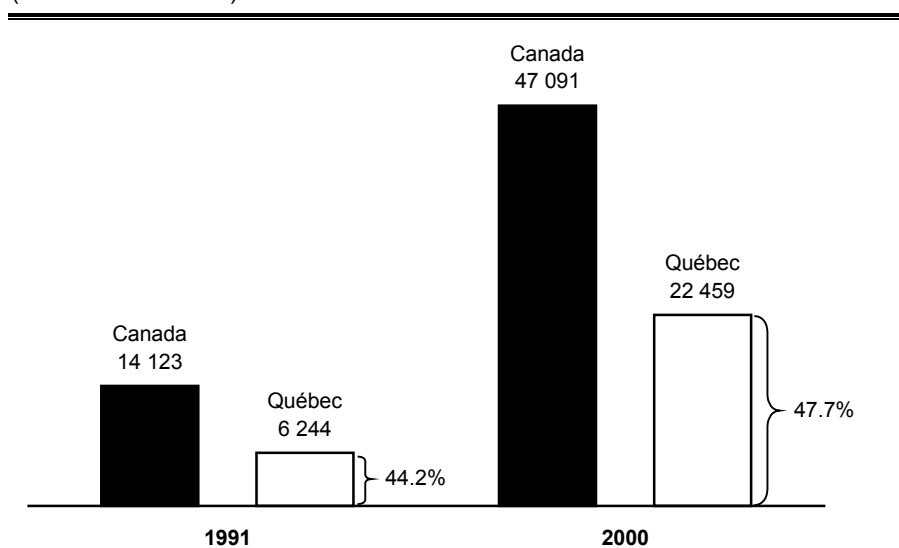
BREAKTHROUGH OF KNOWLEDGE-BASED INDUSTRIES

The development of high tech industries in Québec is a direct outcome of the successful R&D and innovation efforts of Québec businesses. This development is apparent on several levels.

High technology exports

Québec alone accounts for almost 50% of Canada's high technology exports. Already very strong in 1991, its share of such exports was even higher in 2000.

GRAPH 19
Comparison of Québec and Canadian
high tech exports,¹ 1991 and 2000
 (In millions of dollars)



¹ Advanced-knowledge industries: aircraft, chemical products (including pharmaceuticals), electronic products, industrial machines, pipeline transport, telecommunications, electricity and business services (including information systems).

Source: Institut de la statistique du Québec.

Highly successful sectors

Québec businesses performed very strongly in three sectors in particular: information technologies, biopharmaceuticals and aerospace.

Information technologies

- ➡ Over 4 000 enterprises are established in Québec. In 1999, they generated revenues of \$31 billion.
- ➡ Information technology exports reached upward of \$9 billion in 1999.
- ➡ These businesses provide more than 100 000 jobs.
- ➡ They invested \$800 million in R&D in 1999.

Biopharmaceuticals

- ➡ The biopharmaceuticals industry provides jobs to 14 000 people in Québec. It also invests heavily in research and development.
- ➡ Roughly 5 000 jobs directly involve R&D, which represented investments of nearly \$375 million in 2000.
- ➡ Québec accounts for 45% of Canada's capital spending in this sector.

Aerospace

- ➡ The Québec aerospace industry ranks sixth in the world.
- ➡ Québec has 26% of the global business aircraft market, over 40% of the commercial helicopter market and 45% of the regional aircraft market.
- ➡ Montréal is now the second largest aerospace centre in the world, after Seattle and before Toulouse. In 2000, the Québec aerospace industry invested \$0.5 billion in R&D. It provides 40 000 jobs in Québec and accounts for over 60% of Canadian aerospace exports.

Sources: E&B Data, ministère de l'Industrie et du Commerce du Québec and Institut de la statistique du Québec.

Success of designated sites for new economy businesses

The success of designated sites for new economy businesses is another illustration of the triumphant breakthrough of knowledge-based industries.

To date, 350 businesses have moved into the designated sites created under the government's economic policy.

In the past three years, these businesses have created nearly 5 000 jobs, a 75% increase over the number of jobs declared by the corporations when they decided to set up business in the designated sites, generally less than three years ago.

The fiscal measure regarding the Cité du multimédia has enabled eligible corporations to create over 3 000 new jobs. These 113 corporations have more than doubled their personnel from the 2 672 employees at the time they moved into the sites. As shown by this increase of over 118%, the results are even better than anticipated and the objective of 10 000 jobs in the Cité du multimédia will be reached in half the expected time, i.e. in 2004 rather than in 2010.

All told, these measures have made it possible to support over 11 000 jobs in new economy businesses. At that rate, these initiatives will have created or sustained an estimated 20 000 jobs and up by 2004.

TABLE 21
Job creation in designated sites
Balance sheet – August 2001

Fiscal measures	Number of businesses	Number of jobs at time of moving in	Balance sheet		%
			Number of jobs in August 2001	Number of jobs created	
CNEs	115	1 433	1 905	472	32.9
Cité du multimédia	113	2 672	5 840	3 168	118.6
CNNTQ	81	1 741	2 548	807	46.4
CDTIs	41	491	804	313	63.7
Total	350	6 337	11 097	4 760	75.1

Sources: Investissement Québec and ministère des Finances du Québec.

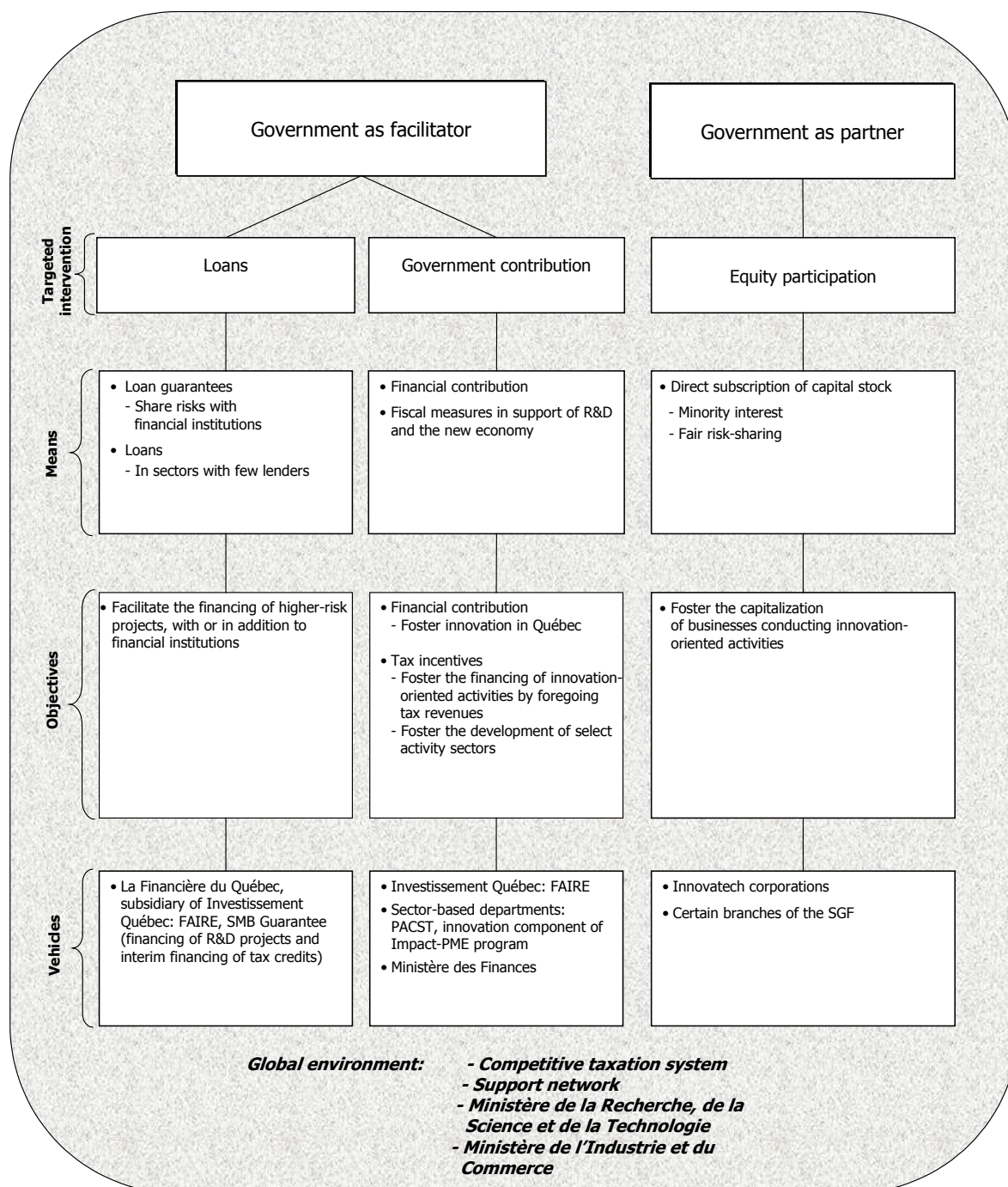
GOVERNMENT SUPPORT FOR BUSINESS FINANCING AND CAPITALIZATION

As with investments in physical capital, the government provides considerable support for R&D and innovation by facilitating the efforts of businesses in obtaining financing or by playing a partnership role in their capitalization. It also supports research and innovation by offering special assistance to the network, thereby giving an impetus to business research.

The following diagram summarizes the mechanisms implemented for each of these approaches.

DIAGRAM 3

Québec's financial instruments for accelerating business innovation



Government as facilitator

The same as for investments in physical capital, the Québec government facilitates the financing of R&D and innovation, in two ways:

- ➡ by making loans to businesses or helping them obtain loans;
- ➡ by contributing directly to their investments.

Loans and loan guarantees

The same mechanisms as those discussed for bolstering investment apply here as well: the Québec government makes loans and loan guarantees, primarily through La Financière du Québec, a subsidiary of Investissement Québec.

TABLE 22
Financing programs and innovation projects, 2000-2001

Loans and loan guarantees	Amount of financing provided (millions of \$)	Number of projects financed
FAIRE	5.9	3
SMB Guarantee	74.1	270
Total	80.0	273

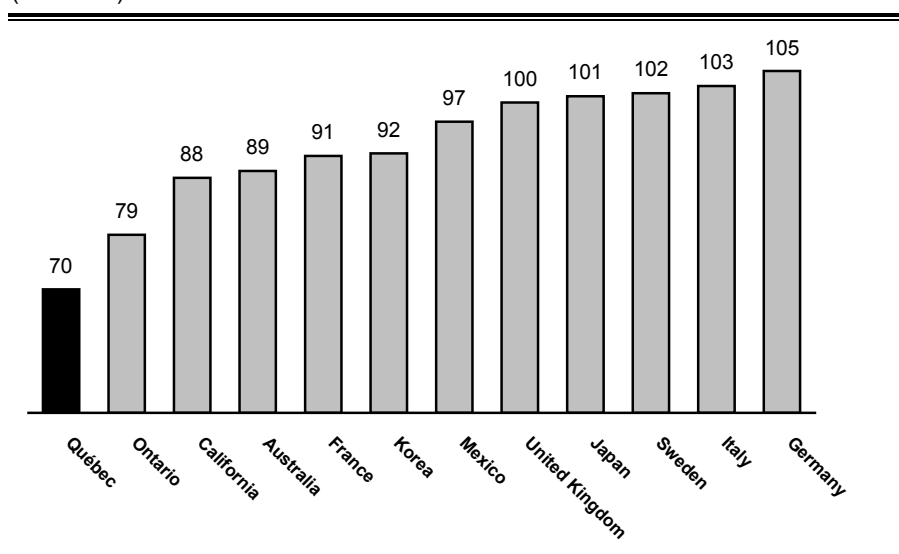
Direct contribution

As with investments, the government also supports R&D and innovation by contributing directly to the financing of projects and activities. Although it does this primarily through fiscal measures, the government's economic policy contains budgetary measures as well.

- ➡ Fiscal measures designed to foster R&D are by far the principal form of direct contribution to businesses' research effort.

According to a Conference Board of Canada study, Québec has one of the most competitive R&D support systems in the world. In fact, it is more favourable than the systems existing in Germany, France and Japan.

GRAPH 20
R&D tax treatment, spending of \$100, competitiveness of select jurisdictions,¹ 1998
 (In dollars)



¹ Revenue required to cover \$100 in R&D spending by a large corporation.
 Source: Conference Board of Canada.

Fiscal measures fostering R&D represent a major investment for the government: in 2000, refundable tax credits for R&D amounted to \$430 million.

- ➡ To support activities further downstream of the innovation process, the government introduced tax measures in the *1996-1997 Budget Speech* to assist businesses in the new economy. Additional measures have been established since the *1997-1998 Budget Speech* to encourage advanced-knowledge enterprises to concentrate their operations in designated sites.

Seven fiscal measures in support of the new economy have been implemented, resulting in the creation of:

- information technology development centres (CDTIs),
- the Cité du multimédia, in Montréal,
- the Centre national des nouvelles technologies de Québec (CNNTQ),
- new economy centres (CNEs) in the various regions of Québec,
- the Cité de l'optique, in Québec City,
- E-Commerce Place, in Montréal,
- the Cité de la biotechnologie et de la santé humaine du Montréal métropolitain.

The impacts some of these measures have had on business start-ups and job creation have already been discussed. As also seen, the **2002-2003 Budget Speech** introduces improvements to these measures through the extension of existing programs and changes to the E-Commerce Place program.

- ➡ Always with a view to contributing directly to business research and innovation efforts, the government's economic policy introduced a number of budgetary measures.
 - The ministère de l'Industrie et du Commerce (MIC) offers businesses financial assistance under the innovation component of the Impact-PME program.
 - The Programme d'amélioration des compétences en science et en technologie (PACST), also administered by the MIC, supports enterprises dealing with a shortage of skilled workers. Since 1997, the department has spent over \$60 million on these two programs.
 - The FAIRE program ensures further support for innovation projects.

TABLE 23
Major government contributions to innovation projects, 2000-2001

	Total contributions (millions of \$)	Number of recipient businesses or projects
<i>Financial contributions</i>		
FAIRE	72.5	38
PACST	12.1	23
Impact-PME (innovation component)	11.3	889
Sub-total: government contributions	95.9	950
<i>Fiscal measures¹</i>		
Research and development ²	429.5	4 145
New economy		
– CDTIs	25.7	92
– Cité du multimédia	25.1	73
– CNNTQ	1.9	58
– CNEs	1.5	111
– Production of multimedia titles	15.0	69
Other ³	18.4	305
Sub-total: fiscal measures	517.1	4 853
Total	613.0	5 803

(1) Fiscal measures are those in effect in 2001, and calendar year 2000 is the reference for the financial impact.

(2) Includes the tax credit for scientific research and experimental development and the tax credit based on R&D spending growth.

(3) Includes E-Commerce Place, the tax credit for design, the Cité de l'optique, the Cité des biotechnologies et de la santé humaine and the Technopôle Angus.

The government as partner

The government also plays a partnership role in supporting business innovation, in the following ways.

- ➡ The four Innovatech corporations, created over the years since 1992, are mandated to foster technological progress by Québec enterprises by contributing financially to business investments, primarily in the form of venture capital.

The Innovatech corporations essentially invest in the following sectors: industrial technologies, information and communication technologies, and biotechnology and life sciences.

- ➡ Certain activities of the SGF also target innovation-intensive sectors (SGF Tech and SGF Santé).

TABLE 24
Major state equity participations in innovation projects, 2000-2001

	Total participations (millions of \$)	Number of projects or capitalized businesses
<i>Direct subscription of capital stock</i>		
SGF Tech and SGF Santé	182.0	16
Innovatech corporations	132.0	112
Total	314.0	128

Network support

The economic policy provides for various instruments designed to bolster Québec's research and innovation network. These instruments also contribute to the global business environment in the R&D and innovation sector.

University research and grant-providing funds

The government oversees three funds that grant money for research projects:

- ➡ The Fonds québécois de la recherche sur la société et la culture (FQRSC).
- ➡ The Fonds de la recherche en santé du Québec (FRSQ).
- ➡ The Fonds québécois de la recherche sur la nature et les technologies, which replaced the Fonds pour la formation de chercheurs et l'aide à la recherche (FCAR).

Ministère de la Recherche, de la Science et de la Technologie

On the front lines of government support for innovation is the ministère de la Recherche, de la Science et de la Technologie (MRST), created in 1999. The department's mission is to promote research, science, technology and innovation by fostering synergy between the various sectoral players through the establishment of mechanisms facilitating consultation, cooperation, and integration of their respective activities.

To accomplish this mission, the MRST formulated the government policy on science and innovation entitled *Knowledge to Change the World*. The policy was released on January 25, 2001, and funding in the amount of \$250 million was announced in the *2001-2002 Budget Speech*.

The MRST implements numerous assistance programs aimed at supporting research and development, partnerships, research mentoring, technology transfer, and the dissemination and promotion of knowledge.

The action taken by the MRST is driven by four main focuses:

- research and innovation;
- scientific culture and knowledge-sharing;
- the future workforce in science and technology;
- developmental projects.

To encourage research and innovation, the MRST supports research granting agencies, fosters concerted research efforts and works with partners involved in innovation-intensive sectors.

As regards scientific culture, the MRST, in conjunction with its partners, promotes the dissemination of scientific works in non-scientific language, and seeks to get young people in particular and the public in general more interested in science and careers in science.

To ensure a new generation of science and technology workers, the MRST promotes science and technology careers through education, mentoring, information and support strategies. It also sees to the renewal of university scientists through its grant-providing funds.

Lastly, the MRST supports developmental projects through the sharing of its expertise as well as through its services, issue tables and programs.

Additional network support

The government has created other instruments as well to support research and innovation in the global business environment.

- ➡ Several of these instruments are administered by the ministère de l'Industrie et du Commerce (MIC), whose mission is to contribute to Québec's economic development by enhancing market development and company competitiveness with a view to encouraging job creation.
- ➡ The creation of Innovation Québec was announced in the *1999-2000 Budget Speech*. Its purpose is to maintain a world-class scientific research base in Québec.
- ➡ Valorisation-Recherche Québec is a non-profit organization that contributes financially to projects developed by university research groups and to the commercialization of the resulting products.
- ➡ The Centre de recherche industrielle du Québec (CRIQ) stimulates the development of Québec enterprises by shouldering them in their innovation efforts.
- ➡ Several research centres are directly or indirectly financed by the Québec government.
- ➡ The government has created 30 or so liaison and transfer centres to ensure business-university interaction and the transfer of technologies to the regions and activity sectors.

Building tomorrow's businesses today

The government strategy for making Québec businesses more competitive was released on September 28, 2001. Entitled "Bâtir aujourd'hui l'entreprise de demain" (Building tomorrow's businesses today), the strategy has been allocated up to \$83.5 million over three years. It targets the adoption of more-successful business practices by 2 500 Québec enterprises by 2005 to make them more competitive. The strategy is being implemented by the MIC in close cooperation with Emploi-Québec.

Analysis of two of the economic policy's focuses, namely, increased investment and heightened research and innovation, highlighted the thinking behind the government's actions and determined the principal instruments for achieving the goals of those actions.

We will now take a look at those actions and identify the resources allocated to the economic policy's implementation.

SECTION 3

MARSHALLING THE NECESSARY FINANCIAL RESOURCES

Since the mid-1990s, the Québec government has implemented a structured economic policy that makes use of an array of measures to influence the chief determinants of the standard of living and level of employment.

For these measures to be effective, the strategy had to be backed by significant financial resources. The purpose of the third section of this publication is to quantify the financial resources the Québec government has marshalled for the purposes of its economic policy. This quantification will also be useful in assessing the relative importance of the tools used and the respective weight of the effort allocated to each objective in carrying out the policy.

Accordingly, this section will consider:

- ➡ The investments and financial resources allocated over time to carrying out the government's economic policy;
- ➡ the composition and allocation of the financial resources used to implement this economic policy.

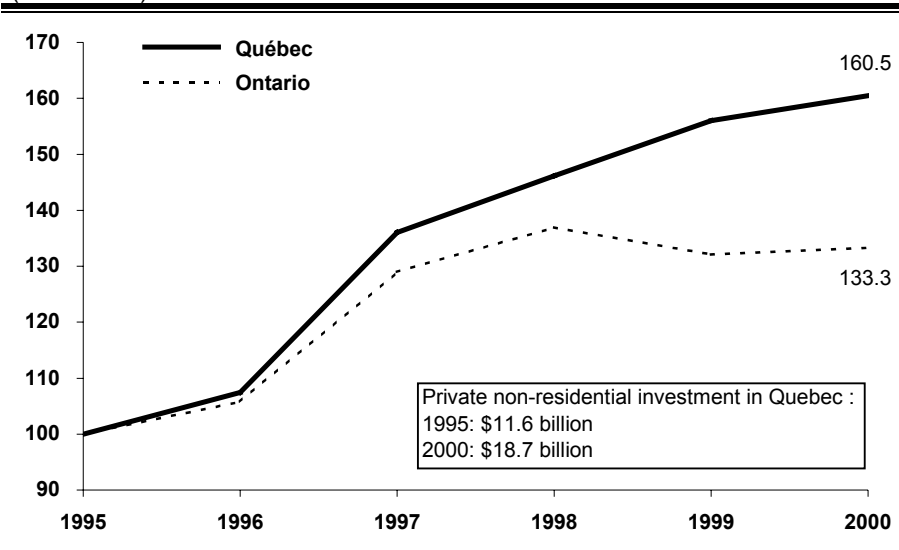
1. INVESTMENTS AND FINANCIAL RESOURCES ALLOCATED OVER TIME TO THE ECONOMIC POLICY

INCREASE IN INVESTMENTS

Section 2 examined the most recent data concerning investments made in Québec's economy.

- ➡ Since 1995, private non-residential investment has risen very strongly in Québec, from \$11.6 billion in 1995 to \$18.7 billion in 2000.
- ➡ Investment has accordingly grown by 60% in five years, while investment in Ontario's economy over the same period rose 33%.
- ➡ For each year during the period 1995-2000, the rate of growth of investment was higher in Québec than in Ontario.

GRAPH 21
Québec-Ontario comparison of the index of private non-residential investment, 1995 to 2000
(1995 = 100)



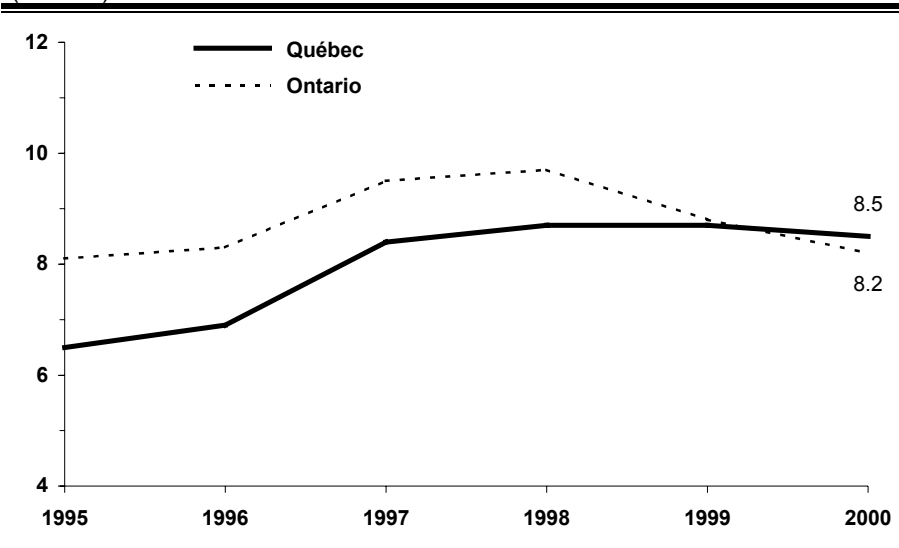
Sources: Statistics Canada and ministère des Finances du Québec.

It is interesting to compare the growth of investment with that of GDP. Investment is one of the major determinants of the increase in GDP and its share of an economy's total output is a good measure of the economy's dynamism and growth potential.

- ➡ Between 1995 and 2000, investment as a proportion of GDP rose by over 30% in Québec, while in Ontario, the proportion in 2000 was similar to that in 1995.
- ➡ In 2000, investment as a proportion of GDP reached the same level in Québec as in Ontario, i.e. about 8.5%.

The results obtained as to growth in investment are very encouraging, but much work remains to be done. Québec has yet to equal Ontario in terms of investment per capita, which provides a good measure of the effort still to be made.

GRAPH 22
Private non-residential investment as a proportion of GDP – Québec and Ontario, 1995 to 2000
(Percent)



Sources: Statistics Canada and ministère des Finances du Québec.

INCREASE IN FINANCIAL RESOURCES ALLOCATED TO THE ECONOMIC POLICY

To stimulate and accelerate investment, Québec has allocated substantial and growing resources to its economic policy.

- ➡ Between 1995 and 2000, the financial resources² allocated to implementing economic policy rose from \$1 billion to \$1.9 billion.
- ➡ These financial resources correspond to budgetary and fiscal measures. Total resources, including equity participations by government corporations, such as the SGF, have grown from \$1.1 billion to \$2.6 billion.

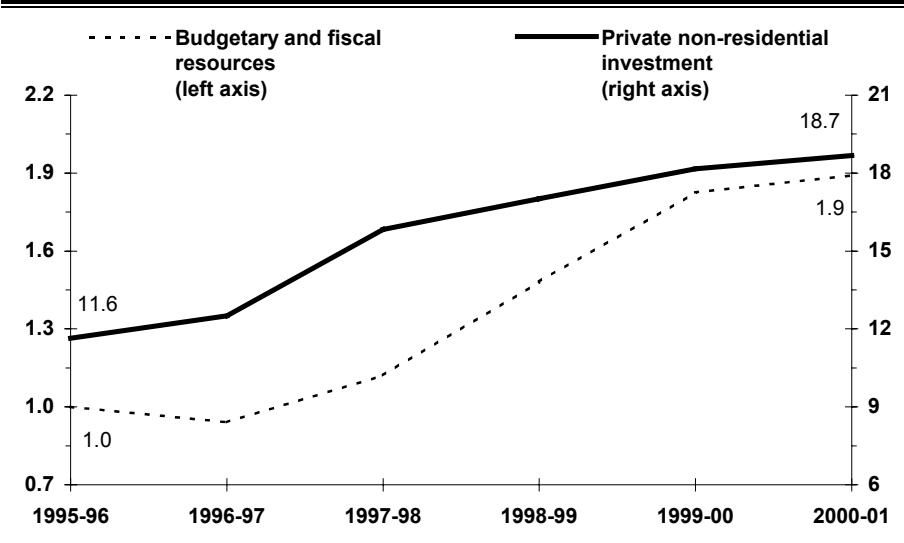
However, equity participations must be treated separately, since they are not outflows of funds of the same type as budgetary and fiscal measures. They are investments that yield revenue for the government and which the latter may recover once its intervention is over.

2 This section shows not only the financial resources marshalled for innovation and investment, but also other forms of support for businesses, such as assistance for training and for cultural enterprises. For budgetary assistance, financial resources represent the cost for the government on an annual expenditure basis. Accordingly, these figures cannot be compared to the amount of the authorized commitments shown in the preceding section.

GRAPH 23

Private non-residential investment and budgetary and fiscal resources allocated to businesses, 1995-1996 to 2000-2001

(In billions of dollars)

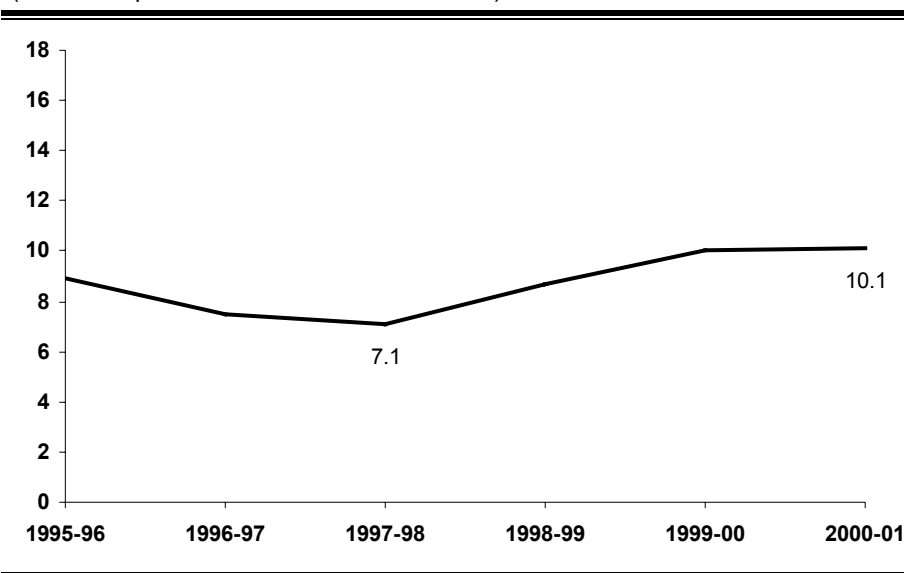


Sources: Statistics Canada, Secrétariat du Conseil du trésor and ministère des Finances du Québec.

Over the 1995-2000 period, growth in investment and in resources allocated to the implementation of economic policy, excluding equity participations, has been comparable.

In fact, the proportion of budgetary and fiscal assistance to investment has remained relatively stable throughout the 1995-2000 period, rising from 8.9% in 1995-1996 to 10.1% in 2000-2001, following a decline between 1996 and 1998.

GRAPH 24
Budgetary and fiscal resources allocated to businesses,
1995-1996 to 2000-2001
(Percent of private non-residential investment)



Sources: Statistics Canada and ministère des Finances du Québec.

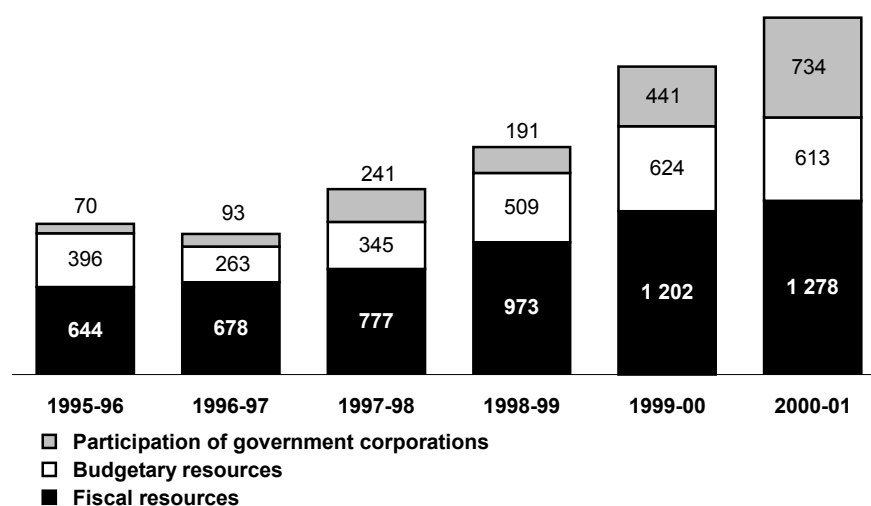
2. THE NATURE OF THE TOOLS USED

FISCAL AND BUDGETARY RESOURCES

The financial resources allocated to the implementation of the government's policy are fiscal and budgetary in nature, or consist of equity participations.

- ➡ Overall, the government has made greater use of each of these three tools in carrying out its economic policy. However, funds allocated to equity participations have grown particularly rapidly.
- ➡ Comparing the two other types of tools, namely fiscal and budgetary resources, it can be seen that their respective size has not changed since 1996-1997: year after year, fiscal resources allocated to economic policy are about double the amount of budgetary resources.

GRAPH 25
Nature of government resources allocated to the implementation of economic policy, 1995-1996 to 2000-2001
(In millions of dollars)



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

UTILIZATION OF FISCAL MEASURES IN ECONOMIC POLICY

The preceding figures quantify the contribution of fiscal measures to the implementation of economic policy: the relative share of fiscal resources in the overall package of financial means used has not changed a great deal, but fiscal measures account for over half of all these financial resources.

The side-bar below cautions the reader as to the exact meaning of the concept of tax expenditures. Bearing that in mind, this publication is an opportunity to isolate the main features of the strategy the government has followed in its use of fiscal measures.

- ➡ Over the last decade, Québec businesses have always been supported by a tax system that has been competitive on the whole.
- ➡ The government has used the tax system for specific initiatives to achieve what have been considered priority goals. Accordingly, tax incentives have been put forward to lower fixed charges on investment and employment, and support research and innovation, including the development of the new economy.
- ➡ These initiatives have yielded good results. They have contributed to the growth in investment and the development of key sectors of the knowledge-based economy.
- ➡ The **2002-2003 Budget Speech** marks a new stage in the use of fiscal measures: the government is now dealing with the overall tax burden on businesses, under pressure from decisions taken in competing jurisdictions. At the same time, it is bolstering specific measures while continuing to apply an aggressive fiscal policy to achieve objectives in terms of investment and the dissemination of technological progress.

**Two cautionary notes:
the specific nature of equity participations and
the false perspective certain tax expenditures can give**

Among the financial resources allocated to economic policy, budgetary resources and a large share of tax expenditures – those corresponding to refundable tax credits – correspond to actual outflows of funds for the government. The same cannot be said for equity participations and certain other tax expenditures.

As has already been pointed out, equity participations in the capital of businesses are not outflows of funds of the same type as budgetary and fiscal means of intervention. They are investments that yield revenue for the government and which it can recover once its intervention is over.

Another cautionary note is needed, this time concerning fiscal measures: we refer here to certain tax expenditures – non-refundable tax credits and tax holidays – that are determined in relation to the common law tax regime.

- ➡ This means that if this tax regime is changed, the quantification of the tax expenditures must be adjusted accordingly, even if in practice the business concerned receives the same assistance – under the form of the common law regime instead of under an exceptional regime.
- ➡ The assessment of tax expenditures can accordingly lead to paradoxical situations: a jurisdiction is considered not to have tax expenditures once all taxpayers are covered by the regime that used to apply to specific groups of taxpayers.
- ➡ In practical terms, the reduction plan for the tax on capital initiated by the Québec government as part of the **2002-2003 Budget Speech** results in a reduction in the tax expenditure corresponding to the tax holidays applied to this tax. Yet in practice, the business concerned receives the same or improved support, and in terms of public finances, the tax reduction is more expensive than the tax holiday that existed previously.
- ➡ Consider the example of an SME that currently enjoys a holiday from the tax on capital amounting to \$100, had the tax been applied to it. If the tax on capital is eliminated for all businesses, the financial situation of the SME is unchanged, but everything happens as if the tax expenditure corresponding to the tax holiday had disappeared – though in reality the holiday has been replaced by the complete elimination of the tax.

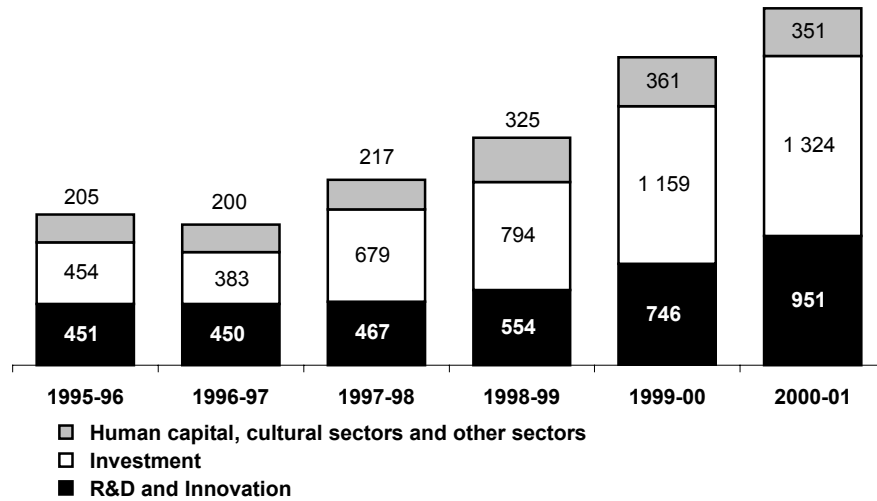
GREATER ASSISTANCE FOR INVESTMENT

The budgetary and tax resources, as well as the funds allocated to equity participations, are assigned to any of the objectives of economic policy, namely bolstering physical capital, disseminating technological progress or certain initiatives relating in particular to the improvement of human capital.

- ➡ Between 1995-1996 and 2000-2001, the resources allocated to bolstering physical capital through investments rose significantly, from \$454 million to over \$1.3 billion.
- ➡ Resources allocated to R&D and innovation, that involve greater risk, also rose, but to a lesser degree. Amounts allocated to disseminating technological progress rose from \$451 million in 1995-1996 to \$951 million in 2000-2001.
- ➡ Funds allocated to other government initiatives including resources devoted to the development of human capital³ in businesses, also grew, but less substantially, rising from \$205 million to \$351 million.

3 These amounts exclude funds allocated to training individuals outside businesses and those granted under programs of the ministère de l'Éducation.

GRAPH 26
Composition of government initiatives for businesses,
1995-1996 to 2000-2001
(In millions of dollars)



Note: Figures include equity participations of Innovatech corporations and the SGF.

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

An overall examination of the financial resources allocated to the implementation of economic policy provides essential information on the execution of such policy.

- ➡ We have a more accurate idea of the actual amount of these resources and their growth. Such resources must be seen in context with the variable on which they act – primarily the amount of investment made by businesses.
- ➡ The nature of the tools used also provides indications on the strategy the government has followed, a strategy featuring growing involvement in business capital and the stress placed on supporting investment in physical capital.

CONCLUSION

The **2002-2003 Budget Speech**, which has been moved ahead by five months to deal with an unexpected economic situation, allows the government to respond quickly to this situation and implement action to maintain jobs and economic activity. We have seen that these actions mesh coherently with the economic policy that has been followed since the mid-1990s.

The **2002-2003 Budget Speech** thus provides an opportunity to look back at this policy, assess it and explain future developments.

The government has carried out this exercise with transparency, as is essential in our democratic system: it is fundamental that citizens be able to make an informed judgement on the nature of the choices that have been made and the results obtained.

Such transparency helps explain the government's overall economic policy, its coherence, the options it has chosen and its underlying logic.

This publication confirms the interventionist nature of the government's economic policy – an economic policy that also assigns a central role to private enterprise: through its investments, private enterprise is able to generate lasting growth in employment and wealth. Private enterprise is the engine of productivity growth, and thus of the standard of living.

The government has consistently marshalled significant resources to stimulate businesses, provide them with the support they need, and sustain their initiatives. As we have seen, the results to date tend to show that the government has chosen the right strategy.

2002 › 2003 BUDGET

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