



QUEBEC BUDGET 2010

March 31, 2010

Robert Hogue
Senior Economist
(416) 974-6192
robert.hogue@rbc.com

David Onyett-Jeffries
Economist
(416) 974-6525
david.onyett-jeffries@rbc.com

Setting the course to balancing the books

The public sector 2010 budget season so far has been marked by all governments restating their firm commitments to eliminating their deficits in the medium term but few offered as clear a roadmap to the ultimate destination as did Quebec yesterday. In his maiden budget, Finance Minister Raymond Bachand provided a refreshingly detailed plan that included both significant tax increases and spending restraints. These measures will still leave a \$4.5-billion hole in the province's finances in 2010/11 – slightly deeper than the downwardly revised \$4.3-billion shortfall in 2009/10 – but lend much more credibility to the goal of balancing the books by 2013-14 (as required by current provincial legislation). This would be no small feat given that, if nothing had been done, an estimated \$12.3 billion gap between revenues and expenses would have emerge by the terminal date. In his budget, Minister Bachand identified specific measures amounting to \$11.2 billion by 2013/14 or more than 90% of the estimated gap. Of that amount, \$6.2 billion (or 62%) will be found within the government (largely in the form of spending restraints), \$3.5 billion (31%) will come from individuals and \$800 million (7%) from businesses (in the form of various tax and fee increases). After providing only the broad outline of a plan last year, the Quebec government now has come forth with a relatively specific roadmap.

While such strong commitment to balancing its books within its earlier set timeline might seem overly zealous, it really is born out of necessity. Quebec is the most indebted province in Canada and faces more challenging demographics that will weigh on core spending programs in the years ahead. Thus, the province has little room to maneuver and must show a high degree of fiscal vigilance.

Budget highlights

On the revenue side, the budget introduces several new measures. The provincial sales tax rate will rise to 9.5% on January 1, 2012, representing an additional 1 percentage point increase to the similar-sized hike announced last year that will come into effect on January 1, 2011. The budget also boosts the rates on both the gasoline tax and fuel tax by 1 cent per litre effective April 1, 2010 (to 16.2 cents per litre and 17.2 cent per litre, respectively), followed by additional 1 cent per litre increases in each of the next three years. The revenues from these higher excise taxes will be fully allocated to public transit and upgrading roads (a form a user fee). Similarly, “health contributions” of \$25 per adult will be introduced starting July 1, 2010 (rising to \$100 in 2011 and \$200 in 2012), which will be used to finance health care initiatives. The budget speech stated that the government is also “considering a health deductible calculated on the basis of medical visits during the year”. This proposed user fee would amount to \$25 per doctor visit to a maximum of 1% of taxable income; however, this is not included in the Budget plan. Finally, an additional charge of 1 cent/kWh on electricity will be implemented over five years, starting in 2014.

In **2010/11**, the government's own-source revenues are projected to rise by 3.7% to \$49.2 billion, thanks primarily to a 6.0% jump in personal income tax revenues (to \$18.6 billion) and

3.8% increase in consumption taxes (to \$14.1 billion). Federal transfers are expected to edge higher by 0.6% to \$15.3 billion, bringing overall provincial revenues to \$64.5 billion, up 2.9%.

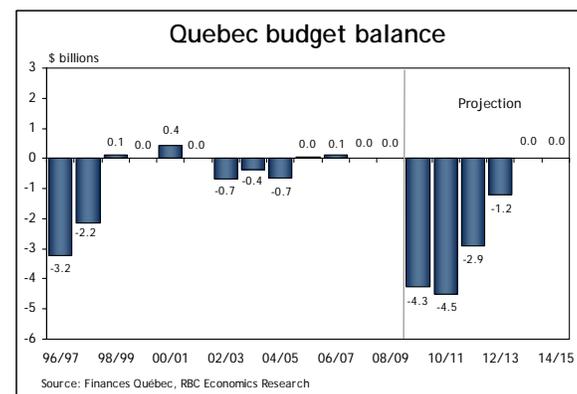
On the expenditure side, new measures focus on restraining overall growth. Total spending growth is capped at 2.2% through the medium term, representing a lower ceiling than the 3.2% laid out in last year's budget and less than one-half the average growth in the last seven years. This belt tightening will be achieved through a civil service payroll freeze until 2013/14, a two-year pay freeze for the premier, ministers and MNAs, a 10% decrease in administrative operating expenses by 2013/14, and a 25% reduction in advertising, training and travel costs.

In 2010/11, program spending is set to rise by 2.9% to \$62.6 billion. However, only four priority areas will see faster increases than the rate of inflation – health (up 3.7%), education (2.2%), transportation (9.4%) and families and the elderly (5.4%). All other programs combined will be restrained to a growth of 0.9%. In the case of health, were it not for a non-recurring \$126 million expenditure associated with the H1N1 pandemic in 2009, the spending increase would have measured 4.1%.

The **Québec Infrastructures Plan** has been updated to cover the period 2009 to 2014. A total of \$42.6 billion is being earmarked through the course of the five-year plan. On an annual basis, total infrastructure spending is projected to peak at \$9.1 billion in 2010/11, up 2.4% relative to 2009/10. Annual spending will decline to \$8.9 billion in 2011/12, \$8.1 billion in 2012/13 and \$7.5 billion in 2013/14. The year-over-year increase in 2010/11 is a significant upward revision from the projected 5.3% decline in last year's Plan.

The plan to eliminate the deficit

As noted above, the budget identifies more than 90% of the “efforts” to be carried out to erase the estimated \$12.3 billion gap between revenues and expenses by 2013/14. In terms of government efforts, keeping program spending growth at 2.2% annually instead of the last seven years' average of 4.8% will help generate savings of \$5.2 billion by 2013/14 within government departments and organizations. A further \$530 million will be achieved through spending control at other public bodies. Measures to combat tax evasion and avoidance will produce \$1.2 billion. In terms of the contribution from taxpayers, the rise in the Québec sales tax, the health contribution, the rise in the fuel tax and the indexing of user fees (announced last year) will generate \$3.5 billion in new revenues. On the business side, the rises in the Québec sales tax and the fuel tax, as well as a new mining duties regime and a temporary rise in the compensatory tax on financial institutions will bring in nearly \$800 million in extra revenues. The government still needs to identify additional measures to close the remaining \$1.1 billion gap.



Conservative assumptions

The fiscal projections are based on relatively conservative economic assumptions, with real GDP growth forecast at 2.3% in 2010 and 2.6% in 2011. RBC's growth forecasts for these years are 2.8% and 3.5%, respectively. However, the absence of contingency reserves beyond 2010/11 leaves out an element of caution.

Debt

As a result of the province's deficits, aggressive capital spending program and other investments and loans, Quebec's gross debt (debt contracted on financial markets and the net liability for the retirement plans and for employee future benefits of public and parapublic sector employees, minus the balance of the Generations Fund) is expected to increase from \$151 billion (or 50.1% of GDP) at the end of 2008/09 to \$160 billion (53.2%) in 2009/10, \$171 billion (54.5%) in 2010/11 and \$180 billion (55.1%) in 2011/12. As a share of GDP, gross debt is projected to decrease thereafter, reaching 52% at the end of 2014/15. Meanwhile, the Generations Fund is forecast to grow more four-fold from just under \$2 billion (book value) at March 31, 2009, to \$8.3 billion in March 31, 2015. Total financing requirements are expected to diminish to \$12.9 billion in 2010/11 from \$15.5 billion in 2009/10 (of which almost 19% was funded in foreign markets) but to expand again to \$17.9 billion in 2011/12.

Quebec's fiscal plan

(\$ millions)	Actual		Forecast		Projections		
	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Total revenues	62,916	62,650	64,489	65,936	68,480	70,941	73,652
Total expenditures	65,054	66,923	69,551	71,748	74,041	76,283	79,028
Program spending	58,550	60,769	62,561	63,907	65,282	66,686	69,282
Interest on public debt	6,504	6,154	6,990	7,841	8,759	9,597	9,746
Net results of consolidated entities	880	598	697	848	926	852	1,038
Contingency reserve		300	300				
Plan to return to balanced budgets			1,051	3,036	4,496	5,613	5,880
Surplus/(Deficit)	(1,258)	(3,975)	(3,614)	(1,928)	(139)	1,123	1,542
Deposit of dedicated revenues in the Generations Fund	(587)	(715)	(892)	(972)	(1,061)	(1,123)	(1,227)
Rise in the price of heritage pool electricity							(315)
Uses from the stabilization reserve	1,845	433					
Budgetary balance for the purposes of the Balanced Budget Act	0	(4,257)	(4,506)	(2,900)	(1,200)	0	0

Source: Finances Québec, RBC Economics Research

The material contained in this report is the property of Royal Bank of Canada and may not be reproduced in any way, in whole or in part, without express authorization of the copyright holder in writing. The statements and statistics contained herein have been prepared by RBC Economics Research based on information from sources considered to be reliable. We make no representation or warranty, express or implied, as to its accuracy or completeness. This publication is for the information of investors and business persons and does not constitute an offer to sell or a solicitation to buy securities.

