



QUEBEC BUDGET 2011

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Slippery road to balanced budget

In his maiden budget last year, Quebec Finance Minister Raymond Bachand presented an impressively detailed roadmap to return his government's budget to balance by 2013/14, announcing both significant tax increases and spending restraint in his three-year plan. Facing an estimated \$12.3 billion gap between revenues and expenses by the terminal date of his plan if nothing was done, Minister Bachand last year identified measures amounting to \$11.2 billion or more than 90% of the gap, the majority of which (62%) found within the government (largely in the form of spending restraints). Individual and business taxpayers were also called to 'contribute' more with increases in the Quebec Sales Tax (QST) rate and other fees. With such a roadmap now in place, it was widely expected that this year's budget would look much more like a progress report, indicating the distance travelled to date and whether the current and future course remained on track.

In the event, the budget presented yesterday by Minister Bachand was indeed of the 'staying the course' kind, with very few new major announcements. In fact, the most notable new measures – raising the Quebec Pension Plan (QPP) contribution rate from 9.9% to 10.8% by 2017 and a \$325 increase per year in university tuition fees in each of the next five years – either had little to do directly with the budget balance or had limited impact in the near term.

As far as the progress report goes, the 2011 budget brings some mild disappointments, although the adoption of a new reporting framework (that introduces special funds which move revenues and expenditures off the main account) makes it difficult to gauge where we really stand relative to last year's plan. While the return to a balanced position is still projected in 2013/14, the deficits for 2011/12 (\$3.8 billion) and 2012/13 (\$1.5 billion) were both revised higher (from \$2.9 billion and \$1.2 billion, respectively, in last year's budget, and from \$3.2 billion and \$1.4 billion, respectively, in this past December's mid-year update). Part of the reason for the higher deficits relative to Budget 2010 is the introduction of contingency reserves (\$300 million in 2011/12 and \$200 million in 2012/13) – however, the reserves had already been introduced in the mid-year update and, therefore, are not behind the deterioration since then (faster growth in spending is).

Somewhat disheartening is the apparent slippage on the expenditure front. Using the earlier budget framework, program spending is scheduled to increase by 3.7% in 2011/12 and an average of 2.8% annually in the following two fiscal years, which is moving away from last year's pledge to cap program spending growth at 2.2% per year. The rate of increase of 3.7% in 2011/12 will also be faster than the 3.1% pace now estimated in 2010/11 (up from 2.9% previously). Also concerning is the continued ramping up of capital spending in the upcoming fiscal year at a time when the economy no longer needs a jumpstart from the public sector. The latest update to the Quebec government's infrastructure plan calls for a rise of 7.9% in infrastructure spending in 2011/12 to \$9.6 billion, which would constitute a higher peak than previously projected. While such a ramp up might be meant to address the province's so-called 'infrastructure maintenance deficit', the concern is that it will interfere with efforts to reduce the provincial debt. In 2010/11, net capital expenditures accounted for 50% of the increase in Quebec's debt.

On the topic of the debt, Budget 2011 reveals a slightly worse outlook for the province. With deeper projected deficits in the next two fiscal years and a higher capital spending profile in the next four years, Quebec will be piling on debt a little faster than previously projected. While gross debt as a percentage of GDP will still peak in 2012, it will track higher than shown in Budget 2010 throughout the projection period. Given Quebec's elevated debt, we were hoping that any variance would be on the side of improvement, not deterioration.

Nonetheless, the news was not all bad in yesterday's budget. The deficit for 2010/11 has been revised lower to \$4.2 billion from \$4.5 billion in last year's budget, and with the \$300 million contingency allowance still in place, there is scope for further improvement when the final numbers are released. Moreover, Minister Bachand's conservative assumptions – he assumes real GDP growth for the province of just 2.0% in 2011 and 2.2% compared to RBC's 2.6% and 2.7%, respectively – might bring some upside surprises to revenues down the road. A possible sales tax harmonization deal with the federal government could also provide some extra cash in the near term.

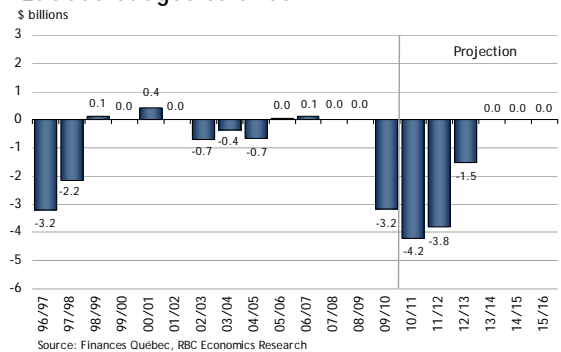
All things considered, Minister Bachand's second budget shows progress along the course he set out last year. We just would have liked to see more of it.

Budget highlights

The 2011 Budget presents revenue and expenditure numbers under a new structure that take into account the creation of special funds – the Land Transportation Network Fund (FORT), the Fund to Finance Health and Social Services Institutions (FINESSS) and the Tax Administration Fund (FRAF) “whose purpose is to fund the Agence du revenu du Québec”. Further reporting changes also arise from the allowance for doubtful accounts being applied against revenues instead of program spending as required per new legislation (resulting in a \$900 million reclassification shift from program spending to own-source revenues). The new structure and changes do not affect the overall budget balance; however they lower the level of both budgetary revenues and expenditures. Therefore, the fiscal plan numbers shown in the table next page are not comparable to those that appeared in previous budget and mid-year update commentaries.

Budget 2011 forecasts **total revenues** to increase by 4.8% under the new framework to \$65.4 billion in 2011/12, with a 7.3% increase in own-source revenues. A substantial part of the projected own-revenue growth comes from the various measures announced in previous budgets, with QST, electricity rate and fuel tax hikes all proceeding as planned. Consumption tax revenues alone are expected to increase by 15.9% or approximately \$2 billion, accounting for nearly two thirds of the increase in overall revenues. Government enterprise revenues are also expected to increase slightly, but this is more than offset by a \$412 million drop in federal transfers due to a large decline in equalization

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payments. Equalization is indexed to growth over the past three years; since Quebec performed relatively well during the recession, its payments will fall this year.

On the **expenditure side**, higher debt servicing costs combined with moderate program spending growth will push total expenditures up 3.5% in 2011/12 under the new budget framework, to \$69.1 billion. Program expenditures are forecast to increase by 2.4%; however, this excludes spending from new health, transportation and revenue collection funds recently created. Including these expenditures to form a basis comparable to last year's budget numbers, program spending is expected to rise by 3.7%. This is higher than the government's target of 2.2% growth in last year's budget but still low by historical standards; in the four years prior to 2009/10, program expenditures grew by an average of 5.8%. The 2011/12 increase includes a 5.0% increase in health spending (based on last year's reporting framework; new accounting rules put growth at 3.6%), a 6.1% increase in spending on family and seniors' programs, and a 2.2% increase in education spending. These increases are partly offset by a planned -0.2% reduction in spending for most other programs. Debt servicing costs are expected to surge by 12.4% as a result of higher projected interest rates and increasing debt levels.

Capital spending

The updated Quebec Infrastructures Plan shows that planned government infrastructure spending has been ratcheted up in each of the next four years, totalling \$2.3 billion (or nearly 5%) in extra spending relative to the 2010/11 projections. While the 2009-14 Quebec Infrastructures Plan had investment peaking at \$9.1 billion in 2010/11, the updated plan projects a further increase to \$9.6 billion in 2011/12. Spending on infrastructure will then begin to decline, but will remain at relatively high levels (above \$8.0 billion per year) over the entire forecast period.

Debt, the Generations Fund and financing requirements

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 by approximately \$10.3 billion at the end of 2011/12 to \$184 billion, pushing the debt-to-GDP ratio to 55.7%. Debt-to-GDP is expected to decline after this, reaching 53.6% at the end of 2015/16. The debt profile is higher than it was in last year's budget, when the gross debt-to-GDP ratio peaked at 55.1% at the end of 2011/12 and gradually diminished to 52.0% at the end of 2014/15. Contributions to the Generations Fund will reach \$940 million in 2011/12, which will bring the Fund's book value to \$4.3 billion. This is a substantial increase over the \$2.0 billion in the fund at the end of 2009, and is part of the government's plan to increase the value of the fund to over \$8.0 billion by 2015. Total financing requirements are expected to diminish to \$17.4 billion in 2011/12 from \$18.9 billion in 2010/11 (which included \$3.0 billion in pre-financing for 2011/12) and fall again in 2012/13 to \$15.0 billion.

Quebec's fiscal plan

(\$ millions)	Actual	Preliminary	Forecast		Projections		
	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Total revenues	59,291	61,388	62,790	65,071	67,299	69,594	77,339
Total expenditures	64,506	66,763	69,087	70,769	72,668	74,852	77,335
Program spending	58,389	59,819	61,284	62,113	63,325	65,510	67,836
Interest on public debt	6,117	6,944	7,803	8,656	9,343	9,342	9,499
Net results of consolidated entities	2,275	1,156	1,012	973	890	952	972
Contingency reserve		300	300	200			
Plan to return to balanced budgets		1,051	2,725	4,172	4,562	4,829	
Measures to be identified				300	1,025	1,025	1,025
Surplus/(Deficit)	(2,940)	(3,468)	(2,860)	(453)	1,108	1,548	2,001
Payments to the Generations Fund	(725)	(732)	(940)	(1,047)	(1,108)	(1,548)	(2,001)
Stabilization reserve fund	433						
Accounting changes	58						
Budgetary balance for the purposes of the Balanced Budget Act	(3,174)	(4,200)	(3,800)	(1,500)	0	0	0

Source: Finances Québec, RBC Economics Research

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