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2009 Quebec budget

Deficits return

The recession storm that has blown up since last fall is mowing down almost everything in its path and slamming Quebec's public finances. It was against the backdrop of a much deteriorated economy that the province's Minister of Finance, Monique Jérôme-Forget, tabled her 2009 budget yesterday. This budget augurs renewed deficits which will total \$11.6 billion over the next four fiscal years. A balanced budget was achieved for the year ending this month, however, by using much (\$2 billion) of the budget reserve that had been amassed in the last few years (\$2.3 billion). The government will exhaust the reserve when it uses the remainder (\$295 million) next year.

Grimmer forecast for 2009-2010 and 2010-2011

The economic about-face will hammer revenues over the next two fiscal years, bringing forecast revenues down by a total of about \$5 billion from the revenues forecast in the March 2008 budget. Economic support measures and program spending increases will add about \$3.6 billion to spending compared with previous forecasts. The impact on the deficits will, moreover, be amplified by the federal government's changes to the equalization program, which has a shortfall of \$770 million over these two years, with almost all of it (\$695 million) falling in 2010-2011. However, two key elements will provide some relief: a reduction in debt service of more than \$1.2 billion over two years (due to lower interest rates) and the road map for a return to fiscal balance, which plans to generate nearly \$1.1 billion in additional revenues in 2010-2011 (see below). In all, the bottom line deteriorates by \$3.9 billion in 2009-2010 and \$3.8 billion the following year.

Recovery measures in the spotlight

As expected, the Quebec government is focused on kick starting the economy. Rather than constituting a new direction, this budget is much more of an extension of the measures announced since last year's budget (particularly the November 4 Economic and Financial Update and the January 19 Economic Statement). The cornerstone is still infrastructure investment, which has been bolstered by \$363 million over two years (including the share of government corporations) – and which combines with the \$1.4 billion increase to the Québec Infrastructure Plan announced in January. In all, the government plans to make infrastructure investments of \$8.9 billion in 2009-2010 and \$8.5 billion in 2010-2011, up from the \$8.3 billion for the fiscal year now closing. Roads, health care and education will grab much of these amounts.

Many other recovery measures target business and workers. They include:

- The creation of a \$500 million emergency fund to get businesses back on their feet
- A new stock savings plan

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- Expansion of the Renfort program to include the forestry and tourism sectors
- An additional \$500 million for the Employment Pact (increased to \$1.5 billion), and
- \$125 million to set up a seed fund and \$825 million to finance a venture capital fund for technology companies

These measures are in addition to those announced since last fall (including measures to promote home renovations, improve business liquidity and protect corporate pension funds).

The economy will also be jump started by increasing program spending, which will go up 4.5% in 2009-2010 compared with the 3% projected in last year's budget. Health spending will rise 5.7%, while education spending will go up 3.5%. However, at over 18%, the biggest increase will be in transportation spending.

Factoring in all of the initiatives contained in this budget, as well as in previous statements and budgets, the Quebec government estimates that more than \$15 billion will be injected into the province's economy over two years, \$8.1 billion in 2009-2010 and \$7 billion in 2010-2011, which translates into 2.7% of GDP in 2009 and 2.2% in 2010.

Plan to restore fiscal balance

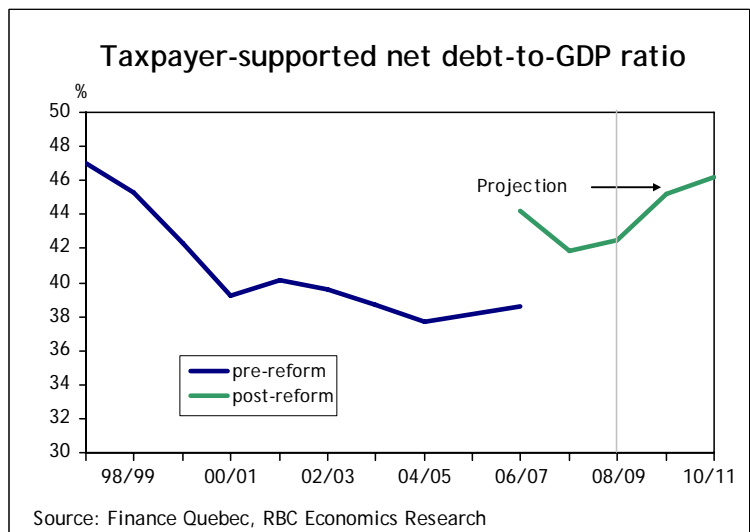
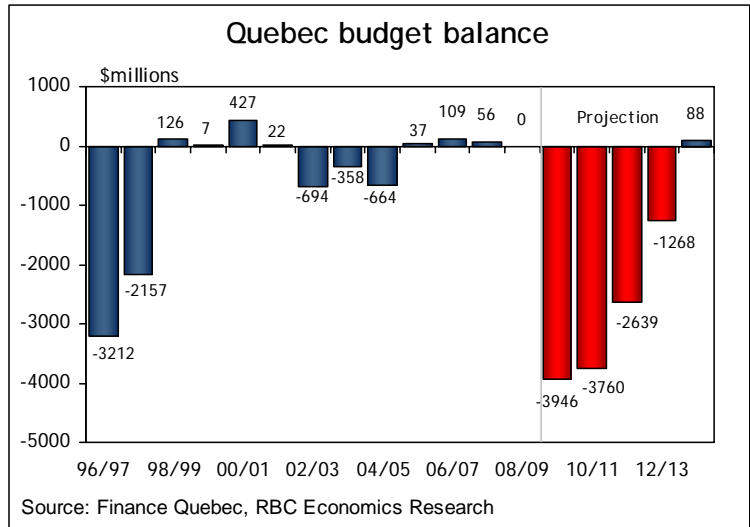
Given the sizeable deficits announced, the *Balanced Budget Act* of 1996 requires the Minister of Finance to table a financial plan to absorb the deficits within a five-year period. In fact, the Act states that all overruns must be fully offset by an equivalent surplus the next fiscal year, but the restrictions are more lax under extreme circumstances (such as we are now dealing with). Although the government has indicated that it plans to suspend its obligation to comply with the Act, it nonetheless presented its plan to restore fiscal balance (slated for 2013-2014). The plan features four key initiatives:

- A ceiling of 3.2% on annual program spending growth as of 2010-2011
- Stepping up efforts to counter tax evasion and avoidance
- Indexing of all non-indexed user fees as of January 1, 2011, with the exception of the \$7-a-day fee for child care, and
- An increase in the Quebec sales tax, which will go from 7.5% to 8.5% on January 1, 2011

The additional revenues generated by this plan will total \$1 billion in 2010-2011 (first year in force), then climb to \$6.1 billion in 2013-2014. However, the budget only identifies some of the additional revenue sources. Of the \$1 billion for 2010-2011, the source of \$450 million is unknown. Close to two thirds of the \$6.1 billion for 2013-2014 will be identified at a later date.

The debt grows

Budget shortfalls and extensive capital spending will make Quebec's debt balloon from \$130 billion on March 31, 2009 to almost \$146 billion on that date in 2011 (based on the *Act to reduce the debt and establish the Generations Fund*). The province's debt will rise from 42.8% to 46.3% of GDP during this time. The increase will no doubt make the government miss the 2013 target of 38% set out in the *Act to reduce the debt*. The government has also acknowledged that it will have to review the targets it had set within the next two years.



Comments

Like most governments in other provinces, the Quebec government is faced with a very delicate situation: the economic storm is eating away at its revenues while the assistance needed by recession-struck workers and businesses is rising rapidly. It is therefore not surprising to see the budget balance move into the red. Moreover, this budget's deficits are still nowhere near as large (especially in relation to the economy's size) as the deficits that assaulted the province in the mid-90s, and the government is even drafting a plan to restore fiscal balance, which should provide some comfort. However, much remains to be done to develop this plan, and it will certainly not be easy to steer the ship safely back into harbour once the economic storm is over, particularly since the budget reserve is exhausted and the government has not made any provision for contingencies. Although the budget's economic assumptions are in line with the current average forecast (which is more pessimistic than our forecast), the events of the last year should prompt greater prudence: forecasters (including us) have had to adjust their targets often, and always to the downside. Let us hope that, starting now, the economy will start behaving as predicted – or better. Otherwise, the climb back up will be even steeper and harder than this budget suggests.

Quebec's fiscal plan (millions of dollars)

	Preliminary		Forecast	
	<u>07/08</u>	<u>08/09</u>	<u>09/10</u>	<u>10/11</u>
Revenue	62,920	62,479	62,212	64,017
Expense	61,638	63,989	66,093	68,525
Net results of consolidated orgs.	-162	205	355	563
Contingency reserve				
Budget balance for purposes of public accounts	1,120	-1,305	-3,526	-3,945
Deposits of dedicated revenues in the Generations Fund	-403	-569	-715	-880
Budgetary balance before reserve	717	-1,874	-4,241	-4,825
Deposit in the Generations Fund from the budgetary reserve	-200	-132		
Budgetary reserve	-517	2,006	295	
Budgetary balance before plan to restore fiscal balance	0	0	-3,946	-4,825
Impact of the plan to restore fiscal balance				1,065
Budgetary Balance for the purposes of the <i>Balanced Budget Act</i>	0	0	-3,946	-3,760

Source: Finances Québec, RBC Economics Research