March 28, 2017

Quebec harvests the fruits of its labour

Highlights

- Having balanced its books in 2015-16, the Quebec government expects to end fiscal 2016-17 with a surplus of $250 million. For 2017-18 and the following four fiscal years, its Financial Framework projects balanced budgets.
- Growth of consolidated revenue is budgeted at 3.7% for 2017-18 and growth of consolidated expenditure (before debt service) at 3.8%. For the subsequence four years, average annual growth is projected at 3.0% for consolidated revenue and 2.5% for consolidated expenditure.
- The budget assumes real GDP growth of 1.7% in 2017, 1.6% in 2018 and 1.5% in 2019. Nominal GDP growth is assumed at 3.3% in each of these three years. These rates are comparable to those of private-sector forecasts.
- The tax burden on individuals in 2017 is reduced $295 million, or $55 per taxpayer, by an increase in the "basic personal amount." Beginning in 2018 the basic personal amount will be indexed. In addition, the health contribution is eliminated retroactive to 2016 for taxpayers with incomes of $134,095 or less. Higher-income taxpayers will benefit from its complete elimination in 2017.
- The rates of the compensation tax for financial institutions will not be lowered on March 31 this year as previously planned. The tax itself will not end on March 31, 2019, as previously planned. Instead it is extended for three additional years.
- Other budget measures bear on educational success, economic development, public transit and health. The financial impact of the budget measures as a whole for 2016-17 and 2017-18 will amount to 0.6% of GDP.
- Investments under the Quebec Infrastructure Plan over the 10 years from 2017 to 2027 will amount to $91.1 billion.
- As at March 31, 2017, gross government debt is estimated at $203 billion, or 52.7% of GDP. The ratio of gross debt to GDP will accordingly decline for a second consecutive year, and faster than previously projected. According to preliminary results, the borrowing program for the 2016-17 year amounted to $22.7 billion, including $8.7 billion in pre-borrowing that is projected to reduce the borrowing requirement for 2017-18 to only $11.3 billion. For the following two years the government projects total borrowing of $20.6 billion in 2018-19 and $17.9 billion in 2019-20.

Quebec – 2017 Budget

Surplus of $250 million in 2016-17

Last year the Quebec government tabled a balanced budget for fiscal 2016-17. Debt service is now estimated to have cost $716 million less than budgeted. An economy stronger than expected resulted in additional revenue of $162 million (despite lower-than-expected revenue from cap-and-trade auctions). These improvements related to the state of the economy thus total $878 million. On the other hand, the government has undertaken new commitments totalling $953 million ($494 million for elimination of the health contribution, $288 million for economic development, $100 million in health and social services and $71 million in other measures). These commitments are to be funded partly by a draw of $300 million from the contingency reserve. Add in residual favourable revisions of $25 million, and the 2016-17 fiscal year is estimated to end with a surplus of $250 million.

This surplus will be allocated to the stabilization reserve, created from the fiscal 2015-16 surplus of $2.191 billion. The estimated $250-million surplus of the fiscal year now ending will bring this stabilization fund to $2.4 billion.

Balanced budget for 2017-18

For a third consecutive year, the government has tabled a balanced budget for 2017-18. Consolidated revenue is budgeted to grow 3.7%, or $3.8 billion.

In own-source revenue, personal income tax is budgeted to to grow 3.0% (+$883 million) to $30.6 billion, despite budgeted costs of $295 million for raising the basic personal amount and $211 million for elimination of the health contribution. Consumption tax revenue is budgeted to rise 2.6% to $19.7 billion. Corporate taxes are budgeted to rise 4.9% to $7.2 billion.

Contributions for health services are budgeted to grow 0.2% in 2017, reflecting in large part the elimination of the health contribution. Revenue from duties and permits is budgeted to grow 11.5% to $3.7 billion. This growth is attributable mainly to an anticipated increase in revenue from Quebec's cap-and-trade system for greenhouse-gas emission allowances, which had been disapointing in the previous year.

Revenue from government enterprises is budgeted to fall 5.7%, mainly because of the reduction of Hydro-Québec earnings by factors including adjustment of the accounting impact of application of IFRS standards and the impact of the startup of electricity generating facilities.

Federal transfers are budgeted to grow 7.5%. Equalization payments are budgeted to rise 10.5%, essentially because of an increase in the Canadian equalization envelope and a decrease in Quebec's share of the personal income tax, consumption tax and property tax bases. Other transfer programs — health, postsecondary education and social programs, and others — are budgeted to grow 10.8%, mainly because of the federal government's enhancement of the Canada Student Loans Program last year and an increase in funding for immigrant integration programs.

In sum, mission expenditures (program spending plus other consolidated expenditures) are budgeted to grow 3.8%, or $3.5 billion, from 2016-17, including $1.3 billion for new measures outlined below. Debt service is budgeted to cost $181 million less than in fiscal 2016-17.

The contingency reserve for 2017-18 is budgeted at $100 million. The resulting operating surplus (before deposit of dedicated revenues in the Generations Fund) is $196 million more than the estimate for 2016-17. However, the deposit in the Generations Fund increases by $446 million. For this reason the 2016-17 surplus of $250 million (within the meaning of the Balanced Budget Act) becomes a zero budgetary balance in 2017-18.

The contingency reserve, budgeted last year at $400 million for 2016-17, is budgeted at $100 million for 2017-18 and 2018-19. The reduction is justified by the presence of the stabilization reserve of $2.4 billion that the government could draw on if a deficit were to emerge in these two fiscal years. The contingency reserve is projected to return to $400 million in 2020-21 and $900 million in 2021-22.

Main budget measures

The budget measures taken together will have a financial impact of $1.4 billion in fiscal 2017-18. This year's budget measures also have an impact of $853 million on fiscal 2016-17. The overall fiscal stimulus thus amounts to $2.3 billion, which is 0.6% of GDP.

The tax burden of individuals is reduced $295 million in 2017 by an increase in the basic personal amount. The reduction amounts to $55 per taxpayer. Beginning in 2018 the basic personal amount will be indexed. In addition, the health contribution is elminated retroactive to 2016 for taxpayers with incomes of $134,095 or less. Higher-income taxpayers will benefit from its complete elimination in 2017. The tax burden is also reduced $167 million by extension of the Rénovert tax credit to March 31, 2018.

Apart from reduction of the individual tax burden, the main measures in the budget can be grouped under four headings.

Educational success: $194 million budgeted in 2017 for early childhood, preschool and primary and secondary schooling. Public transit: the government's plans include, beginning in 2019-20, $759 million over four years for Montreal's Réseau électrique métropolitain. Economic development: $288 million allocated in 2016-17 and $525 million in 2017-18.

The current rates of the compensation tax for financial institutions had been slated to decrease on March 31 this year and the tax itself was to end on March 31, 2019. These rates will instead remain at their present level until March 31, 2022. Thus the tax will not end in 2019.

Debt management and borrowing requirements

As at March 31, 2017, gross government debt is estimated at $203 billion, or 52.7% of GDP. The ratio of gross government debt to GDP will accordingly decline for a second consecutive year, and at a pace faster than expected (last year's budget projected a ratio of 54.7% this year). If budgets remain balanced in subsequent years, the ratio of gross debt to GDP is likely to continue declining. The target is a ratio of 45% at the end of fiscal 2025-26.

The Generations Fund has grown from $584 million in 2007, the year of the first payment into it, to $10.6 billion in 2017. The book value of the Fund is projected to reach $26.7 billion in 2021-22. The Finance Department calculates that this amount will subtract 6 percentage points from gross debt. The creation of the Generations Fund, which is dedicated exclusively to repayment of the debt, has added to the credibility of the government's debt-management plan in the eyes of credit-rating agencies over the last 10 years.

Though the ratio of gross debt to GDP will decline in 2017-18, the debt will increase by $3.8 billion. The increase is due in large part to capital investment ($3.7 billion) and investments, loans and advances ($2.0 billion).

Contributions to the Generations Fund will reduce gross debt by $2.5 billion in 2017-18. In the following year the payment into the Fund is projected at $2.8 billion.

The ratio of net debt to GDP is projected at 46.0% a year from now. By the end of fiscal 2021-22 it is projected to decline 6 percentage points to 40.0%.

According to preliminary results, the borrowing program for the 2016-17 year amounted to $22.7 billion, including $8.7 billion in pre-borrowing that is projected to reduce the borrowing requirement for 2017-18 to only $11.3 billion. For the following two years the government projects total borrowing of $20.6 billion in 2018-19 and $17.9 billion in 2019-20.

Over the last decade, the government has pre-borrowed an average $5.7 billion a year.

Conclusion

After several years of efforts to control spending growth, Quebec is harvesting the fruits of its labour. Elimination of the structural deficit, together with favourable conditions, widens the government's option room to move ahead with its plans to improve the competitiveness of the Quebec economy and reduce Quebecers' tax burden, all while maintaining budget balance out to a 2022 forecasting horizon.

For these reasons we welcome the fourth Leitao budget. It introduces a batch of development measures to enhance the growth potential of the Quebec economy and thus limit the unfavourable effect on public finances of the decline of the working-age population. Since the success of such measures can be assessed only in the medium term, we are satisfied with the more conservative assumptions made for revenue growth beyond 2019. Given the uncertain lifespan of the current economic expansion and potential changes in the formula for federal equalization payments, the projected return to a more substantial contingency reserve is consistent with counsels of prudence.

Stéfane Marion / Marc Pinsonneault

Consolidated financial framework, 2016-2017 to 2021-2022
(millions of dollars)

	2016-2017	2017-2018	2018-2019	2019-2020	2020-2021	2021-2022
Consolidated revenue						
Personal income tax	29 686	30 569	31 868	33 066	34 288	35 657
Contributions for health services	6 022	6 036	6 143	6 305	6 452	6 654
Corporate taxes	6 890	7 227	7 484	7 690	7 898	8 064
School property tax	2 164	2 257	2 327	2 385	2 452	2 528
Consumption taxes	19 188	19 681	20 077	20 431	20 927	21 376
Duties and permits	3 328	3 710	3 822	3 973	3 905	3 665
Miscellaneous revenue	9 937	10 319	10 881	11 258	11 819	12 254
Government enterprises	4 753	4 480	4 402	4 582	4 711	4 844
Own-source revenue	**81 968**	**84 279**	**87 004**	**89 690**	**92 452**	**95 042**
% change	***0.9***	***2.8***	***3.2***	***3.1***	***3.1***	***2.8***
Federal transfers	20 498	22 029	22 221	22 553	23 156	24 235
% change	*8.4*	*7.5*	*0.9*	*1.5*	*2.7*	*4.7*
Total consolidated revenue	**102 466**	**106 308**	**109 225**	**112 243**	**115 608**	**119 277**
% change	***2.3***	***3.7***	***2.7***	***2.8***	***3.0***	***3.2***
Consolidated expenditure						
Health and Social Services	−38 556	−40 223	−41 670	−42 843	—	—
Education and Culture	−21 707	−22 662	−23 433	−24 089	—	—
Economy and Environment	−12 698	−12 965	−13 352	−13 681	—	—
Support for Individuals and Families	−9 915	−9 935	−10 130	−10 265	—	—
Administration and Justice	−7 511	−8 067	−7 948	−8 039	—	—
Mission expenditures	**−90 387**	**−93 852**	**−96 533**	**−98 917**	**−101 133**	**−103 554**
% change	***4.5***	***3.8***	***2.9***	***2.5***	***2.2***	***2.4***
Debt service	−9 687	−9 868	−9 758	−10 010	−10 448	−10 834
% change	*−3.2*	*1.9*	*−1.1*	*2.6*	*4.4*	*3.7*
Total consolidated expenditure	**−100 074**	**−103 720**	**−106 291**	**−108 927**	**−111 581**	**−114 388**
% change	***3.7***	***3.6***	***2.5***	***2.5***	***2.4***	***2.5***
Contingency reserve	−100	−100	−100	−100	−400	−900
SURPLUS	**2 292**	**2 488**	**2 834**	**3 216**	**3 627**	**3 989**
BALANCED BUDGET ACT						
Deposits of dedicated revenues in the Generations Fund	−2 042	−2 488	−2 834	−3 216	−3 627	−3 989
BUDGETARY BALANCE[1]	**250**	**—**	**—**	**—**	**—**	**—**

(1) Budgetary balance within the meaning of the *Balanced Budget Act*.

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