2015 QUÉBEC BUDGET

TD Economics

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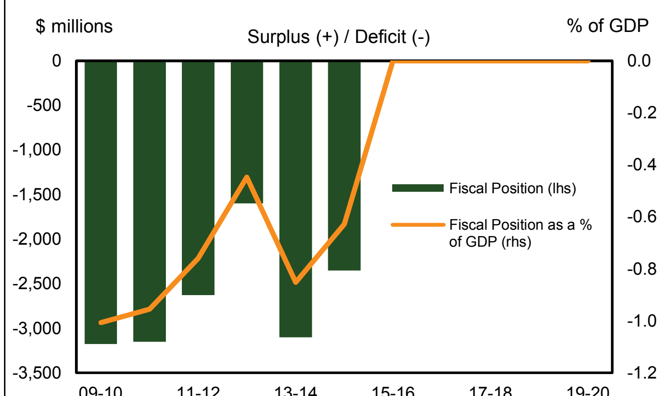
QUÉBEC GOVERNMENT KEEPS THE FISCAL TRAIN ON TRACK IN BUDGET 2015

Highlights

- The Québec government tabled its second budget today since coming to power in April 2014. The 2015 Québec Budget is the latest installment in the government's plan to return to budgetary balance. Having stayed on track since coming to office, Québec's majority Liberal government is beginning to see the light at the end of the tunnel in the form of balanced budgets forecast for fiscal 2015-16 and beyond.
- Much of the improved fiscal position can be tied to expenditure restraint. Since taking office, the government has identified $7.2 billion in needed spending restraint, and with Budget 2015 they have delivered on the final $1.2 billion of this amount.
- Underpinned by reasonable economic growth assumptions, revenues are projected to grow moderately over the next few years. The province's economy is expected to be fuelled by solid growth south of the border and a weaker loonie.
- Contributing to the revenue outlook is the implementation of some of the findings of the Québec Taxation Review Committee. The recommendations introduced in Budget 2015 include, among others, the gradual elimination of the health contribution and a reduction in the general corporate income tax rate.
- As annual budget surpluses return, gross debt is expected to crest at 54.9% of GDP in 2014-15, before gradually retreating toward sub-50% by fiscal 2019-20.

There were few surprises in today's release of the 2015 Québec Budget. As was widely expected, the Québec government delivered on its commitment made in the Fall Economic and Fiscal Update to find an additional $1.2 billion in savings. In doing so, it is projecting a balanced budget in the 2015-16 fiscal year, vaulting Québec into a very exclusive club among Canadian provinces (Chart 1). This is the first time the Québec budget has been in the black since fiscal 2008-09, although it is not expected to be the last, as the government is projecting a string of surpluses through 2019-20.

CHART 1: BALANCE* RETURNS FOR THE PROVINCE OF QUÉBEC



* Within the meaning of *Budget Balanced Act* after stabilization reserve.
Source: 2013-14 Federal Fiscal Reference Tables, Québec 2015 Budget.

Also important was the introduction of fundamental changes to Québec's tax structure, as per the recommendations of the Québec Taxation Review Committee. With a forthcoming shift to a more growth oriented tax mix, the future growth prospects for Québec have brightened. This is a welcome development given the comparatively high level of taxation and public debt in Québec, as well as the recent and prospective weakness in economic growth.

Expenditure restraint lines up with expectations

As was forecast in its Update, the Québec government estimates that it was able to restrain expenditure growth (+2.3%) to less than

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TABLE 1: QUÉBEC GOVERNMENT FISCAL POSITION [C$ millions unless otherwise noted]						
	2015 Budget					
Fiscal Year	**14-15**	**15-16**	**16-17**	**17-18**	**18-19**	**19-20**
REVENUES	**96,013**	**100,160**	**103,291**	**105,884**	**108,320**	**111,082**
% change	3.0	4.3	3.1	2.5	2.3	2.5
Own-source	77,293	80,716	83,362	85,547	87,646	89,939
% change	3.5	4.4	3.3	2.6	2.5	2.6
Federal transfers	18,720	19,444	19,929	20,337	20,674	21,143
% change	0.9	3.9	2.5	2.0	1.7	2.3
EXPENDITURES	**97,110**	**98,574**	**100,655**	**102,719**	**104,835**	**107,236**
% change	2.3	1.5	2.1	2.1	2.1	2.3
Program expenditures	86,777	88,091	89,721	91,590	93,462	95,669
% change	2.9	1.5	1.9	2.1	2.0	2.4
% of GDP	23.2	22.7	22.3	22.0	21.8	21.5
Debt charges	10,333	10,483	10,934	11,129	11,373	11,567
% change	-2.6	1.5	4.3	1.8	2.2	1.7
Total consolidated entities	**1,600**	**1,919**	**2,184**	**2,415**	**2,530**	**2,708**
Contingency Reserve	-	-	-400	-400	-400	-400
SURPLUS (DEFICIT)	**-1,097**	**1,586**	**2,236**	**2,765**	**3,085**	**3,446**
% of GDP	-0.3	0.4	0.6	0.7	0.7	0.8
Generations Fund deposits	1,253	1,586	2,236	2,765	3,085	3,446
BUDGETARY BALANCE*	**-2,350**	**0**	**0**	**0**	**0**	**0**
% of GDP	-0.6	0.0	0.0	0.0	0.0	0.0
NET DEBT	**190,402**	**193,002**	**194,030**	**193,067**	**191,466**	**189,370**
% of GDP	50.7	49.5	48.1	46.3	44.5	42.6
GROSS DEBT	**206,185**	**210,468**	**214,089**	**216,538**	**218,490**	**219,750**
% of GDP	54.9	54.0	53.1	51.9	50.7	49.4
ACCUMULATED DEFICITS	**124,786**	**123,200**	**120,964**	**118,199**	**115,114**	**111,668**
% of GDP	33.2	31.6	30.0	28.4	26.7	25.1

* Budgetary balance within the meaning of the *Balanced Budget Act* after contributions towards the Generations Fund.
Sources: Québec Budget 2015.

that of revenues (+3.0%) in 2014-15 (Table 1). It was also able to identify an additional $1.2 billion in new measures in fiscal 2015-16, beyond the $6.1 billion already announced, with over one-third of total savings coming from cuts to government departments and enterprises (Table 2). These initiatives included but are not limited to (fiscal impact in parentheses):

- 20% reduction in tax credit rates ($270 million);
- Adjustment to childcare funding ($193 million);
- Elimination of preferred tax rate on some capital of insurance corporations ($128 million);
- Temporary surtax on financial institutions ($125 million);
- Elimination of reduced tax rate on auto insurance premiums ($116 million); and
- Reduction of the conversion rate for tax credits for union and professional dues ($112 million).

In light of continued belt tightening, expenditure growth is expected to advance by a modest 1.5% in fiscal 2015-16, less than half the expected growth rate of revenues. Expenditures in fiscal 2016-17 aren't expected to advance much faster (+2.1%). Furthermore, after identifying $2.3 billion in savings in its preliminary report, the Ongoing Program Review Committee is set to submit its final report in June 2015, with more savings to come.

This said, the planned investments in the 2015-2025 Québec Infrastructure Plan have been left unchanged at $88.4 billion, as the Québec government views this as providing a powerful stimulus for economic activity and job creation. This equates to an annual level of investment similar to that observed around the time of the 2008-09 recession. Indeed, in order to meet new priorities over the short term, the government has accelerated investment by $1.4 billion (from the existing allocation) over the next four years.

TABLE 2: MEASURES FOR RETURNING TO A BALANCED BUDGET ($ Millions)		Share of identified effort
Budgetary Balance Before Measures - Budget 2014-15	**-7,274**	
Control of government spending	3,078	
Reduction of tax expenditures	348	
Use of the contingency reserve	200	
Total measures - Budget 2014	**3,626**	**50%**
Control of government spending		
Reduction of the cost of public services	1,125	
Program review measures	736	
Reduction of tax expenditures	600	
Total measures - Update 2014	**2,461**	**34%**
Total Measures Budget 2015	**1,187**	**16%**
Total for measures identified	**7,274**	**100%**
Budgetary Balance - Budget 2015-16	**-**	

* Within the Meaning of the Balanced Budget Act.
Source: Québec Budgets 2014 and 2015.

Revenue growth to outpace expenditures...

Relative to the Update, the projection of own-source revenues was adjusted downward in fiscal 2014-15 through 2016-17, as lower expected personal income tax revenues more than offset higher forecast for revenues from consumption taxes. In contrast, federal transfers are forecast to be slightly higher, although this poses a notable risk to Québec's equalization payments in an environment where it is one of a minority of provinces expected to be in a balanced budget position.

In fiscal 2014-15, revenues are estimated to be $96.0 billion, an increase of 3.0% over the prior year. Momentum is expected to increase into fiscal 2015-16, with the overall take forecast to increase by 4.3% as a result of stronger nominal GDP growth (Table 3). Indeed, excluding government enterprises, growth in own-source revenues is projected to rise by 5.3% in 2015-16, as a result of changes in economic activity and the effects of the revenue measures implemented. All told, beyond fiscal 2015-16, the Québec government is projecting revenues to advance by 2.6% annually, on average, through 2019-20, besting the 2.2% annual increase expected for expenditures.

...but the best is yet to come

Built into the revenue projections are a subset of the recommendations of the Québec Taxation Review Committee. The final report of this Committee was music to the ears of most economists, as it reads like a 'how-to' guide for the development of a more efficient tax regime. The changes to Québec's system of taxation could be a game changer for its economy. Lower taxes on workers and businesses are expected to provide added incentives to work, invest, and hire. However, as one of the goals of these recommendations was to be revenue neutral, they won't come without some pain, in the form of higher consumption taxes and a reduction in available tax expenditures.

Highlights of the recommendations that were announced in today's budget include (cumulative fiscal impact in parentheses):

- Easing of the tax burden on individuals, notably through the gradual elimination of the health contribution (-$2.0 billion);
- Easing of the tax burden on corporations, such as a lowering of the general corporate income tax rate (-$0.5 billion);
- New initiatives to stimulate private investment (-$0.4 billion);
- New initiatives for communities and culture (-$0.3 billion); and
- New initiatives to foster the performance of the labour market (-$0.2 billion).

Together, these measures are expected to provide a cumulative $3.4 billion in tax relief from fiscal 2015-16 through 2019-20, although most of this relief is going to come toward the end of the projection. And more measures are expected to be introduced in the coming years, such as further reductions in personal income taxes balanced against higher taxes on consumption.

Balanced budgets to lower Québec debt burden

As a result of these tax measures, own-source revenue growth is expected to be stronger than would otherwise be

TABLE 3: QUÉBEC ECONOMIC ASSUMPTIONS
[% change unless otherwise noted]

	2015 BUDGET		
Calendar Year	**2014**	**2015**	**2016**
Real GDP	1.5	2.0	2.0
Nominal GDP	3.5	3.8	3.4
Household income	2.7	3.4	3.3
Employment rate (%)	59.7	59.8	59.9
Unemployment rate (%)	7.7	7.5	7.3
Population (000s)	8,215	8,282	8,348
Housing starts (000s)	38.8	36.8	35.7
3-month T-bills (%)	0.9	0.6	0.9
10-year bonds (%)	2.2	1.7	2.6

Source: Québec Budget 2015.

the case. When combined with continued expense control measures, which will keep expenditure growth below that of revenues over the outlook, the Québec government is forecasting a fiscal balance every year beginning in fiscal 2015-16. Furthermore, these budgetary objectives will be met while maintaining deposits of dedicated revenues in the Generations Fund, as per Québec's Balanced Budget Act.

In light of prospects for balanced budgets beginning in fiscal 2015-16, the government is expected to make headway on addressing its debt burden. This progress will be supported by continued low interest rates, which will constrain growth in the debt service costs. Taken together, the increased debt accumulation posted in recent years is likely to ultimately reverse. Gross debt is expected to crest at 54.9% of GDP in fiscal 2015-16, before gradually declining thereafter. Ultimately, the government is projecting the gross debt-to-GDP ratio will fall to 49.4% by 2019-20, thereby putting Québec well on its way to reaching its goal of 45% gross debt-to-GDP by 2025-26.

Bottom line

The Québec government has delivered its promised balanced budget in 2015-16 and every fiscal year thereafter. As a result, the debt-to-GDP ratio is expected to start coming down in fiscal 2015-16, marking the beginning of a new fiscal era for Québec.

Beyond the near-term budget balance, Budget 2015 also contained bold changes to the Québec tax system, which should be supportive of economic growth and fiscal performance over the longer run.

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