

Budget Highlights

Pension Reform and Deficit Reduction

Fiscal Year 11/12
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The Province of Quebec is projecting a \$3.8 bln deficit in FY11/12 and continues to target a balanced budget by FY13/14, while introducing changes to its pension system. At 1.1% of GDP, the coming year's deficit remains modest compared to those of the mid-1990s. The Province will restrain spending, and revenue-raising measures, most of which were implemented in last year's budget, will continue to take effect, leading to a balanced budget in FY13/14. However, the plan still leaves \$1 bln in "measures to be identified" in that fiscal year, little changed from the amount estimated in the fall. The FY10/11 deficit now stands at \$4.2 bln,

an improvement from the \$4.6 bln estimated in the Fall Update and \$4.5 bln projected in last year's budget. However, the FY11/12 deficit is larger than the \$3.2 bln projected in the fall and the \$2.9 bln projected last year. The deterioration in the past year comes as a \$1.2 bln revenue improvement is offset by higher spending, the addition of a \$300 mln contingency reserve, and \$311 mln in unidentified measures.

Total revenue is expected to rise 4.8% to \$65.4 bln in FY11/12, with own-source revenue rising 7.3%, owing to higher tax receipts—consumption taxes will lead the way with a 15.9% jump thanks to another 1 ppt QST hike at the start of 2012 (the first took place in January, as implemented in last year's budget). Federal transfers will total \$15.0 bln, down 2.7% from the prior year. New revenue-related measures include an **increase in tuition fees** totaling \$375 per year for the next five years (for a cumulative 75% increase when all is said and done). This, along with increased government funding, will ultimately raise \$850 mln for universities by FY16/17. **The royalty structure for shale natural gas is changing** from a fixed rate system (currently either 10% or 12.5%) to a sliding scale based on prices and productivity—the royalty maxes out at 35% when prices reach \$15/Mcf, and volume is at 2,500 Mcf/d. Note that only 1% of Quebec's total revenue came from natural resources in FY09/10, and the changes will only take place once the current environmental assessment is completed.

Fiscal Outlook

(C\$ millions)

	estimate		forecast	
	10/11	11/12	12/13	13/14
Revenues	62,376	65,378	69,087	72,087
Expenditures	66,753	69,078	70,759	72,659
Program Spending	59,819	61,284	62,113	63,325
Debt Service	6,934	7,794	8,646	9,334
Consolidated entities	1,209	1,143	1,119	655
Public Accounts Balance	(3,168)	(2,557)	(553)	83
Contingency Reserve	(300)	(300)	(200)	—
Generations Fund	(732)	(940)	(1,047)	(1,108)
Unidentified Measures	—	0	300	1,025
Consolidated Balance*	(4,200)	(3,800)	(1,500)	0

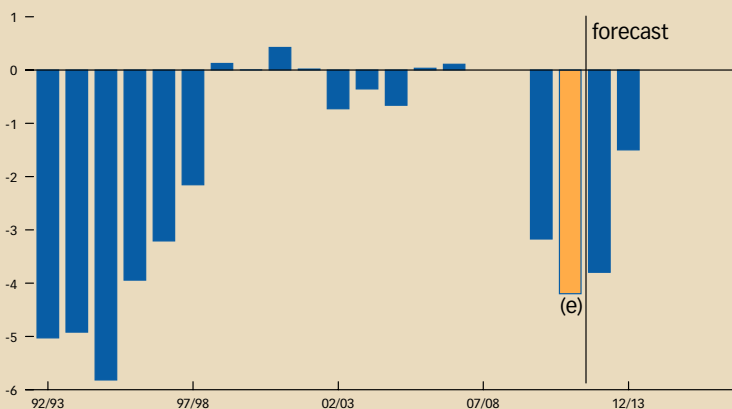
() = deficit

Note: Totals may not add due to rounding.

 * For the purposes of the *Balanced Budget Act* Source: Provincial forecasts

Budgetary Balance

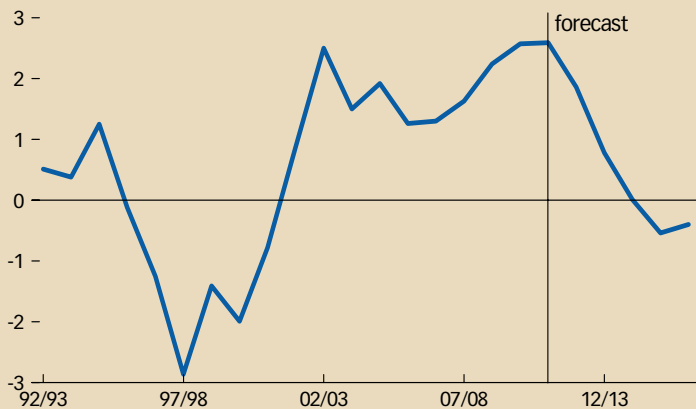
(\$ billions)



Source: Provincial forecasts

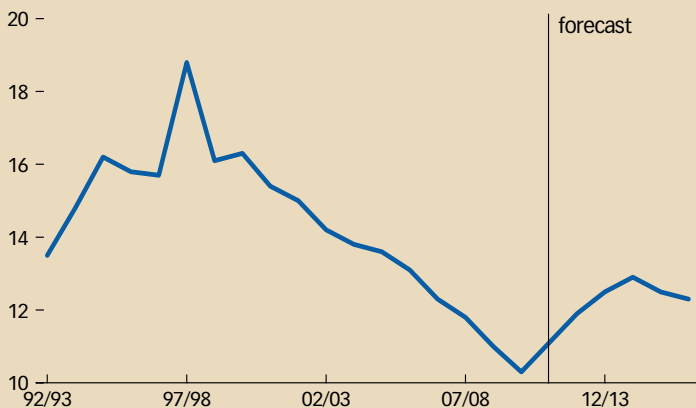


Real Program Spending per Capita
(5-year annualized % chng)



Source: Provincial forecasts

Debt Service Cost
(% of total revenue)



Source: Provincial forecasts

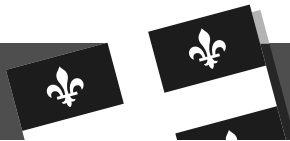
The Province is also making significant changes to its pension system beginning in January 2012, including the following: **1) An increase in the annual QPP contribution rate** to 10.8% from 9.9% over six years (this will ultimately cost a Quebecer earning \$40,000 an additional \$164 per year). **2) Changes to the adjustment factors for early/late retirement.** Currently, pensions are increased/reduced by 0.5% per month for retirement after/before age 65. Now, the incentive to retire later will be greater (the factor increases to 0.7%), as will the penalty to retire earlier (the factor will be phased in to 0.6% by 2016). This means that someone retiring at 65 will see no change to his/her pension, someone retiring at 70 will see a 9% higher maximum pension than previously, while someone retiring at 60, at a \$35,000 income level, will see a 6% lower pension. **3) Automatic changes to the contribution rate to meet the steady state contribution rate** (this will not apply until 2018, and will be limited to 0.1% per year). **4) The introduction of a voluntary retirement savings plan**, in which employees with no pension will be automatically enrolled (and have the option to opt out).

Total spending is slated to rise 3.5% to \$69.1 bln in FY11/12, with program spending increasing 2.4%. Health care and education will see firm growth of 3.6% and 2.2%. However, spending restraint efforts are ongoing, and program spending growth will be targeted at 2.5% per year over the five-year forecast horizon. This represents a contraction of about 0.4%

per year on a real per-capita basis, quite a bit less aggressive than was seen during the mid-1990s.

Quebec's total borrowing requirements will be \$17.4 bln in FY11/12 versus \$18.9 bln in the prior year, and dipping again to \$15.0 bln in FY12/13. Borrowing for the Consolidated Revenue Fund and Financing fund will be \$9.4 bln and \$4.5 bln, respectively, while Financement-Quebec will borrow \$3.5 bln. **Quebec's gross debt will rise \$10.3 bln to \$183.8 bln by the end of FY11/12, or 55.7% of GDP.** The ratio will peak there before falling to 53.6% by 2016. The higher debt load will lift debt servicing costs to 11.9% of total revenues in FY11/12, rising to 12.9% by FY13/14, still comfortably below the late-1990s high of almost 19%, but susceptible to an increase in interest rates.

Economic growth in Quebec is expected to moderate in the coming year, as the strong Canadian dollar weighs on exports and fiscal restraint begins to bite. Real GDP growth should mellow to 2.7% in 2011 and 2.5% in 2012, from an estimated 2.9% rate last year. Interestingly,



Quebec is in a rare position of having a jobless rate (7.7% in February) below the 10-year average (8.2%), and now consistently below that of Ontario—the latter feat stems from a milder hit to employment during the recession and slightly slower labour force growth in recent years. **The Province has built conservative growth assumption into this budget** of 2.0% in 2011 and 2.2% in 2012, which we deem achievable.

The Bottom Line: Through a combination of prior tax increases and planned spending restraint, the Province of Quebec is planning to balance the budget by FY13/14. Still, more than \$1 bln worth of measures need to be identified by that time, leaving some work still to be done.

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