BUDGET 2017-2018

THE QUÉBEC
ECONOMIC
PLAN

GENERATIONS FUND

A Renewed Commitment to Fostering Intergenerational Equity

Québec

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Budget 2017-2018
Generations Fund – A Renewed Commitment to Fostering Intergenerational Equity

Legal deposit – March 28, 2017
Bibliothèque et Archives nationales du Québec
ISBN 978-2-550-78059-5 (Print)
ISBN 978-2-550-78060-1 (PDF)

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TABLE OF CONTENTS

List of charts

List of tables

INTRODUCTION

In 2006, the government was faced with a substantial debt, owing largely to decades of budgetary deficits. Given the demographic change that Québec also had to address, the government realized that it had to take action on the debt in order to foster intergenerational equity and ensure that social programs would be sustainable.

To achieve that objective, the government adopted debt reduction targets and created the Generations Fund. This commitment was included in a law passed almost unanimously[1] in the National Assembly, making it possible to:

— engage in a sustainable approach to debt reduction;

— determine which resources dedicated to the Generations Fund would be devoted to repaying the debt.

Today, Québec's debt remains high and continues to deprive the government of major resources that must be devoted to debt service. This situation amplifies the challenges that Québec must still address.

— The demographic change announced in 2006 is now a reality.

— The need to renew and modernize public infrastructure continues to exert pressure on the debt.

— Québec is not immune to an economic slowdown. In fact, it still has to contend with an uncertain global economic environment.

The last few years have shown that Québec is on the right track; fiscal balance has been restored in a sustainable fashion, which is a crucial first step in reducing the debt burden.

Efforts to reduce the debt must continue. Québec's ability to make collective choices is at stake.

In that regard, the Generations Fund is the most powerful instrument of intergenerational equity ever adopted by a government. Every deposit in the Generations Fund is made with young Quebecers foremost in mind.

The objective of this paper is to renew the government's commitment to reduce the debt by continuing to make deposits in the Generations Fund.

— The first part reiterates the importance of continuing to pursue efforts to reduce the debt.

— The second part provides a picture of the Generations Fund after ten years of existence.

[1] Three Members of the National Assembly voted against the passage of the *Act to reduce the debt and establish the Generations Fund*.

1. A COMMITMENT TO CONTINUED DEBT REDUCTION EFFORTS THROUGH THE GENERATIONS FUND

In the March 2010 budget, the government set the debt reduction objectives that must be achieved by 2025-2026. These objectives have been included in the *Act to reduce the debt and establish the Generations Fund*. For fiscal 2025-2026:

- the gross debt must not exceed 45% of GDP;
- the debt representing accumulated deficits must not exceed 17% of GDP.

Debt reduction continues to be a government priority. Indeed:

- Québec's debt remains high compared to that of the other Canadian provinces;
- the substantial debt service that this entails deprives the government of resources for funding public services;
- an overly high level of debt curbs economic growth and the rise in living standards.

In addition, reducing the debt burden enables Québec to gain leeway for meeting continuing challenges:

- the demographic change, which is slowing growth of the labour pool;
- the need to maintain a high level of investment spending on infrastructure;
- the need to prepare for an economic slowdown that could result from the global economic situation.

The results of recent years are encouraging. The debt burden has started to decline.

The sums accumulated in the Generations Fund reduce the level and weight of the debt by an equivalent amount. Therefore, it is necessary to continue efforts to achieve the debt reduction objectives.

The March 2017 Québec Economic Plan renews the government's commitment to meeting the debt reduction targets by 2025-2026. To that end, it will continue to devote the projected amounts every year to the Generations Fund in order to reduce the debt.

The *Act to reduce the debt and establish the Generations Fund*.

The *Act to reduce the debt and establish the Generations Fund* (CQLR, chapter R-2.2.0.1) was passed on June 15, 2006. This Act set debt reduction targets and established the Generations Fund, a fund dedicated exclusively to repaying the gross debt.

The Act also specifies the revenue sources dedicated to the Generations Fund for repayment of the debt.

The Act also allows the government to order that a part, which it establishes, of any sum that would otherwise have been attributed to the General Fund of the Consolidated Revenue Fund be allocated to the Generations Fund.

The sums constituting the Generations Fund are deposited with the Caisse de dépôt et placement du Québec and managed in accordance with an investment policy determined by the Minister of Finance in collaboration with the Caisse.

1.1 A debt that remains high

1.1.1 Québec's public debt: current situation

With the achievement of fiscal balance as of 2015-2016, annual deficits no longer raise the level of the debt. However, Québec's debt remains high.

— The gross debt, which represents debt contracted on financial markets, is the second highest in Canada.

— The "grocery" debt, arising from current deficits rather than borrowings to fund assets such as infrastructure, is still the highest in Canada.

In fact, Québec's gross debt as a percentage of GDP is the highest in Canada after that of Newfoundland and Labrador.

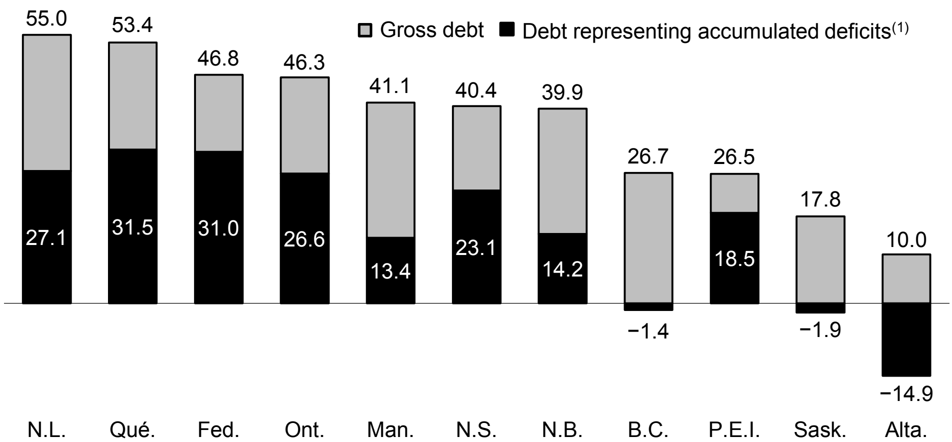
— As at March 31, 2016, Québec's gross-debt-to-GDP ratio stood at 53.4%, while the average of the Canadian provinces was 37.7%, which corresponds to a difference of 15.7 percentage points.

In addition, the debt representing accumulated deficits as a percentage of GDP is higher in Québec than in the rest of Canada.

— Québec's ratio of debt representing accumulated deficits to GDP was 31.5% as at March 31, 2016, while the average of the Canadian provinces was 15.3%, which corresponds to a difference of 16.2 percentage points.

CHART 1

Gross debt and debt representing accumulated deficits as at March 31, 2016
(percentage of GDP)



(1) A negative entry means that the government has an accumulated surplus.
Sources: Governments' public accounts and Statistics Canada.

❑ An improvement since 2010

Even though the debt is still high, Québec has improved its relative position.

— The gross debt has grown at a rate below the Canadian average. It represents 53.4% of GDP in Québec compared to an average of 37.7% in Canada. This corresponded to a difference of 15.7 percentage points in 2016, compared to a difference of 19.4 percentage points in 2010, that is, a ratio of 51.9% in Québec and 32.5% on average in Canada.

— In addition, the size of the "grocery" debt was reduced in Québec from 34.7% of GDP to 31.5% between 2010 and 2016, whereas it increased elsewhere in Canada, from 12.3% to 15.3%.

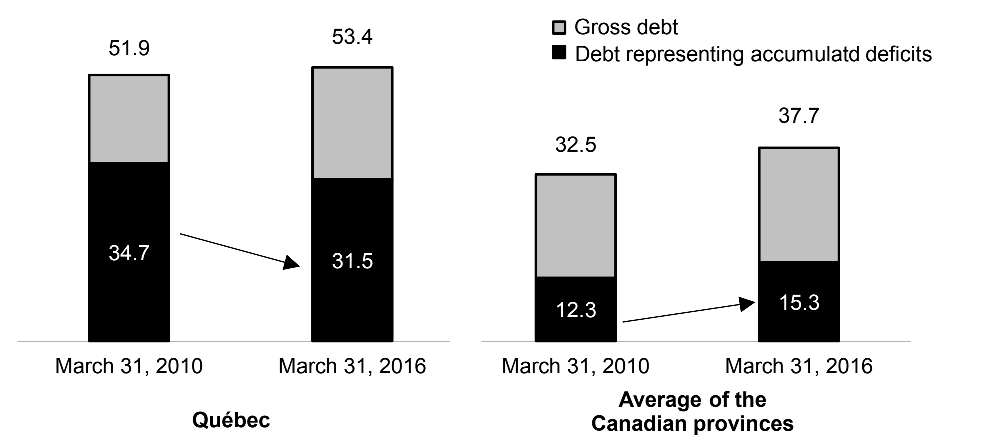
Even though Québec's "grocery" debt is still the highest in Canada, the situation has improved since 2010.

— In fact, the burden of debt representing accumulated deficits fell from 34.7% to 31.5% between March 31, 2010 and March 31, 2016, despite the fact that the gross debt burden increased.

— Over the same period, the increase in the gross debt burden from 51.9% to 53.4% is explained mainly by government investments in infrastructure, which provide benefits for the public over many years and increase the economy's ability to produce wealth.

CHART 2

Comparison of Québec's debt in 2010 and 2016
(percentage of GDP)



Good debt and "grocery" debt

Not all debt is bad per se for a government; instead, it is the reasons why a government incurs debt that may be more or less fair for future generations.

Debt is fully justified when it is used to fund public services or investments that generate benefits over many years.

- For instance, spending on infrastructure (e.g. roads, buildings) provides benefits for the public that extend over the useful life of such assets. Furthermore, it increases the economy's ability to produce wealth.
- As well, capital outlays in government enterprises that are used to fund productive investments, in particular Hydro-Québec dams, contribute to economic development and thus to society as a whole for the future.

On the other hand, using debt to fund current expenditures is not fair to future taxpayers who will bear the financial charges of services from which they will enjoy little benefit.

- Debt accumulated to fund current expenditures, that is, the "grocery" debt, is recorded as debt representing accumulated deficits.

In addition, when a government is faced with a substantial temporary slowdown in economic activity and falling tax revenues, it may run deficits and increase its debt in order to avoid having to temporarily reduce the level of public services and in order to support economic growth. In such situations, the size and duration of the deficits should be limited.

In Québec, a significant portion of the government's debt stems from past deficits. However, the debt representing accumulated deficits is declining; it will go from 32.7% of GDP as at March 31, 2015 to 22.2% of GDP as at March 31, 2022.

Change in the debt representing accumulated deficits of the Québec government as at March 31
(millions of dollars)

	2015	2016	2017	2018	2019	2020	2021	2022
Debt representing accumulated deficits	121 268	120 121	118 079	115 591	112 757	109 541	105 914	101 925
% of PIB	*32.7*	*31.5*	*30.1*	*28.5*	*26.9*	*25.3*	*23.7*	*22.2*

Factors responsible for the growth in the gross debt

The main factors responsible for the growth in the gross debt are the government's investments in fixed assets (infrastructure) and its enterprises (e.g. Hydro-Québec).

Every year, the government borrows money on financial markets in order to fund capital investments.

The government also invests in its enterprises. Such investments may be made through advances, capital outlays or by allowing government enterprises to keep part of their net earnings.

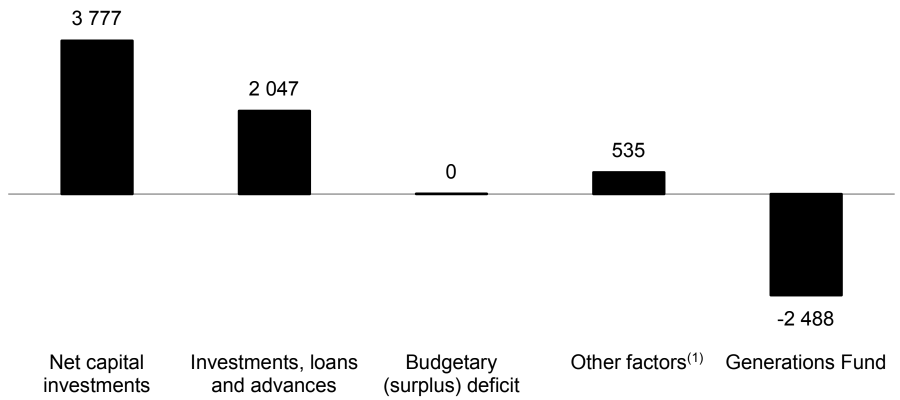
- For example, Hydro-Québec pays the government every year a dividend corresponding to 75% of its net earnings. Hydro-Québec uses the portion of net earnings (25%) not paid to the government to fund its own investments, particularly hydro-electric dams. For the government, this constitutes an investment in Hydro-Québec that creates a financial requirement and thus leads to an increase in the gross debt.

A budgetary deficit also leads to an increase in the gross debt. Conversely, a budgetary surplus, such as the budgetary surplus of $2.2 billion recorded in 2015-2016, leads to a reduction in the gross debt.

The deposits made annually in the Generations Fund reduce the gross debt.

For instance, in 2017-2018, the gross debt will increase by $3.9 billion, mainly because of capital investments[1] and investments, loans and advances.

Factors responsible for the growth in the gross debt in 2017-2018
(millions of dollars)



(1) Other factors include in particular the change in other accounts, such as accounts receivable and accounts payable.

1 These are net capital investments, which consist of gross investments minus depreciation expenses. Even though gross investments have an impact on the gross debt, net capital investments are presented in the factors responsible for the growth in the gross debt due to the fact that depreciation expenses are presented in the budgetary balance. In 2017-2018, gross capital investments will amount to $7 643 million and depreciation expenses to $3 866 million, for a total of $3 777 million in net investments.

❑ Catching up with the 2010 projections

The budget forecasts that the reduction targets for the gross debt will be met by 2025-2026.

— The gross debt burden as a percentage of GDP will be reduced from 52.7% as at March 31, 2017 to 45% as at March 31, 2026.

— The difference to be made up over the next nine years is larger than forecast in 2010.

Indeed, compared with the projections made when the debt reduction targets were adopted in the March 2010 budget, the reduction of the debt burden is behind schedule.

— The gross debt as at March 31, 2017 will stand at 52.7% of GDP, or 2.0 percentage points more than the March 2010 projection.

— However, the difference compared to the March 2010 projections is declining; it was 2.9 percentage points as at March 31, 2015.

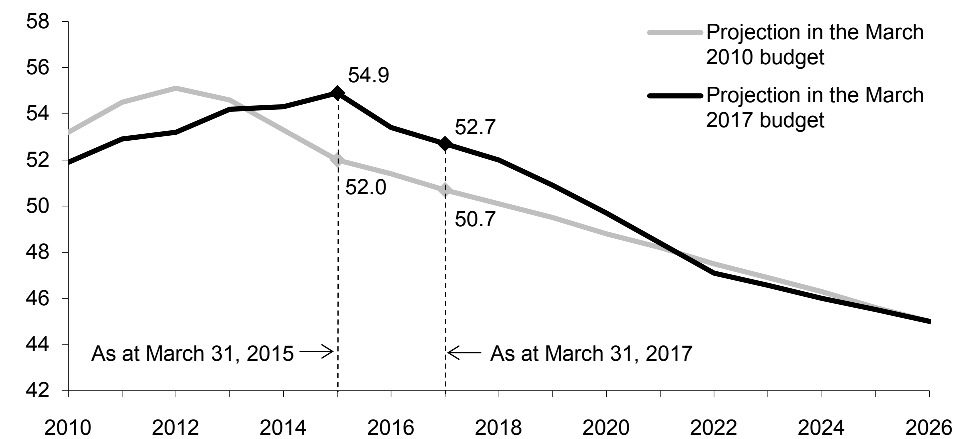
This difference is mainly attributed to:

— the two-year postponement of the return to a balanced budget, announced in 2013. Indeed, in the March 2010 budget, the return to a balanced budget was forecast for 2013-2014, whereas it was achieved in 2015-2016. This means that six years of deficits, from 2009-2010 to 2014-2015, were recorded rather than four;

— inclusion in the government's gross debt of the debts of the health and social services and education networks contracted in their own name. This accounting change was made in December 2010.[2]

CHART 3

Adjustment to the gross debt as at March 31
(percentage of GDP)



2 For more details, see Appendix 2 of this document.

1.1.2 **A high level of debt service**

A large debt leads to a high level of debt service. Debt service corresponds to the amount of interest that must be paid annually on the debt. Higher amounts reduce the government's financial capacity to fund public services.

— Every dollar devoted to debt service is one dollar less for increasing public services.

— Debt service is especially constraining when it stems from debt contracted to fund current expenditures, because it is not associated with any assets such as infrastructure investments that increase the economy's ability to produce wealth.

❑ Comparison with other Canadian jurisdictions

In 2017-2018, debt service is expected to stand at $9.9 billion, which represents 9.3% of the government's revenues as a whole.

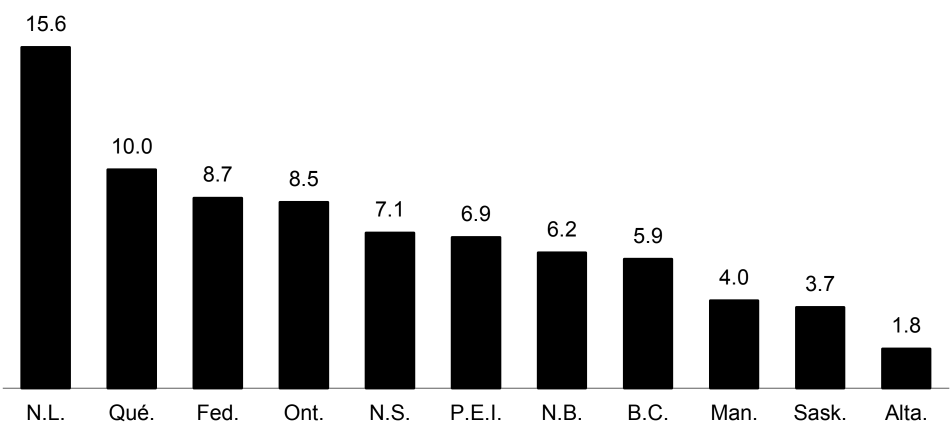
— For every dollar the government collects, 9.3 cents will be devoted to paying the interest on the debt.

— This represents $27 million less per day to fund public services.

After Newfoundland and Labrador, Québec had the highest debt-service-to-revenue ratio in 2015-2016.

CHART 4

Debt service of governments in Canada in 2015-2016
(percentage of revenue)



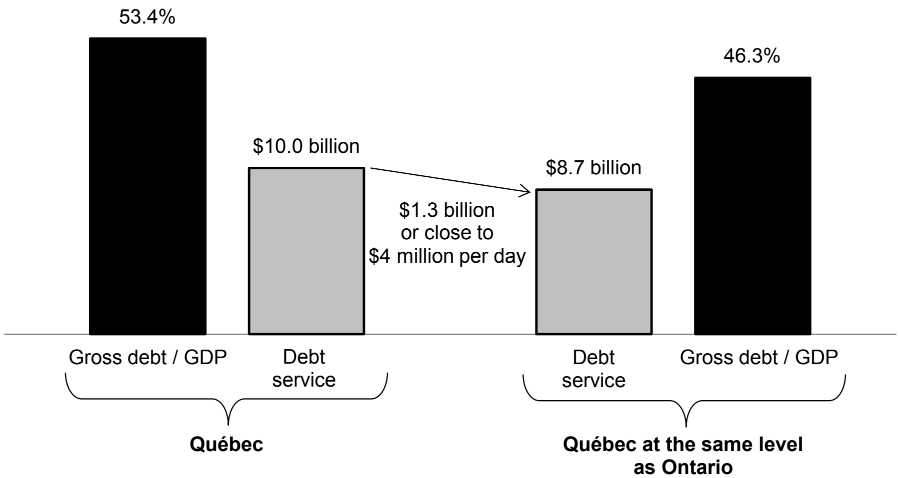
Sources: Governments' public accounts.

A high level of debt service reduces the government's financial capacity

In 2015-2016, Québec's debt service stood at $10.0 billion, for a gross-debt-to-GDP ratio of 53.4% as at March 31, 2016.

If, as at March 31, 2016, Québec had had a gross-debt-to-GDP ratio equal to that of Ontario (46.3%), Québec's debt service would have amounted to $8.7 billion, or $1.3 billion less. This would represent close to $4 million more per day for funding public services.

Gross debt and debt service in 2015-2016



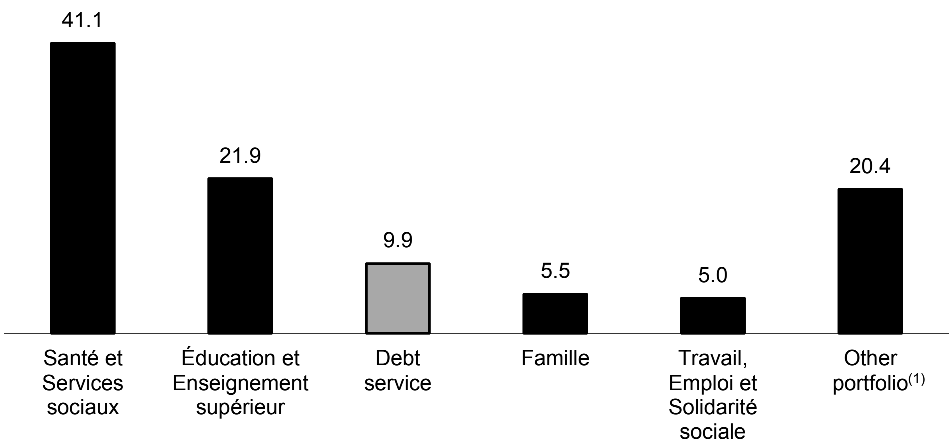
❑ Debt service: the government's third largest expenditure item

Debt service is the third largest expenditure item after health and education.

— Québec has to cover expenditures for debt service that represent nearly half of those incurred in education.

CHART 5

Consolidated expenditure by departmental portfolio in 2017-2018
(billions of dollars)



(1) Includes the 16 other departmental portfolios, including Transport, Mobilité durable et Électrification des transports and Affaires municipales et Occupation du territoire.

1.1.3 The impact of a large debt on public finances and the economy

A debt that is overly high represents a constraint for both public finances and the economy.

❑ A large debt increases vulnerability to a rise in interest rates

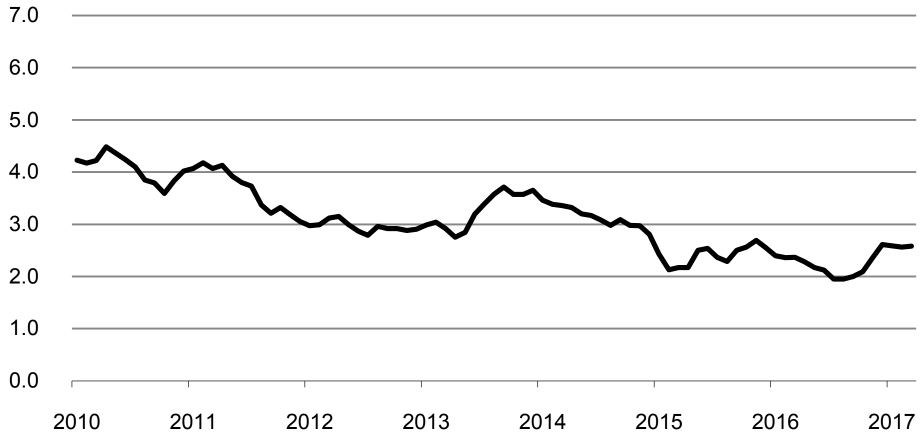
A large debt makes public finances more vulnerable to a rise in interest rates. In recent years, Québec, like many other jurisdictions, has benefited from low interest rates.

— However, interest rates are expected to climb gradually over the coming years, thus increasing debt service.

Even though the debt service forecast takes into account a gradual climb in interest rates, a greater-than-anticipated rise in interest rates of 1 percentage point over a full year would increase the interest expenditure by roughly $250 million.

CHART 6

Yield on the Québec government's 10-year securities
(per cent)



Source: PC-Bond.

❑ A large debt leads to higher borrowing costs

Québec issues bonds to finance its debt. Bond issuers like the Québec government must obtain a credit rating from credit rating agencies. A credit rating measures a borrower's capacity to pay the interest on its debt and repay the principal at maturity.

To establish the credit rating of a borrower, credit rating agencies analyze a series of factors, including:

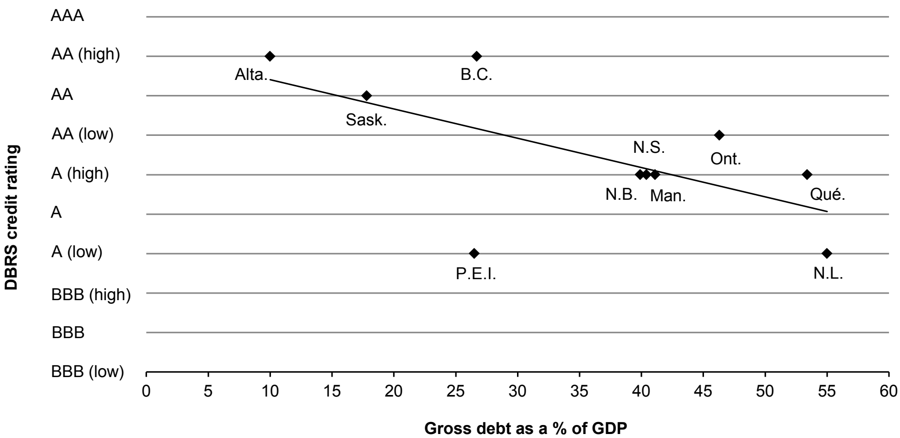
- the size of the economy;
- the extent to which the economy is diversified;
- the situation on the labour market;
- fiscal competitiveness;
- the budgetary situation;
- debt and liquidity levels.

Generally speaking, the more indebted a government is, the lower will be the credit rating assigned to it by credit rating agencies. In the case of bonds associated with a less favourable credit rating, thus riskier bonds, investors will require a higher yield, that is, a higher risk premium.

The yield required by investors corresponds to the cost of the government's borrowings. Therefore, Québec's credit rating has an impact on its borrowing costs, that is, the interest payable on its debt.

CHART 7

Relationship between the provinces' indebtedness and credit rating in 2016



Sources: DBRS and Ministère des Finances du Québec.

❑ A large debt limits economic growth

An overly high level of debt curbs economic growth and the rise in living standards.

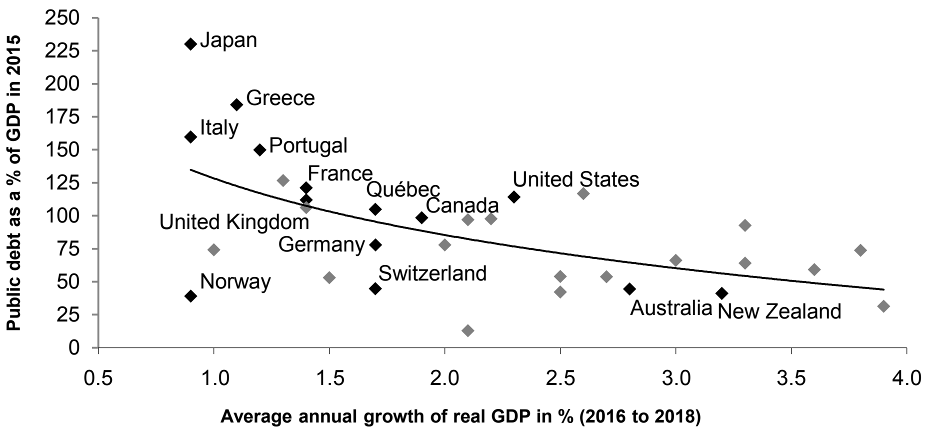
Indeed, a high public debt causes uncertainty as to the tax burden and public services in the future.

— This uncertainty can hamper the ability to attract and retain businesses and skilled labour.

Conversely, a smaller debt fosters a climate of confidence that is conducive to investment and growth in productivity, and thus economic growth.

CHART 8

Economic growth and public debt



Note: According to the methodology used by the OECD, Québec's public debt stood at 104.8% of GDP in 2015. This corresponds to the debt of all levels of public administration. It includes all of the Québec government's liabilities (except the net liabilities in respect of the retirement plans and employee future benefits), the debt of municipalities and a portion of the federal government's debt.

Sources: OECD and Ministère des Finances du Québec.

1.2 Reducing the debt in order to address continuing challenges

The factors that led to the establishment of a debt reduction objective are still present:

- the demographic change, which is slowing growth of the labour pool;
- the need to renew and modernize public infrastructure, which requires keeping investments at high levels that have an impact on the debt;
- the need to prepare for a possible economic slowdown, which could result from a deterioration of the global economic environment.

The debt has to be reduced in order to gain the leeway needed to address these challenges. This is crucial for preserving Québec's ability to make choices in the coming years.

1.2.1 The demographic change

Québec's demographic change will lead to more moderate growth of the labour pool. This will exert pressure on public finances and Québec's economy over the medium term.

❑ Population aging

Québec's population is aging, chiefly because of an increase in the number of older people owing in particular to increased life expectancy, coupled with limited growth in the number of people aged 15 to 64.

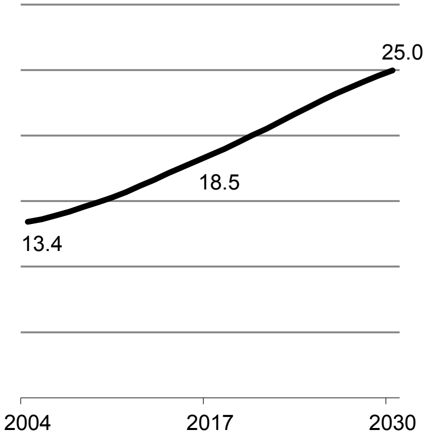
— The proportion of people aged 65 and over in the total population has grown from 13.4% in 2004 to 18.5% in 2017.

The phenomenon of population aging is expected to continue over the coming years as the members of the baby boom generation gradually reach 65.

— The proportion of people aged 65 and over is expected to reach 25.0% in 2030.

CHART 9

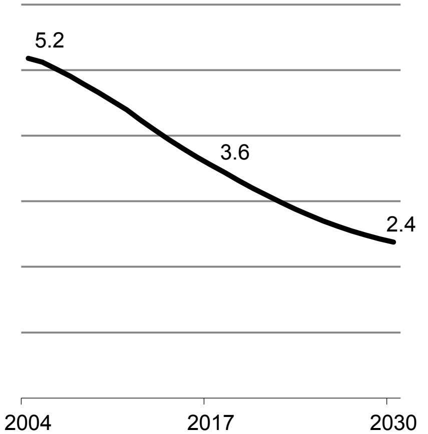
Proportion of people aged 65 and over in the population as a whole
(per cent)



Sources: Institut de la statistique du Québec, Statistics Canada and Ministère des Finances du Québec.

CHART 10

Ratio of people of working age (15-64) to people aged 65 and over
(number)



Sources: Institut de la statistique du Québec, Statistics Canada and Ministère des Finances du Québec.

In tandem with the increase in the number of people aged 65 and over, demographic change is leading to a decrease in the number of people aged 15 to 64. The people in this latter age group make up the bulk of the potential labour pool.

- According to the most recent demographic projections of the Institut de la statistique du Québec, the population between the ages of 15 and 64 will decline by about 0.2% per year between now and 2025. This decrease will result in lower economic growth potential.

Therefore, the ratio of the number of people generally of working age (15-64) to the number of older people (65 and over) will decline over the coming years.

- While this ratio stood at 5.2 in 2004, it has fallen gradually, reaching 3.6 in 2017. It is expected to stand at 2.4 in 2030.

Debt per person aged 15 to 64

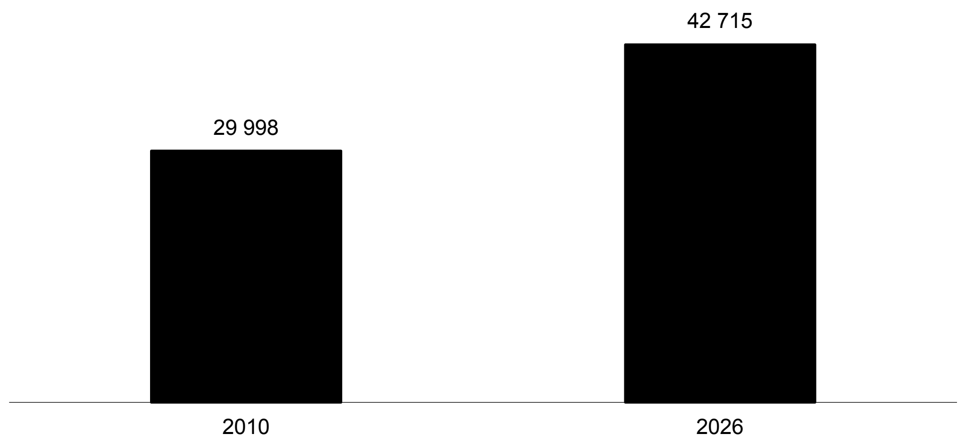
Due to these demographic changes, the population that is generally of working age (15-64) will have to bear a heavier load in order to fund public services and the debt burden.

Indeed, the gross debt per person of working age stood at $29 998 in 2010. It is expected to stand at $42 715 in 2026. This amount would be even higher without the Generations Fund.

- Therefore, the debt will weigh more heavily on people of working age in the coming years, thus increasing the importance of pursuing efforts to reduce its weight.

CHART 11

Gross debt as at March 31 per person aged 15-64
(dollars)



❑ More moderate economic growth over the medium term

The effects of demographic change on Québec's economic growth potential will be felt as of the coming years.

— Growth in real GDP will decrease from an annual average of 2.0%, observed over the period 1982-2010, to 1.6% over the period 2016-2020 and roughly 1.2% over the period 2021-2025.

This anticipated slowdown in growth is directly attributable to the shrinking labour pool.

— Over the coming years, economic growth will be generated essentially by improvements in productivity and the employment rate.

Therefore, the level of the debt must be controlled through deposits of sums in the Generations Fund. Economic growth alone cannot ensure the achievement of the debt burden reduction objectives.

TABLE 1

Economic growth factors in Québec
(annual contribution in percentage points, annual averages)

	Historical data		Outlook	
	1982-2010	**2011-2015**	**2016-2020**	**2021-2025**
Real GDP (% change)	2.0	1.4	1.6	1.2
Production factors (contribution)				
– Labour pool(1)	0.6	0.2	–0.2	–0.2
– Employment rate(2)	0.6	0.6	0.9	0.5
– Output per job(3)	0.8	0.6	0.8	0.9
Nominal GDP	4.9	3.0	3.2	3.0
Real GDP per capita	1.3	0.5	0.8	0.6

Note: Totals may not add due to rounding.
(1) Population aged 15-64.
(2) Total number of workers in relation to the population aged 15-64.
(3) Real GDP per job.
Sources: Institut de la Statistique du Québec and Ministère des Finances du Québec.

1.2.2 Improving infrastructure

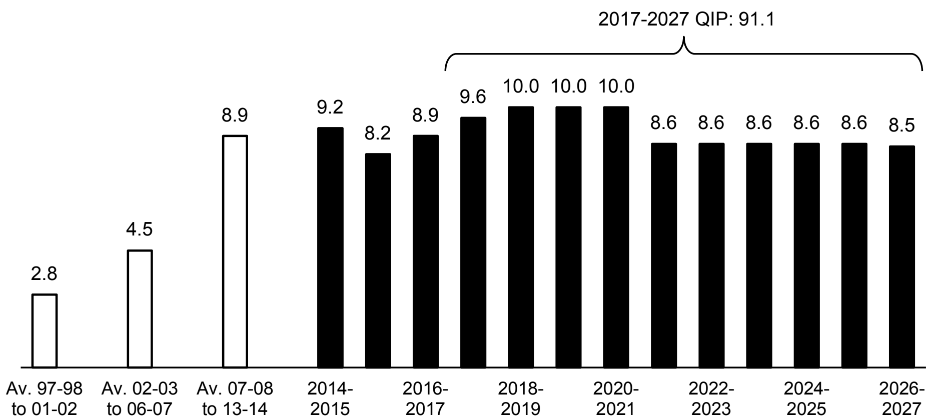
Over the coming years, the government will continue to make investments in order to meet Québec's quality infrastructure needs and support economic growth.

The investments provided for in the 2017-2027 Québec Infrastructure Plan (QIP) will total $91.1 billion over the next ten years.

— This high level of investment will make it possible to replace infrastructure and launch new projects to meet Québec's needs in all sectors.

CHART 12

Investments under the 2017-2027 Québec Infrastructure Plan
(billions of dollars)



Government investments in public infrastructure are a major factor in the growth of the government's gross debt. In fact, the government's infrastructure spending is funded largely by the debt, making it possible to better reconcile these expenditures with the useful life of assets.

❑ Increase in the importance of public capital stock in the economy

In the coming years, the level of Québec government investments provided for under the QIP will average nearly $10 billion a year, thus remaining above pre-2008 levels.

These investments reached 2.3% of GDP in 2016-2017 and the same ratio is expected in the coming years.

Investments under the QIP contribute directly to the increase in public capital stock in the economy.

— Public capital stock rose from 22.5% of real GDP in 2000 and will represent 28.4% of real GDP in 2016.

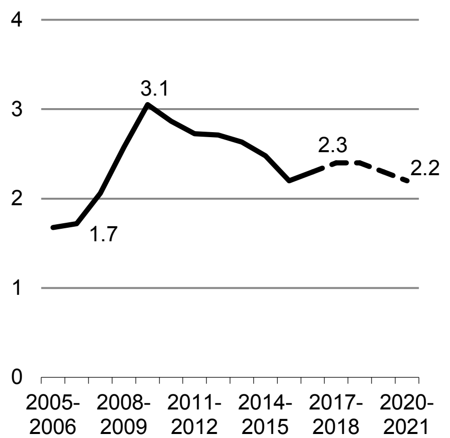
— This growth will raise public capital stock to a level equivalent to that observed in the early 1980s.

Public capital stock is a key determinant of productivity and economic growth. This is why the government invests substantially in infrastructure.

The Generations Fund enables the government to reconcile the maintenance of high levels of investments in infrastructure with the debt reduction objectives.

CHART 13

Annual public capital investments of the Québec government
(percentage of GDP)

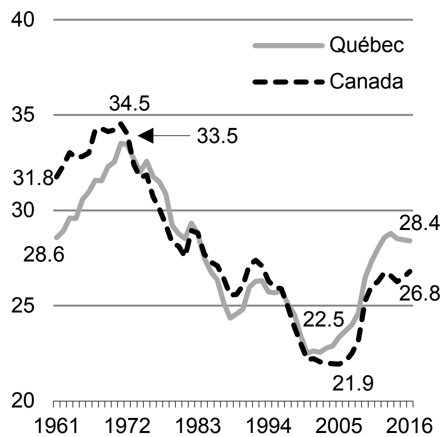


Sources: Institut de la statistique du Québec, Secrétariat du Conseil du trésor and Ministère des Finances du Québec

CHART 14

Change in public capital stock

(percentage of GDP, in real terms)



Sources : Institut de la statistique du Québec, Secrétariat du Conseil du trésor and Ministère des Finances du Québec

1.2.3 Preparing for an economic slowdown that would result from the global economic situation

Reducing the debt will better equip the government to take action to support the economy in the event of an economic slowdown.

- Periods of economic growth are a good time to reduce the debt burden.
- During the global recession of 2008-2009, governments had to adopt ambitious recovery policies in order to support the economy.

The current expansion phase of the Québec economy has continued for 82 months since the end of the last recession. The average length of expansion phases in the last four global economic cycles has been 134 months.

- However, it should be noted that the cycle that preceded the 2008-2009 recession lasted for 81 months.

An economic slowdown would have a non-negligible impact on public finances. In fact, a change of 1 percentage point in nominal GDP has an impact of about $650 million on the government's consolidated own-source revenue.

In the event of a major economic slowdown, the government could be deprived of revenues and have to not only support the economy but maintain its obligations to fund quality public services. It could be necessary to post new deficits in such situations. An overly high level of debt would thus limit the government's leeway.

Impact of the 2008-2009 recession

The reasons that prompted the government to take action a decade ago in order to reduce the debt are still present, especially because Québec, like all industrialized jurisdictions, had to contend with a recession in the meantime.

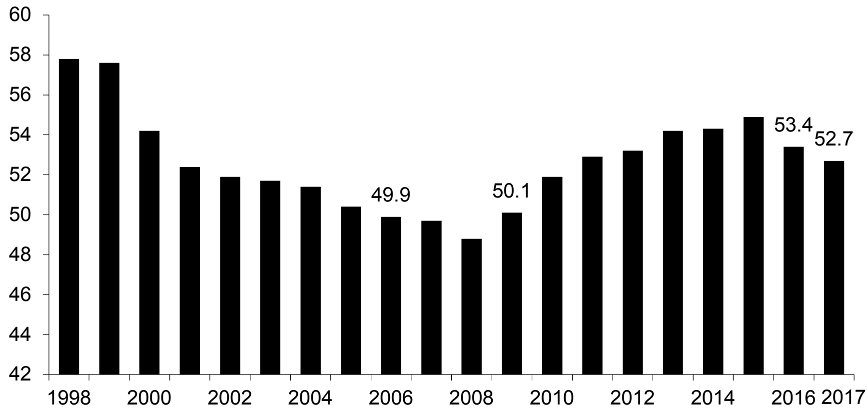
- Between 2009-2010 and 2014-2015, due to the 2008-2009 recession, Québec ran deficits six years in a row, totalling nearly $15 billion, which increased the debt burden.
- These deficits were necessary to maintain the level of public services and support the economy.

In addition, in the wake of the 2008-2009 recession, the government invested massively in its infrastructure in order to support the economic recovery. Like the deficits, these investments increased the government's gross debt burden. Thus, the gross debt burden is currently higher than it was prior to the recession.

- For example, the gross debt stood at 53.4% of GDP as at March 31, 2016, or 3.3 percentage points higher than as at March 31, 2009.

The creation of the Generations Fund limited the growth of the debt burden during this period. In addition, the Generations Fund will contribute to achieving the objective of reducing the ratio of the gross debt to 45% of GDP by 2025-2026.

Gross debt as at March 31(1)
(percentage of GDP)



(1) As of 2009, the gross debt takes into account the debt that the health and social services and education networks have issued in their own name. The data for prior years are not comparable because they do not include this debt.

1.3 Encouraging results regarding the reduction of the debt burden

Québec is on the right track to meet the debt reduction targets.

— Fiscal balance has been restored.

— The debt burden has started to decrease.

❑ Restored fiscal balance

Good management of public finances and the economy made it possible to return to a balanced budget in 2015-2016 and keep it balanced thereafter.

— The surplus of $2.2 billion recognized in 2015-2016 followed six years of deficits totalling nearly $15 billion.

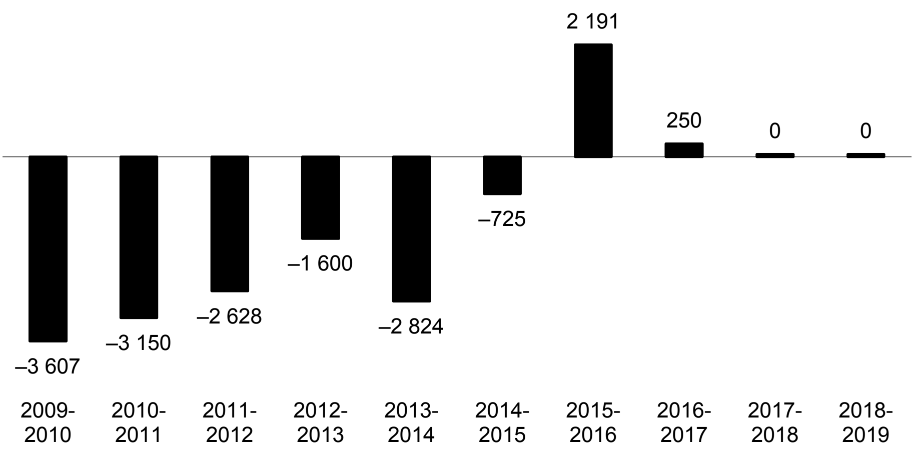
Moreover, forecasts for the coming years anticipate sustainable fiscal balance due to responsible spending management and faster economic growth.

— The government will continue to invest in improving public services, while maintaining spending growth at a rate that is sustainable over the long term.

Therefore, the return to a balanced budget has curbed any increase of the debt arising from deficits.

CHART 15

Budgetary balance,[1] 2009-2010 to 2018-2019
(millions of dollars)



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

❑ A reduction in the debt burden: the first since 2008-2009

The return to a balanced budget, coupled with continued deposits in the Generations Fund, has reversed the progression of the weight of the debt in the economy.

The gross debt as a proportion of the economy began to decline in 2016, posting the first decrease since 2008-2009. The debt burden went from 54.9% of GDP as at March 31, 2015 to 53.4% of GDP as at March 31, 2016, which represents a decrease of 1.5 percentage points.

— The ratio of gross debt to GDP will continue to fall over the coming years.

As for the ratio of the debt representing accumulated deficits, it began to decline in 2013-2014. From a peak of 34.6% reached in 2012-2013, it will have fallen to 30.1% as at March 31, 2017.

The March 2017 Québec Economic Plan is forecasting the achievement of the debt reduction objectives by 2025-2026.

CHART 16

Gross debt as at March 31

(percentage of GDP)

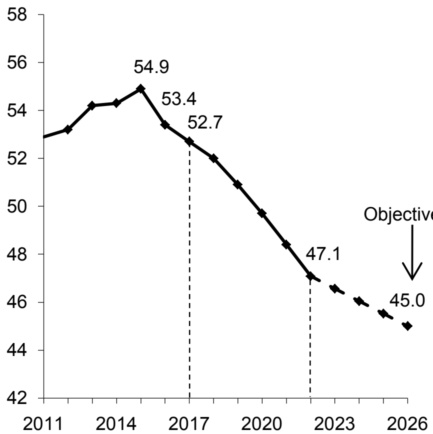
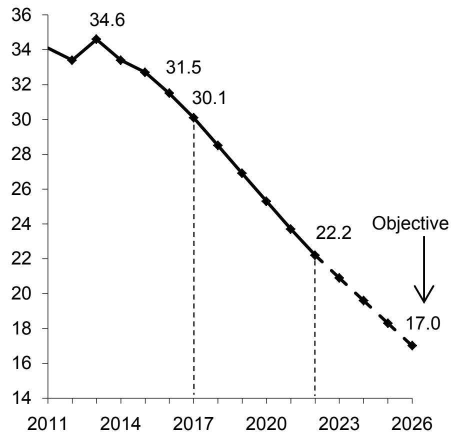


CHART 17

Debt representing accumulated deficits as at March 31

(percentage of GDP)



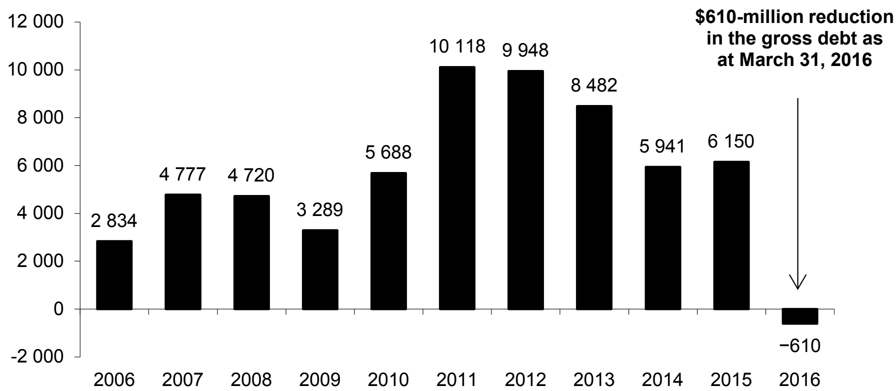
A reduction in the gross debt: the first in nearly 60 years

In 2015-2016, for the first time in nearly 60 years, Québec posted a decrease in the gross debt in absolute terms. Québec was the only Canadian province to see its debt decline in 2015-2016.

− The level of the gross debt stood at $203.3 billion as at March 31, 2016, which is $610 million less than as at March 31, 2015.

This outcome has been achieved due to the combined impact of restored fiscal balance and the deposits made in the Generations Fund.

Annual change in Québec's gross debt as at March 31
(millions of dollars)



1.4 The advantages of continuing to make deposits in the Generations Fund

Reducing the debt burden makes it possible to curb the growth of the debt that is borne by every Quebecer.

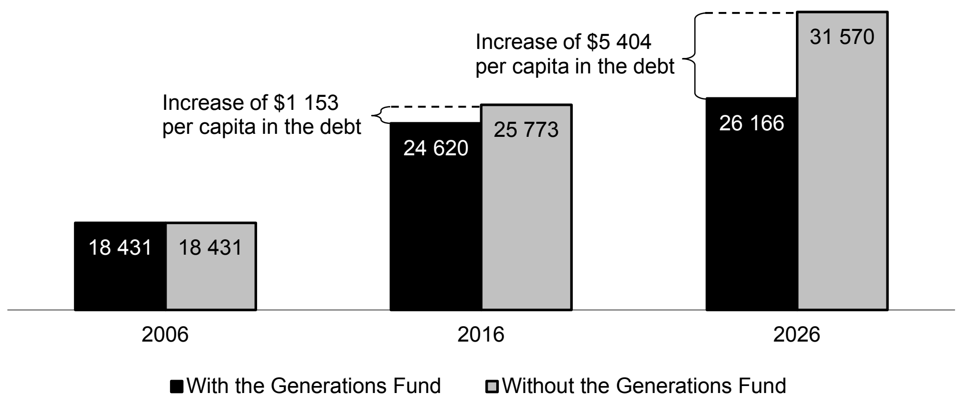
Using revenues dedicated to the Generations Fund for purposes other than debt reduction would jeopardize the achievement of this objective.

Since the creation of the Generations Fund, Quebecers have been able to avoid an increase of $1 153 per capita in the debt.

— By continuing to make deposits in the Generations Fund until 2025-2026, Quebecers will avoid an increase of $5 404 per capita in the debt.

CHART 18

Change in and forecast for the gross debt
(dollars per capita)



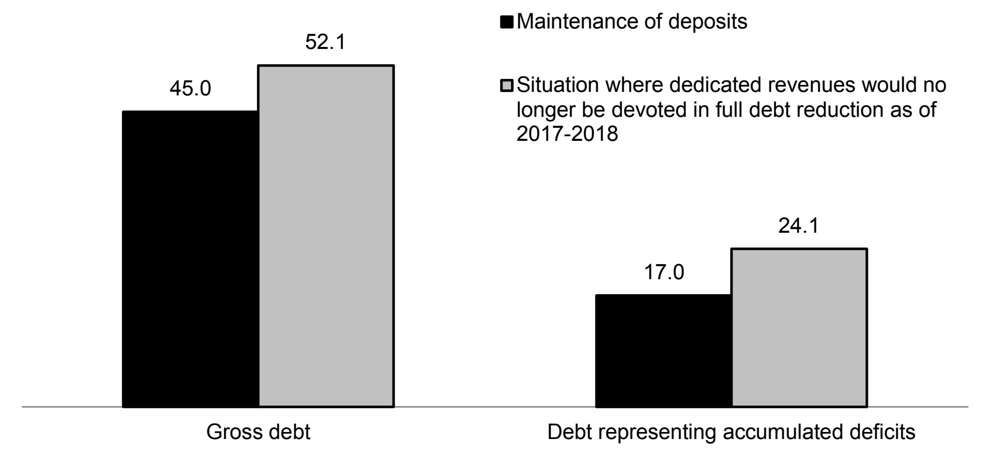
❑ The consequences of ceasing to make deposits in the Generations Fund

Ceasing to make deposits in the Generations Fund as of 2017-2018 would lead to an overrun of 7.1 percentage points of GDP in the debt reduction objectives set by the government.

To achieve the debt reduction objectives that have been included in the *Act to reduce the debt and establish the Generations Fund*, the projected deposits in the Generations Fund between now and 2025-2026 must be made in full.

CHART 19

Gross debt and debt representing accumulated deficits as at March 31, 2026
(percentage of GDP)



Lastly, these projections do not take into account the possible impact of an economic slowdown on the debt burden.

— For example, a recession of comparable magnitude to that of 2008-2009 would add 5.5 percentage points of GDP to the debt burden.

Ceasing to make deposits in the Generations Fund, coupled with an economic slowdown, could lead to a record-high debt burden. In so doing, Québec would transfer to future generations a heavier burden to bear.

2. THE GENERATIONS FUND: AN EFFECTIVE AND TRANSPARENT DEBT REDUCTION TOOL

The Generations Fund is an effective and transparent tool that the government has adopted to ensure that its debt reduction targets are met. It is funded by dedicated revenues devoted to achieving a long-term objective.

— The government has decided to spread its debt reduction efforts over several years so as to not hurt the economy and to respect taxpayers' ability to pay.

— The fund is a transparent tool. It enables the public to easily identify the amounts devoted every year to the government's repayment of the debt.

Now that the Generations Fund has been in operation for ten years, it can be seen that the government's strategy has been successful.

— The fund has grown constantly, making it already possible to reduce the debt burden substantially.

— Investment income will account for a growing share of the revenues dedicated to the fund, creating powerful additional leverage to accelerate reduction of the debt burden.

The efforts made to reduce the debt are measured. They represent 2.3% of the government's revenue.

Accordingly, the government will continue to make the projected deposits in the Generations Fund in order to avoid transferring a heavy burden to future generations.

2.1 Revenues allocated to reducing the debt

When the Generations Fund was created in 2006, the government sought to allocate revenues to it that would have little impact on the competitiveness of Québec's economy and would not add to the tax burden of individuals and businesses.

The first major revenues deposited in the Generations Fund were water-power royalties collected from Hydro-Québec and private producers of hydro-electricity.

— The water-power royalties paid to the Québec government by Hydro-Québec have no impact on electricity rates for consumers.

TABLE 2

Deposits in the Generations Fund
(millions of dollars)

	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020	2020-2021	2021-2022
Dedicated revenues							
Water-power royalties							
Hydro-Québec	641	671	680	687	703	724	733
Private producers	100	103	99	100	102	104	107
Subtotal	**741**	**774**	**779**	**787**	**805**	**828**	**840**
Indexation of the price of heritage electricity	98	164	215	245	325	415	500
Additional contribution from Hydro-Québec	—	—	215	215	215	215	215
Mining revenues	161	77	123	241	297	352	382
Specific tax on alcoholic beverages	100	500	500	500	500	500	500
Unclaimed property	55	55	30	30	30	30	30
Investment income	298	472	626	816	1 044	1 287	1 522
Total dedicated revenues	**1 453**	**2 042**	**2 488**	**2 834**	**3 216**	**3 627**	**3 989**
Deposit from the accumulated surplus of the Commission des normes du travail	131	—	—	—	—	—	—
TOTAL DEPOSITS	**1 584**	**2 042**	**2 488**	**2 834**	**3 216**	**3 627**	**3 989**

Since 2010, the government has had to take steps to ensure that the debt reduction targets will be met. To that end, new revenue sources have been allocated to the Generations Fund. Once again, priority has been given to sources with the least harmful effects on the Québec economy, namely:

- all mining revenues since 2015-2016;
- annual indexing of the price of heritage electricity since 2014.

In addition, in 2013, the government chose to offset the impact on the debt of the additional deficits caused by the decision to postpone for two years the return to a balanced budget, which was forecast for 2013-2014, by increasing deposits in the Generations Fund drawn from the specific tax on alcoholic beverages as of 2016-2017.

- Accordingly, additional deposits of $400 million have been added to the $100 million allocated to the Generations Fund in 2014-2015 and 2015-2016, bringing to $500 million per year deposits in the fund drawn from the specific tax on alcoholic beverages as of 2016-2017.

Lastly, various amounts have been deposited on a one-time basis in the Generations Fund, particularly a portion of the accumulated surplus from the Territorial Information Fund and the entire accumulated surplus of the Commission des normes du travail.[3]

[3] For more details, see Appendix 3 of this document.

The Generations Fund: a strategy recognized by credit rating agencies

Credit rating agencies and investors welcome the Generations Fund, which represents a concrete commitment on the part of the government to reduce the debt.

- When the Generations Fund was created in 2006, DBRS noted that this initiative demonstrated the province's determination to contain the growth of the debt.
- Standard & Poor's, for its part, noted that Québec's credit rating was supported, in particular, by the province's intention to reduce its debt burden through deposits in the Generations Fund.

By making a positive contribution to Québec's credit quality, the Generations Fund helps Québec to maintain access to financial markets in Canada and abroad.

Every year, the Québec government has to borrow large sums to repay maturing borrowings on the one hand and to fund major capital investments on the other.

Over the next five years, the government's medium- and long-term financing program will amount to over $17 billion.

The fact that the government is continuing to implement its debt reduction strategy is important to credit rating agencies.

For example, in June 2016, Fitch's credit rating agency noted that the stable outlook recently assigned to Québec's credit rating was based on the assumption that the debt burden would be reduced in the coming years:

> The Stable Outlook at the current rating level assumes the Province returns to its past focus on debt reduction. The resumption of significant borrowing to support operating deficits would result in a downgrade.[1]

Moody's credit rating agency, for its part, noted that the stable outlook assigned to Québec's credit rating was based on the assumption that Québec would maintain a balanced budget over the medium term, making it possible to gradually reduce the debt burden:

> The rating outlook is stable reflecting the assumption that the province will succeed in recording balanced budgets across the medium term, allowing for a gradual decrease in the debt burden.[2]

1 Fitch, press release, June 14, 2016.
2 Moody's, Credit Opinion, June 28, 2016.

2.1.1 **A measured effort to reduce the debt**

Debt reduction, like the return to sound, balanced public finances and the establishment of conditions favourable to economic growth, is a priority for the government.

To reduce the debt burden, the government has deposited dedicated revenues in the Generations Fund every year since January 2007. These revenues are mainly royalty revenues, which do not increase the tax burden.

— Therefore, the revenues deposited in the Generations Fund have few negative effects on Québec's economy.

Repayment of the debt remains a long-term objective for the Government.

— This objective is so important that deposits in the Generations Fund were maintained from 2009-2010 to 2014-2015 even though the government posted deficits.

The dedicated revenues of the Generations Fund in 2017-2018 are expected to amount to $2.5 billion, which represents 2.3% of the government's revenue.

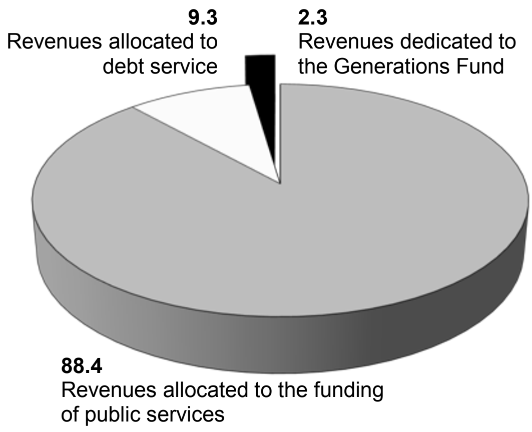
— This is a measured debt-reduction effort that will have benefits over the long term for future generations.

— Progress in the area of debt reduction takes time to be felt. It is impossible to eliminate, in just a few years, debt that has accumulated for more than four decades.

In comparison, revenues allocated to debt service in 2017-2018 will amount to $9.9 billion, or 9.3% of the government's revenue.

CHART 20

Allocation of government revenue – 2017-2018
(percentage of the total)



❑ A balanced approach

While continuing to make the projected deposits in the Generations Fund, the government is pursuing its other objectives, in particular, to provide more funding for public services and infrastructure and improve Québec's competitiveness.

- The government is continuing to strengthen the funding of quality public services, particularly by accelerating in 2016-2017 and 2017-2018 investments in health and education.
- It will continue to invest substantially in the coming years in public infrastructure in order to ensure its quality and support economic growth.
- The results of recent years have enabled the government to reduce the tax burden on individuals and businesses, and particularly to eliminate the health contribution. These measures benefit all Québec taxpayers and improve Québec's competitiveness.

2.2 Sustained growth of the Generations Fund

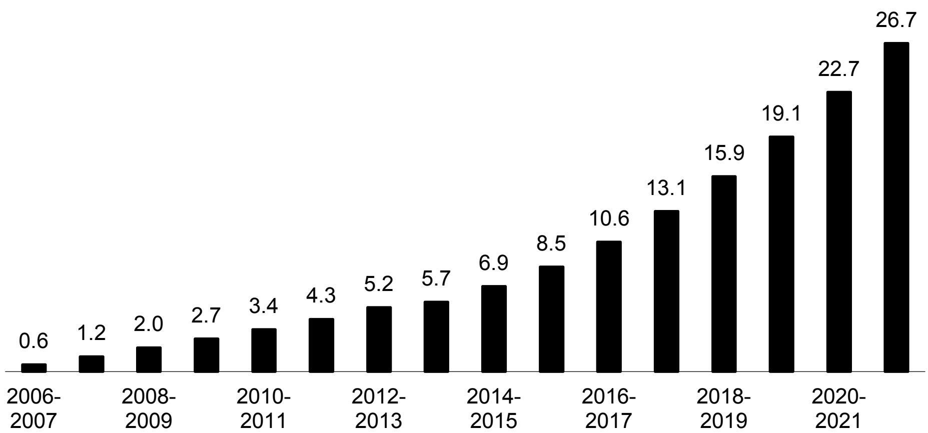
Thanks to continued and growing deposits of dedicated revenues in the Generations Fund, there has been sustained growth in the book value of the fund since its creation.

— Amounting to $0.6 billion in 2006-2007, this value is expected to stand at an estimated $13.1 billion in 2017-2018.

This value is expected to more than double over the subsequent four years, reaching $26.7 billion in 2021-2022.

CHART 21

Change in the book value of the Generations Fund
(billions of dollars)



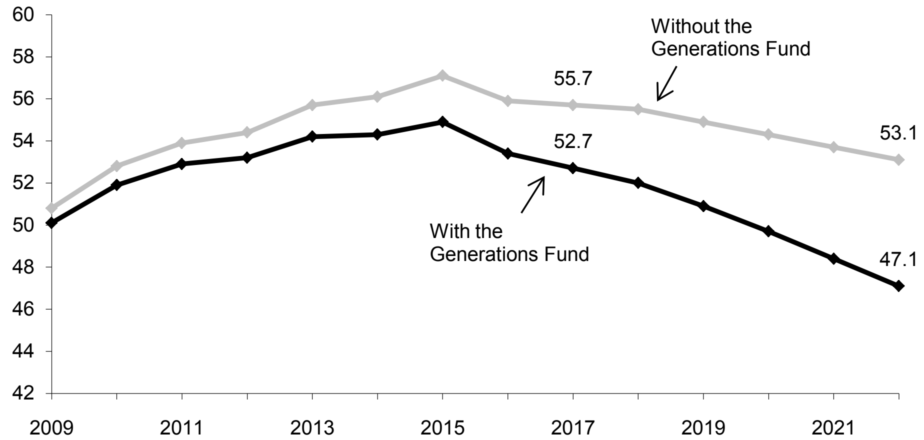
❑ An already lower debt burden

Owing to the growth in its value, the Generations Fund has already made it possible to substantially reduce the debt burden. In addition, deposits in the fund over the coming years will reduce the debt burden even further.

— As at March 31, 2022, the gross debt burden should stand at 47.1% of GDP. Without the Generations Fund, the forecast would be 53.1%. This is a difference of 6.0 percentage point, which represents $27.7 billion,[4] or $3 207 per capita.

CHART 22

Gross debt as at March 31 – With and without the Generations Fund
(percentage of GDP)



[4] The difference of $27.7 billion is $1.0 billion higher than the book value of the Generations Fund as at March 31, 2022 ($26.7 billion) owing to the use of $1.0 billion from the Generations Fund in 2013-2014 to repay maturing borrowings.

2.3 Investment income of the Generations Fund: additional powerful leverage for reducing the debt

When the Generations Fund was created, the government decided to accumulate dedicated revenues in it and to entrust the management of these sums to the Caisse de dépôt et placement du Québec so that they would grow. This strategy is making it possible, as expected, to accelerate reduction of the debt.

As the value of the Generations Fund grows, income from the investment of the sums making up the fund increases, creating additional leverage for repaying the debt.

— Investment income is expected to amount to $626 million in 2017-2018, or 25.2% of the fund's total revenue. As of 2018-2019, it will constitute the main source of revenues dedicated to the fund.

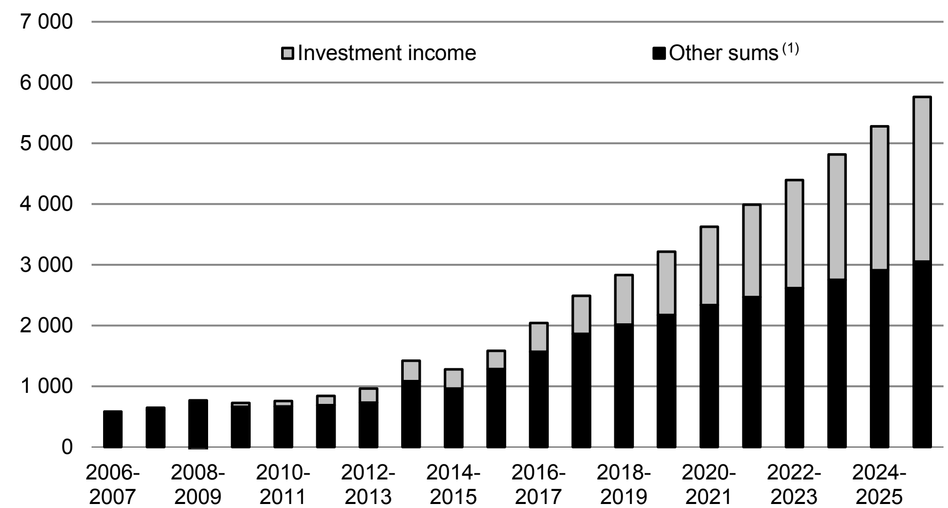
— This income will stand at $1 522 million in 2021-2022, or 38.2% of the fund's total revenue.

— In the coming years, investment income will account for an even larger share. In 2025-2026, it will represent close to half of the fund's annual revenue.

It is important to note that this investment income does not constitute a tax levy and, therefore, it does not curb Québec's economic growth.

CHART 23

Sums dedicated to the Generations Fund
(millions of dollars)



(1) These sums include revenues dedicated to the Generations Fund and certain one-time deposits, such as the $131-million deposit made in 2015-2016 from the accumulated surplus of the Commission des normes du travail.

❑ A return that is higher than the cost of borrowings

Since the first deposit was made in the Generations Fund in January 2007, the return has been higher than the cost of new borrowings by the government nine years out of ten. The return of the Generations Fund thus accelerates debt reduction.

TABLE 3

Comparison of the Generations Fund's annual return and the Québec government's borrowing costs
(per cent, on a calendar year basis)

	Return of the Generations Fund	Cost of new borrowings[1]	Difference (percentage points)
2007	5.6	4.7	0.9
2008	–22.4	4.5	–26.9
2009	11.3	4.4	6.9
2010	12.3	4.1	8.2
2011	4.0	3.7	0.3
2012	8.4	3.0	5.4
2013	12.0	3.3	8.7
2014	11.7	3.2	8.5
2015	8.1	2.4	5.7
2016	7.3	2.2	5.1

(1) The government's borrowing costs correspond to the yield on 10-year maturity Québec bonds.
Source: PC-Bond for the yield on 10-year maturity Québec bonds.

❑ The importance of maintaining Québec's credit rating

To maintain and even improve its credit rating, the government must continue to make deposits in the Generations Fund. This is how it will reduce the debt burden. Not being able to achieve the debt reduction objectives could have a negative impact on Québec's credit rating.

A lowering of the government's credit rating would lead to higher borrowing costs and thus an increase in debt service.

Québec has regained control of its public finances and, in June 2016, this gave rise two positive changes on the part of credit rating agencies.

— The Standard & Poor's (S&P) credit rating agency improved the outlook related to Québec's credit rating, by raising it from "stable" to "positive".

— The Fitch credit rating agency improved the outlook related to Québec's credit rating, by raising it from "negative" to "stable" due to the return to a balanced budget. Fitch had lowered this outlook in December 2013, following the postponement of the return to a balanced budget to 2015-2016, announced in November 2013.

These encouraging decisions on the part of credit rating agencies provide motivation to continue the work in economic development and responsible management of public finances, including debt-burden reduction.

TABLE 4

The Québec government's credit ratings

Credit rating agencies	Credit ratings	Outlook in 2015	→	Outlook in 2016
Moody's	Aa2	Stable		Stable
Standard & Poor's (S&P)	A+	Stable		Positive
Fitch	AA−	Negative		Stable
DBRS	A (high)	Stable		Stable
Japan Credit Rating Agency (JCR)	AA+	Stable		Stable

CONCLUSION

With the creation of the Generations Fund in 2006, the government took a major step to keep public finances sound and ensure greater fairness for future generations, in addition to fostering sustainable social programs and Québec's economic prosperity. At that time, Québec pledged to reduce the debt burden over a period of 20 years.

Progress in this area takes time to be felt. It is impossible to eliminate, in just a few years, debt that has accumulated for more than four decades.

Today, having reached the midpoint of this exercise, Québec is well positioned to meet the targets it has set and has written into law. Fiscal balance has been restored and the debt burden has started to decline. Debt reduction must continue to be a priority.

It is essential to stay the course. Reducing the debt burden constitutes an investment for improving Québec's competitiveness and Quebecers' standard of living and for ensuring the delivery of quality public services.

The government is committed to achieving its debt reduction objectives and continuing to make deposits in the Generations Fund.

APPENDIX 1: THE CONCEPTS OF GROSS DEBT AND DEBT REPRESENTING ACCUMULATED DEFICITS

Gross debt

The gross debt represents the amount of debt issued on financial markets and the net liability for the retirement plans and future benefits of public and parapublic sector employees, minus the balance of the Generations Fund.

The gross debt does not take into account assets acquired by the government by incurring debt. The government's investments in fixed assets or in its enterprises thus contribute, like budgetary deficits, if applicable, to increasing the gross debt.

Credit rating agencies and investors monitor primarily this concept of debt.

Debt representing accumulated deficits

Compared to the gross debt, the debt representing accumulated deficits takes into account financial and non-financial assets that the government has acquired by incurring debt. It corresponds to the difference between the Québec government's liabilities and its assets as a whole. It is calculated by subtracting financial assets, net of other liabilities, as well as non-financial assets from the gross debt. In other words, it is the debt that does not correspond to any assets.

The debt representing accumulated deficits changes in accordance with budgetary deficits. A budgetary deficit leads to an increase in the debt representing accumulated deficits, while a budgetary surplus leads to a decrease in the debt representing accumulated deficits.[5]

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5 In accordance with the *Act to reduce the debt and establish the Generations Fund*, the debt representing accumulated deficits is increased by the stabilization reserve.

APPENDIX 2: DEBT REDUCTION OBJECTIVES ADOPTED IN 2010

When the Generations Fund was created in 2006, the government pledged to reduce the debt to 25% of GDP by 2025-2026. The target of 25% corresponded to the average debt-to-GDP ratio of all the Canadian provinces as at March 31, 2005.

— In 2006, the objective concerned the government's total debt, that is, the concept that corresponded at the time to the government reporting entity.

In December 2007, the government carried out a major accounting reform. In particular, this reform broadened the reporting entity to include institutions in the health and social services network and most institutions in the education network. A new concept of debt was then created, namely, gross debt, which corresponded to the new reporting entity.

— The reform added roughly $26 billion to the government's debt.

The major recession that occurred in Québec in 2008-2009 left budgetary deficits totalling nearly $15 billion from 2009-2010 to 2014-2015, thus adding to the government's debt.

In addition, the government made substantial investments in infrastructure in order to spur economic recovery, which contributed to raising the debt.

In 2010, owing to major changes that had occurred since the Act was passed in 2006, the government set new debt reduction objectives:

— reduce the ratio of gross debt to GDP to 45% in 2025-2026;

— reduce the ratio of the debt representing accumulated deficits by half so that it will amount to 17% of GDP in 2025-2026.

Adjustments to the gross debt compared to the March 2010 budget

When the government set new debt reduction objectives in the March 2010 budget, a gross debt forecast up to March 31, 2015 was presented.

In the March 2010 budget, the gross debt was forecast at $192 169 million as at March 31, 2015. Ultimately, it amounted to $203 957 million, which represents a difference of $11 788 million, or 2.9 percentage points of GDP.

This upward adjustment to the gross debt is explained mainly by the budgetary deficits recorded in 2013-2014 and 2014-2015 that had not been forecast in 2010, the closure of the Gentilly-2 nuclear power plant and the line-by-line consolidation of the debts of the health and social services and education networks, which was carried out in December 2010.

Adjustments to the gross debt as at March 31 since the March 2010 budget
(millions of dollars)

	2010-2011	2011-2012	2012-2013	2013-2014	2014-2015
March 2010 Budget	170 599	180 084	186 490	189 428	192 169
% of GDP	*54.5*	*55.1*	*54.6*	*53.3*	*52.0*
Actual results	173 436	183 384	191 866	197 807	203 957
% of PIB	*52.9*	*53.2*	*54.2*	*54.3*	*54.9*
Difference	**2 837**	**3 300**	**5 376**	**8 379**	**11 788**
% of GDP	***–1.6***	***–1.9***	***–0.4***	***1.0***	***2.9***

Explanation of the adjustments:	
Budgetary deficit recorded in 2013-2014, not forecast in 2010	2 824
Budgetary deficit recorded in 2014-2015, not forecast in 2010	1 143
Subtotal (budgetary deficits not forecast)	**3 967**
Closure of the Gentilly-2 nuclear power plant announced in 2012	1 876
Line-by-line consolidation of the debts of the health and social services and education networks	5 116
Other (e.g. larger-than-anticipated investments, loans and advances)	829
TOTAL	**11 788**

Adjustments to the debt representing accumulated deficits compared to the March 2010 budget

When the government set new debt reduction objectives in the March 2010 budget, a forecast for the debt representing accumulated deficits up to March 31, 2015 was presented.

In the March 2010 budget, the debt representing accumulated deficits was forecast at $109 644 million as at March 31, 2015. Ultimately, it amounted to $121 268 million, which represents a difference of $11 624 million, or 3.0 percentage points of GDP.

This upward adjustment to the debt representing accumulated deficits is explained mainly by the budgetary deficits recorded in 2013-2014 and 2014-2015 that had not been forecast in 2010, the closure of the Gentilly-2 nuclear power plant and the accounting adjustments related, in particular, to the adoption of a new basis of accounting for Hydro-Québec.

Adjustments to the debt representing accumulated deficits as at March 31 since the March 2010 budget
(millions of dollars)

	2010-2011	2011-2012	2012-2013	2013-2014	2014-2015
March 2010 budget	110 242	112 170	112 309	111 186	109 644
% of GDP	*35.2*	*34.3*	*32.9*	*31.3*	*29.7*
Actual results	111 946	115 220	122 615	121 847	121 268
% of GDP	*34.1*	*33.4*	*34.6*	*33.4*	*32.7*
Difference	**1 704**	**3 050**	**10 306**	**10 661**	**11 624**
% of GDP	***–1.1***	***–0.9***	***1.7***	***2.1***	***3.0***
Explanation of the adjustments:					
Budgetary deficit recorded in 2013-2014, not forecast in 2010					2 824
Budgetary deficit recorded in 2014-2015, not forecast in 2010					1 143
Subtotal (budgetary deficits not forecast)					**3 967**
Closure of Gentilly-2 nuclear power plant announced in 2012					1 876
Other (mainly accounting adjustments related, for example, to the adoption of a new basis of accounting for Hydro-Québec and to the new accounting standard for transfer payments)					5 781
TOTAL					**11 624**

APPENDIX 3: HISTORY OF DEPOSITS IN THE GENERATIONS FUND

TABLE 5

History of deposits in the Generations Fund[1]

(millions of dollars)

	Dedicated revenues										
	Water-power royalties										
	Hydro-Québec	Private producers	Indexation of the price of heritage electricity	Other contributions from Hydro-Québec	Mining revenues	Specific tax on alcoholic beverages	Unclaimed property	Investment income	Total	Other deposits	Deposits in the Generations Fund
2018-2019	687	100	245	215	241	500	30	816	2 834		2 834
2017-2018	680	99	215	215	123	500	30	626	2 488		2 488
2016-2017	671	103	164		77	500	55	472	2 042		2 042
2015-2016	641	100	98		161	100	55	298	1 453	131[2]	1 584
2014-2015	660	101	71		—	100	32	315	1 279		1 279
2013-2014	670	93					19	339	1 121	300[3]	1 421
2012-2013	625	92					12	232	961		961
2011-2012	591	91					9	149	840		840
2010-2011	560	90					16	94	760		760
2009-2010	569	89					7	60	725		725
2008-2009	548	88					1	–50	587	132[4]	719
2007-2008	367	46					—	36	449	200[5]	649
2006-2007	65	11		500[6]			5	3	584		584

(1) The Generations Fund began operations on January 1, 2007 pursuant to the A*ct to reduce the debt and establish the Generations Fund* (CQLR, chapter R-2.2.0.1).
(2) Deposit of $131 million from the accumulated surplus of the Commission des normes du travail.
(3) Deposit of $300 million from the Territorial Information Fund.
(4) Deposit of $132 million from the stabilization reserve derived from the sale of assets of the Société immobilière du Québec.
(5) Deposit of $200 million from the sums allocated to the stabilization reserve in 2006-2007.
(6) Revenue from the sale of Hydro-Québec's interest in Transelec Chile.