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2014-2015

June 2014

THE CHALLENGE OF QUÉBEC'S PUBLIC FINANCES



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The Challenge of Québec's Public Finances

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INTRODUCTION

Québec is facing a persistent budget deficit. Eliminating it will be a significant challenge. Returning to sound and balanced public finances is a must: the question is one of freedom of choice for the policy choices available to citizens in years to come.

As part of Budget 2014-2015, the government is releasing information to provide a better understanding of the nature and scope of the challenge of public finances that must be met as a priority. The government is also setting out some options concerning where the coming efforts should be made.

This document has four parts.

- The first part describes the situation all Quebecers are faced with: the public finances are stuck in a **persistent budget deficit**, leading to an increasingly onerous debt load.
- The second part deals with **public spending** and the **pressure** exerted on it.
- The third part of the document focuses on the **government's revenue** and the reasons why it is **growing more slowly**.
- Lastly, the fourth part lays out **answers for the future**, discussing the nature of the responses to the economic challenges and the orientations the government has taken.

1. A PERSISTENT BUDGET DEFICIT

Québec has recorded budget deficits since the 2009 recession.

- In response, the government implemented a recovery plan that gradually reduced the deficit for three years. However, the public finances worsened once again in 2013-2014.

This deficit is contributing to a relentless increase in the debt, as shown by the growth in interest payments in relation to all government spending.

1.1 A negative budgetary balance since the 2009 recession

Since the 2009 recession, Québec has had to deal with significant budget deficits year in, year out.

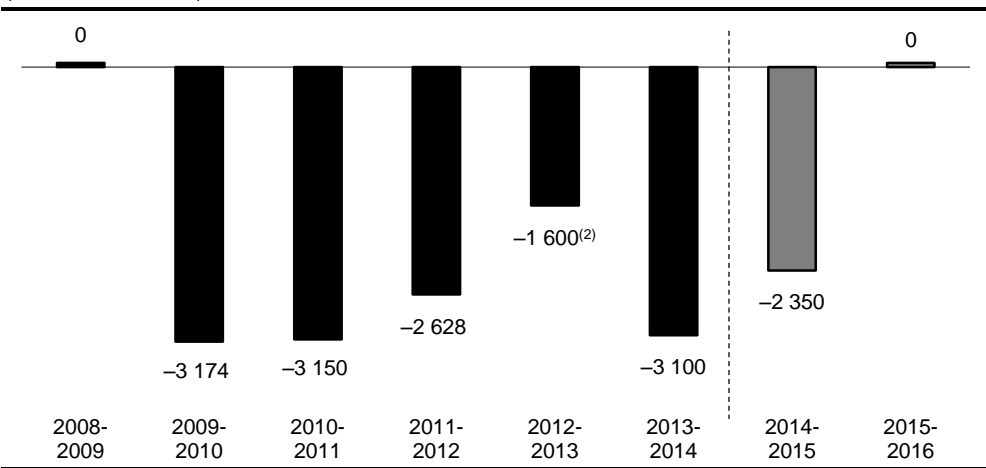
1.1.1 The situation is not improving

The expected deficit of \$3.1 billion in 2013-2014 is of the same size as those in 2009-2010 and 2010-2011, i.e. at the low point of the global crisis.

- The government’s efforts must reduce the deficit in 2014-2015 and balance the budget in 2015-2016.

CHART 1

Budgetary balance⁽¹⁾ from 2008-2009 to 2015-2016
(millions of dollars)



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

(2) Excluding Hydro-Québec’s extraordinary loss of \$1 876 million following the closure of Gentilly-2.

1.1.2 The problem is not recent

☐ Spending has outstripped revenue over the last 30 years

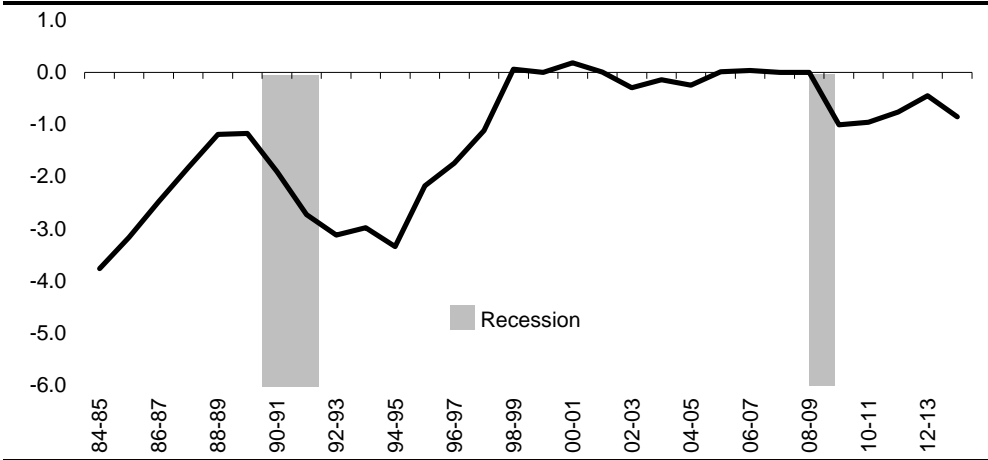
The government has posted budget deficits in just over two thirds of the last three decades, i.e.:

- from 1984-1985 to 1997-1998 inclusive;
- from 2002-2003 to 2004-2005 inclusive;
- from 2009-2010 to 2013-2014 inclusive.

The budgetary situation deteriorated in the wake of the recessions of the early 1990s and 2009.

CHART 2

Budgetary balance⁽¹⁾ from 1984-1985 to 2013-2014 (as a percentage of GDP)



(1) Budgetary balance within the meaning of the *Balanced Budget Act*.
Sources: Statistics Canada and Ministère des Finances du Québec.

Periods of economic growth not resulting in budget surpluses

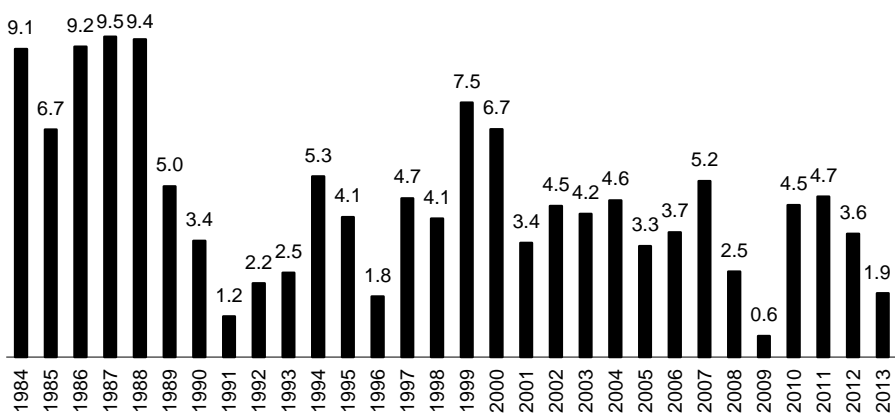
Overall, and despite two recessions, the economy has grown over the last 30 years. In nominal terms, annual economic growth averaged 4.6%.

In general, even in years of particularly strong economic growth, the government was not able to post a budget surplus.¹

- Rather, the government decided to increase spending to add new initiatives and enhance existing services, or reduce the tax burden.

Québec's nominal GDP growth

(per cent)



Sources: Statistics Canada and Institut de la statistique du Québec.

¹ However, since 2006-2007, the government has made deposits in the Generations Fund to reduce the relative weight of the debt in the economy.

1.2 A large debt

The persistent budget deficit is reflected in our debt.

❑ The debt load has grown

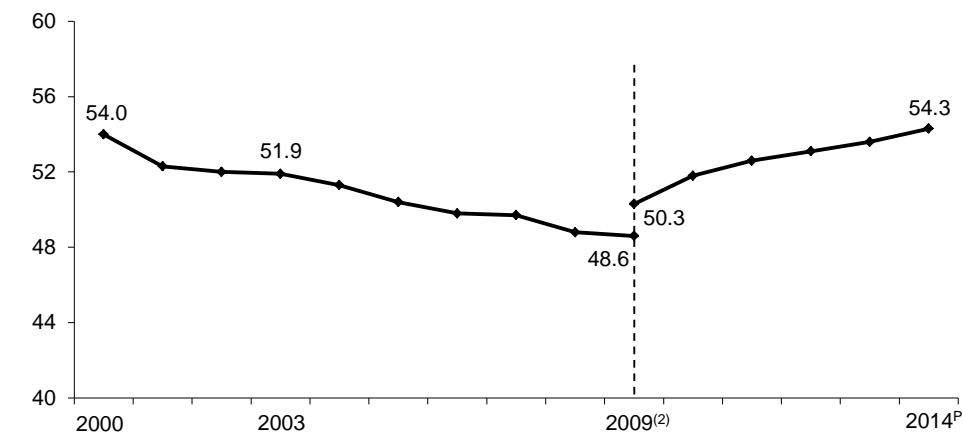
The size of the gross debt has grown over the years.

Until 2009, the debt grew more slowly than GDP. As a result, the size of the debt declined in relation to the size of the economy.

However, since 2009, the debt has risen faster than GDP. This is attributable to budget deficits resulting from the difficult economic situation, together with the increase in capital investments. The ratio of the gross debt to GDP rose from 50.3% as at March 31, 2009 to 54.3% as at March 31, 2014.

CHART 3

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



P: Preliminary results.

(1) The gross debt excludes borrowings made in advance and takes the amounts accumulated in the Generations Fund into account.

(2) The gross debt takes into account the debt that the health and social services and the education networks have contracted in their own name. Accordingly, the data as of 2009 are not comparable with those for prior years since they do not include this debt. The effect of line-by-line consolidation of the financial statements of the networks with those of the government has been to increase the ratio of the gross debt to GDP from 48.6% to 50.3% as at March 31, 2009.

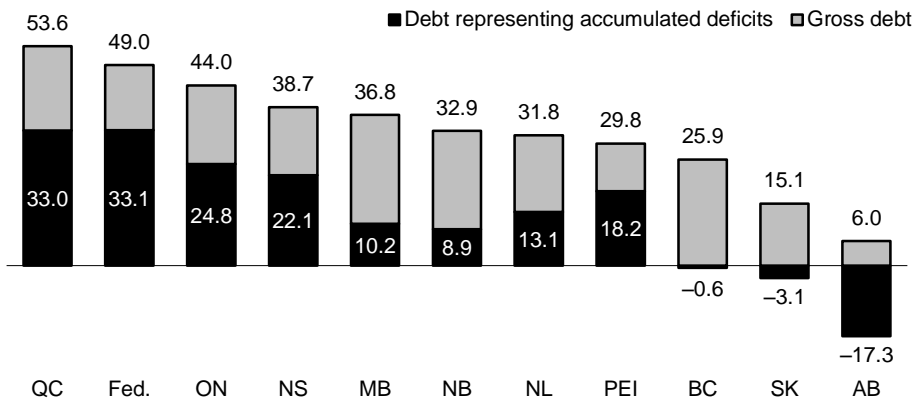
❑ The debt compared with that of the other provinces

Compared with the other provinces and expressed as a percentage of GDP, Québec is carrying more debt, whether on the basis of the gross debt or debt representing accumulated deficits.

- As at March 31, 2013, the ratio of Québec's gross debt to GDP stood at 53.6%.
- It was 44.0% in Ontario, the second-most indebted province, and 38.7% in Nova Scotia, which is the third.

CHART 4

Gross debt and debt representing accumulated deficits as at March 31, 2013 (as a percentage of GDP)



Note: A negative entry means that the government has an accumulated surplus.

Sources: Governments' public accounts, Statistics Canada and Ministère des Finances du Québec.

❑ Debt that limits the capacity to fund public services

Debt has a direct impact on Québec's capacity to fund public services: debt service accounts for a substantial proportion of the government's overall spending.

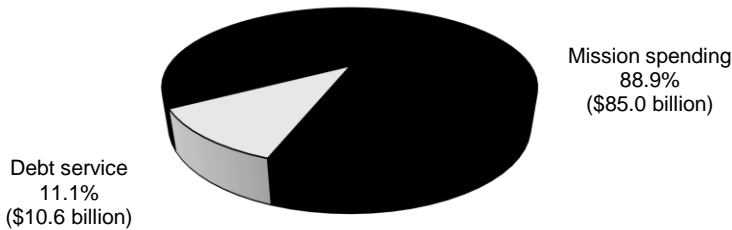
In 2013-2014, the government allocated \$10.6 billion to debt service, representing more than 11% of its spending.

- This amount exceeds the spending of the Ministère de l'Éducation, du Loisir et du Sport, at \$10.4 billion in 2013-2014.
- It also exceeds all the direct financial support the government provides for individuals and families, i.e. the total of family allowances, last-resort assistance and student financial assistance.

The greater the costs associated with the debt, the lesser the financial resources available to fund services, or to improve Québec's tax competitiveness.

CHART 5

Debt service as a proportion of consolidated expenditure in 2013-2014 (per cent)



2. SIGNIFICANT PRESSURE ON PUBLIC SPENDING

To gain a good grasp of the Québec's public spending problem, we will address:

- the major missions of government;
- the relative weight of public spending in Québec's economy;
- the factors that account for the ongoing rise in spending.

2.1 The major missions of government

Government spending is divided among five major missions.

These missions represent the government's primary fields of activity. The five missions are:¹

- Health and Social Services;
- Education and Culture (education, employment, information, culture, communications, tourism and recreation);
- Economy and Environment (natural resources, agriculture, environment, economy, industry and transportation);
- Support for Individuals and Families (support for individuals, families and communities);
- Administration and Justice (governance, public policy and administration, legislation, justice and law).

Depending on the type and nature, spending can be carried out by various entities, such as government departments, special funds, organizations of the health and education networks, as well as non-budget-funded bodies (for instance, the Régie du bâtiment and state museums).

Spending may also be carried out through the tax system, in particular by means of refundable tax credits.

TABLE 1

Consolidated expenditure by mission in 2013-2014 (millions of dollars and per cent)

	\$ million	%
Health and Social Services	36 304	38.0
Education and Culture	20 123	21.0
Economy and Environment	12 147	12.7
Support for Individuals and Families	9 452	9.9
Administration and Justice	7 012	7.3
Subtotal	85 038	88.9
Debt service	10 608	11.1
TOTAL	95 646	100.0

Note: Figures have been rounded off, so the total may not correspond to the total indicated.

1 Government departments and organizations can be involved in more than one mission.

Growth in government spending

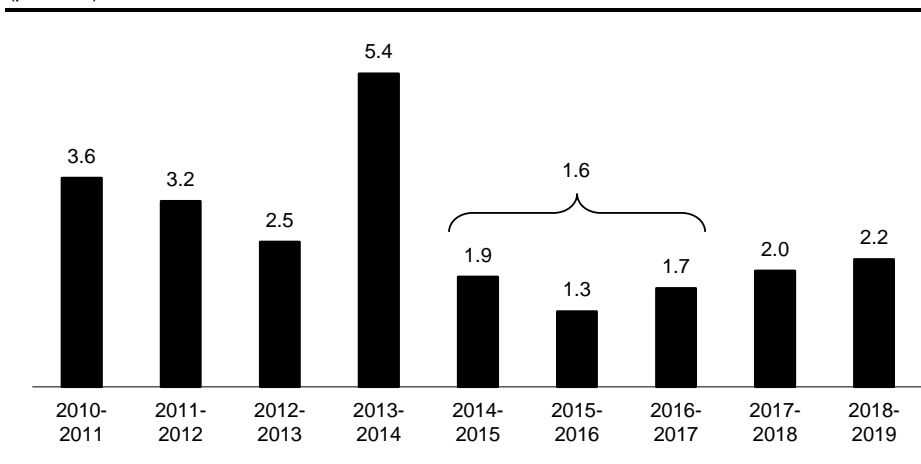
In addition to program spending by government departments, consolidated expenditure includes spending by special funds, non-budget-funded bodies, entities of the health and social services and the education networks, and debt service.

After growing by 5.4% in 2013-2014, the government set objectives for growth in consolidated expenditure excluding debt service:

- 1.9% in 2014-2015;
- 1.3% in 2015-2016;
- 1.7% in 2016-2017.

Growth in consolidated expenditure excluding debt service from 2010-2011 to 2018-2019

(per cent)



2.2 The relative weight of public spending in Québec's economy

Public spending accounts for a little more than one quarter of Québec's economy and shows the extent of the basket of public services.

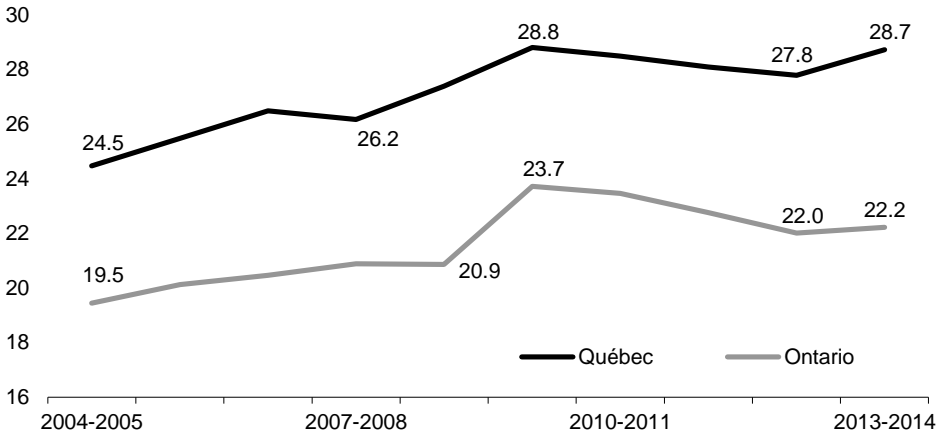
- After rising during the 2009-2010 recession, consolidated expenditure as a percentage of GDP fell until 2012-2013, but remained above its pre-recession level.

In 2013-2014, consolidated expenditure as a percentage of the economy grew to 28.7%, equalling the share in 2009-2010.

- By way of comparison, this share was 22.2% in Ontario in 2013-2014, a difference of 6.5 percentage points.

CHART 6

Change in government spending⁽¹⁾ in the economy in Québec and Ontario (as a percentage of GDP)



(1) Consolidated expenditure by provincial and local public administrations, excluding debt service. The data are taken from Statistics Canada's Financial Management System (FMS), which shows provincial spending on a comparable basis by including spending by local administrations in particular. The Ministère des Finances du Québec makes certain adjustments to the data for Québec to make them more comparable with those of the other provinces. Since FMS data are available only until 2008-2009, the Department has carried out projections for 2009-2010 to 2013-2014.

Sources: Statistics Canada, Department of Finance Canada and Ministère des Finances du Québec.

Less wealth than in most other provinces

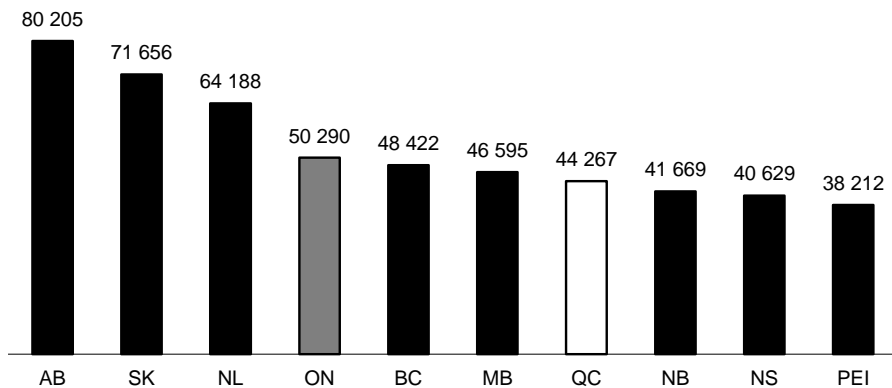
The higher percentage of public spending in the economy in Québec than in Ontario reflects not just the extent of the basket of services offered in Québec but also Québec's relatively lower wealth.

Indeed, Québec per capita GDP ranked seventh among the provinces in 2012.

- It was \$6 023 less than Ontario's, while the gap with Alberta was nearly \$36 000.
- Just three provinces were less rich than Québec at the time, namely New Brunswick, Nova Scotia and Prince Edward Island.

Per capita gross domestic product – Calendar year 2012

(dollars)



Sources: Statistics Canada and Ministère des Finances du Québec.

2.3 The factors that account for the ongoing rise in spending

The rise in spending is attributable to factors present in every activity sector.

However, the outlook varies from sector to sector, such as health and social services, primary and secondary education, higher education and family.

Upward pressure on spending growth will continue in the years ahead.

2.3.1 Factors present in every activity sector

Generally speaking, the growth in public spending² can be attributed to:

- changes in the number of service recipients, such as the growth in student enrolment or users of the health system;
- changes in the price of public service delivery, attributable in particular to the rising price of goods and pay rises;
- quantitative and qualitative improvements to services, including the creation of new programs.

2 For this section, the notion of spending refers to program spending, to which is added spending by the Land Transportation Network Fund (FORT) and the Fund to Finance Health and Social Services Institutions (FINESSS).

❑ Change in the number of service recipients

Spending reacts to population growth and, for specific services, to the change in population of specific age groups:

- a high proportion of children under age 5 benefits from subsidized daycare spaces;
- young people age 5 to 16 receive education services at the primary and secondary levels;
- a high proportion of individuals age 17 to 24 attend higher education institutions;
- the population as a whole receives health services, though the nature and cost of services required depend on age.

Over the coming years, Québec’s population will continue to grow, but more slowly than in the past. However, the changes will be more significant in certain specific age groups.

For instance, the average decline of 1.1% per year among young people age 5 to 16 over the last ten years will be replaced by an increase of 1.2% on average from now to 2024.

TABLE 2

Demographic growth in Québec
(average annual growth rate, per cent)

	Between 2004 and 2014	Between 2014 and 2024
Total population growth	0.9	0.6
Population growth by age group		
Under age 5	1.8	−0.1
Age 5 to 16	−1.1	1.2
Age 17 to 24	0.6	−1.6
Age 25 to 64	0.6	0.0
65 or older	3.3	3.3

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

❑ **Change in the price of public services**

Public spending is influenced by the price of services funded by the government, the change of which is closely tied to the change in the general level of prices in the economy, i.e. inflation.

For services as a whole, the price of public services also reflects the effects stemming from pay rises and costs relating to maintaining pay equity and to special agreements.

❑ **Qualitative and quantitative improvements to services**

A portion of public spending goes to qualitative and quantitative improvements to services, i.e.:

- introduction of new programs and public services;
- improvement of existing services.

Many programs have been put in place since the late 1960s, including the college network and the Régie de l'assurance maladie du Québec.

With respect to public services, the late 1990s saw the introduction of reduced-contribution daycare services whose cost has risen from \$1.3 billion to \$2.3 billion over the last ten years.

Few new programs have been introduced in recent years. Nonetheless, many initiatives have been taken to improve the existing offering of services and broaden public services in certain sectors.

Services can be improved in many ways.

- In some cases, the coverage of existing services is increased.
 - For instance, governments have funded an increase in the number of subsidized daycare spaces at a faster pace than the rate of increase in the number of children under age 5 because the number of spaces was insufficient to meet demand.
- In other circumstances, additional resources were allocated to a service to improve its quality, for instance by raising the number of resource-persons for handicapped pupils or those with adaptation or learning difficulties.

❑ The influence of each of these factors over the last ten years

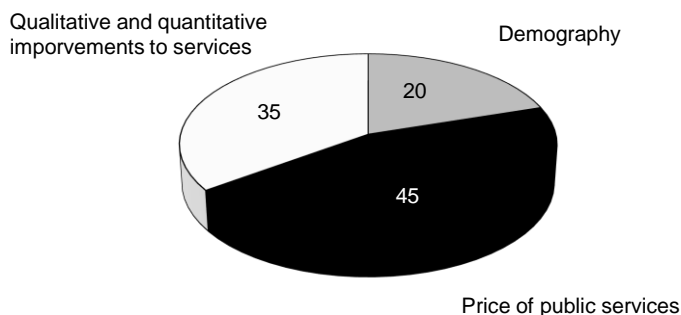
In Québec, between 2003-2004 and 2013-2014, spending has grown by an average of 4.6% per year.³

Demography and price account for two thirds of this growth, with the remaining third resulting from qualitative and quantitative improvements to services.

- The government's major priorities, i.e. health, services to families and primary, secondary and post-secondary education, have benefited from qualitative and quantitative improvements to services.
- Overall, the other government missions have also benefited from qualitative and quantitative improvements to services.

CHART 7

**Share of the contribution of factors in spending growth
between 2003-2004 and 2013-2014**
(per cent)



Source: Calculations by the Ministère des Finances du Québec.

3 Refers to consolidated expenditure excluding debt service.

2.3.2 Health and social services

Spending on health and social services has experienced one of the most significant increases between 2003-2004 and 2013-2014. It has risen by an average of 5.6% annually.

- This is attributable in part to the substantial impact of demographic change and price increases in this sector.

The change in the price of public services accounts for roughly 40% of the growth in health spending.

Health spending is particularly sensitive to changes in the composition of the demand for services resulting from the aging of the population.

- Indeed, per capita health spending is higher for older persons than for other population groups.
- Aging of the population accounts for almost one quarter of the increase in health spending over the last decade.

TABLE 3

Contribution of factors to growth in health and social services spending between 2003-2004 and 2013-2014

	Contribution to growth (percentage points)	Share of growth (per cent)
Aging of the population	1.3	23
Population growth	0.8	15
Price of public services	2.2	39
Qualitative and quantitative improvements to services	1.3	23
– Including: the increase in the number of physicians per capita and the adoption of new technologies		
TOTAL	5.6	100

Source: Calculations by the Ministère des Finances du Québec.

Qualitative and quantitative improvements to services account for 23% of the growth in health spending. They contributed 1.3 percentage points on average to the annual increase in health spending.

- The number of physicians per capita rose by 14% between 2003 and 2012, from 207 to 235 per 100 000 of population.
- The cost of care delivery increased because of the influence of technological advances on medical practice.
- To meet the needs expressed by the public, the coverage of the public health insurance plan was extended to new services.
 - Examples include assisted procreation in 2010 and macular degeneration in 2011.

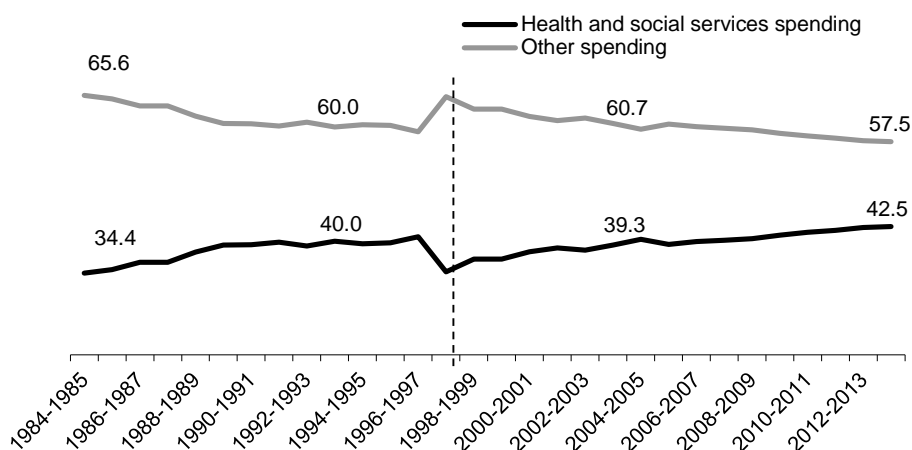
Health spending: growing pressure on government spending

The health and social services sector receives the largest share of the government's budget. In 2013-2014, health spending accounted for more than 40% of consolidated expenditure excluding debt service.

Over the last 30 years, health and social services spending has risen faster than spending in other sectors.

- Its share of the government's budget has risen by almost 10 percentage points during this period.

Share of health and social services spending⁽¹⁾ and other spending in total consolidated expenditure, from 1984-1985 to 2013-2014
(per cent)



Note: Consolidated expenditure of the Health and Social Services mission. The data for 2013-2014 and years prior to 2012-2013 are obtained by applying the 2012-2013 proportion of consolidated health and social services spending compared to program spending in health and social services (including the FINESSS) to program spending in health and social services (including the FINESSS) of other years. The data for years prior to 1997-1998 cannot be restated on the same basis as those for later years because of the reform of government accounting.

(1) Consolidated expenditure excluding debt service.

Source: Calculations by the Ministère des Finances du Québec.

2.3.3 Primary and secondary education

The number of young people age 5 to 16 declined between 2003-2004 and 2013-2014.

- Since this age group is the source of enrolment for primary and secondary education establishments, this made it possible to fund the qualitative and quantitative improvement in education services for these levels, while holding spending growth to 3.2%.

The qualitative and quantitative improvement in services accounts for just over two thirds of the spending growth for primary and secondary education over this period. Their contribution amounted to 2.2 percentage points.

- Primary and secondary education services improved in many ways over this period.
- For instance, the number of pupils per class fell in primary and secondary schools, especially in disadvantaged areas.
- In addition, to support at-risk pupils and handicapped pupils as well as those with adaptation or learning difficulties, resource-persons were added in primary and secondary schools as of 2006-2007.

TABLE 4

Contribution of factors to the growth in primary and secondary education spending between 2003-2004 and 2013-2014

	Contribution to growth (percentage points)	Share of growth (per cent)
Growth in the population age 5 to 16	-1.0	-31
Price of public services	2.0	63
Qualitative and quantitative improvements to services	2.2	68
— <i>Including: support for pupils with adaptation or learning difficulties</i>		
TOTAL	3.2	100

Source: Calculations by the Ministère des Finances du Québec.

2.3.4 Higher education

Spending for higher education increased by an average of 3.9% annually between 2003-2004 and 2013-2014.

The increase in the price of public services and that in the number of adults age 17 to 24, which is the main source of enrolment for post-secondary education institutions, account for just over two thirds of this increase.

Qualitative and quantitative improvements to services alone account for 30% of the growth in spending.

- In recent years, coverage of post-secondary education services has broadened: enrolment in post-secondary education institutions has risen faster than the population age 17 to 24.
- This is attributable in particular to the support the government has provided to develop the supply of college and university programs and attract new sources of enrolment: the government has, among others, supported continuing education and the supply of new programs throughout Québec.

TABLE 5

Contribution of factors to growth in higher education spending between 2003-2004 and 2013-2014

	Contribution to growth (percentage points)	Share of growth (per cent)
Growth in the population age 17 to 24 ⁽¹⁾	0.5	14
Price of public services	2.2	56
Qualitative and quantitative improvements to services	1.2	30
– <i>Including: increase in enrolment of higher education institutions</i>		
TOTAL	3.9	100

(1) Refers to the impact of the growth of the population age 17 to 24 on spending growth for a constant enrolment rate in higher education institutions.

Source: Calculations by the Ministère des Finances du Québec.

2.3.5 Family

Spending on family services, consisting mainly of grants for daycare services, rose by 5.6% on average per year between 2003-2004 and 2013-2014.

The increase in the number of children under age 5, which has an impact on the demand for subsidized daycare spaces, accounts for almost one third of the increase in spending for family services.

In addition to funding the growth in spending attributable to the change in demography and price, the government funded the qualitative and quantitative improvement in services. In particular, the government significantly increased the number of subsidized daycare service spaces.

TABLE 6

Contribution of factors to growth in family support spending between 2003-2004 and 2013-2014

	Contribution to growth (percentage points)	Share of growth (per cent)
Growth in the population under age 5 ⁽¹⁾	1.7	30
Price of public services	2.2	39
Qualitative and quantitative improvements to services	1.7	31
– <i>Including: increase in the proportion of children benefiting from a subsidized daycare service space</i>		
TOTAL	5.6	100

(1) Refers to the impact of the growth in the population under age 5 on that of spending for a given proportion of children in a subsidized daycare service space.

Source: Calculations by the Ministère des Finances du Québec.

2.3.6 Upward pressure on spending growth will continue

Because of the forecast change in demography and prices between 2013-2014 and 2023-2024, spending would have to be increased by 3.0% per year on average to maintain the existing basket of services without changing how services are delivered.

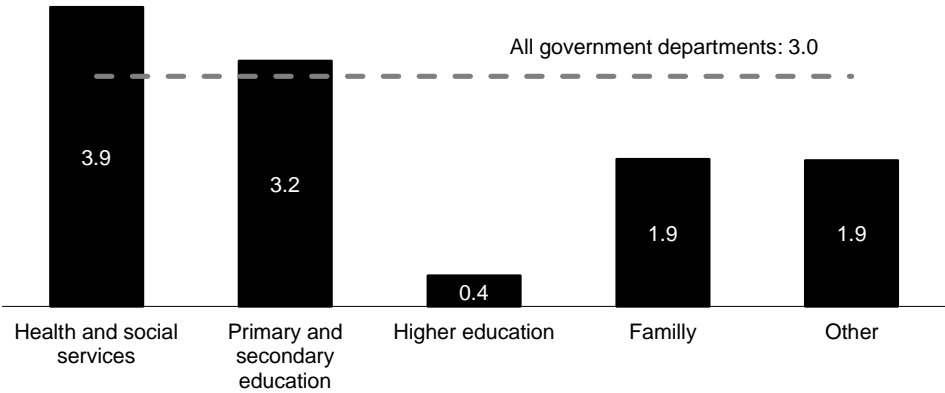
- For health and social services as well as for primary and secondary education, growth attributable to these factors is expected to be especially substantial, amounting to 3.9% and 3.2% per year on average.

Compared with what prevailed in the last decade, the impact of demography⁴ and prices on spending growth between 2013-2014 and 2023-2024 should be similar for spending as a whole and:

- higher for primary and secondary education, because of the increase in the number of young people age 5 to 16;
- lower for family support and higher education because of the decline in the number of children under age 5 and young people from 17 to 24;
- similar for health and social services.

CHART 8

Impact of demography and prices on spending growth between 2013-2014 and 2023-2024
(percentage points)



Source: Calculations by the Ministère des Finances du Québec.

4 The table showing growth forecasts by age group is on page 15.

3. MORE MODERATE GROWTH IN GOVERNMENT REVENUES

The issue of revenues is characterized essentially by slower growth, based on foreseeable trends. To properly understand this issue, the following elements will be discussed, in order:

- the make-up of government revenues;
- the share occupied by tax revenues in the economy;
- the slower growth in revenues observed in recent years;
- the factors explaining slower growth in revenues;
- current forecasts regarding trends in government revenues.

3.1 The make-up of government revenues

The government draws its revenues primarily from four different sources.

- Income and property taxes represent the government's most important revenue source. This category includes, in particular, personal income tax, contributions for health services and corporate income tax. Revenues related to this first revenue source represent just over 40% of total revenues.
- Federal transfers constitute the second most important revenue source for the Québec government. They represent 20% of government revenues.
- Consumption taxes constitute nearly 20% of government revenues.
- Revenues from government enterprises (Hydro-Québec, Loto-Québec and the Société des alcools du Québec, primarily) represent approximately 6% of government revenues.

TABLE 7

Consolidated revenues by source in 2013-2014
(millions of dollars and per cent)

	\$ million	%
Income and property taxes	39 556	42.2
Consumption taxes	17 156	18.3
Duties and licences	2 167	2.3
Miscellaneous	9 403	10.0
Government enterprises	5 444	5.8
Federal transfers	18 820	20.1
Revenues of the Generations Fund	1 121	1.2
TOTAL	93 667	100.0

Note: Since figures are rounded, they may not add up to the total shown.

3.2 The share occupied by tax revenues in the economy

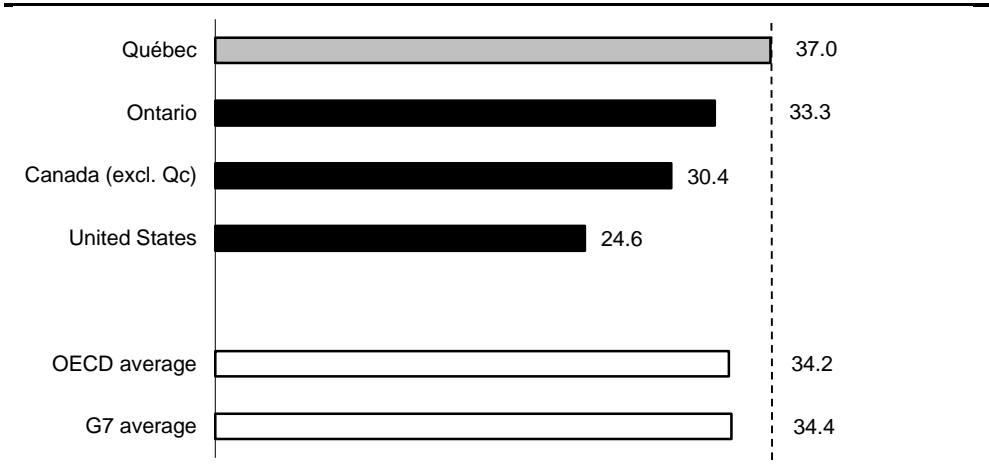
In 2010, the total tax revenues collected in Québec, including all tax revenues of the different levels of government, represented 37% of GDP.

The weight of tax revenues in the economy was heavier in Québec than in Ontario, the rest of Canada, the average for the OECD member countries and the average for the G7 countries.

- By way of comparison, the overall tax burden totalled 33% in Ontario, 30% in the rest of Canada and 25% in the United States.
- As a proportion of GDP, the average tax burden amounted to just over 34% on average in the OECD member countries and in the G7 countries.

CHART 9

Share of total tax revenues⁽¹⁾ — 2010⁽²⁾
(as a percentage of GDP)



(1) Includes total tax revenues of federal, provincial and municipal public administrations.

(2) Last year available for comparison with the jurisdictions presented in the chart.

Sources: Statistics Canada, OECD and Ministère des Finances du Québec.

3.3 Slower growth in revenues observed in recent years

Overall, the government's own-source revenues grew more slowly between 2010-2011 and 2013-2014 than had been anticipated at the time the plan to restore fiscal balance was announced.

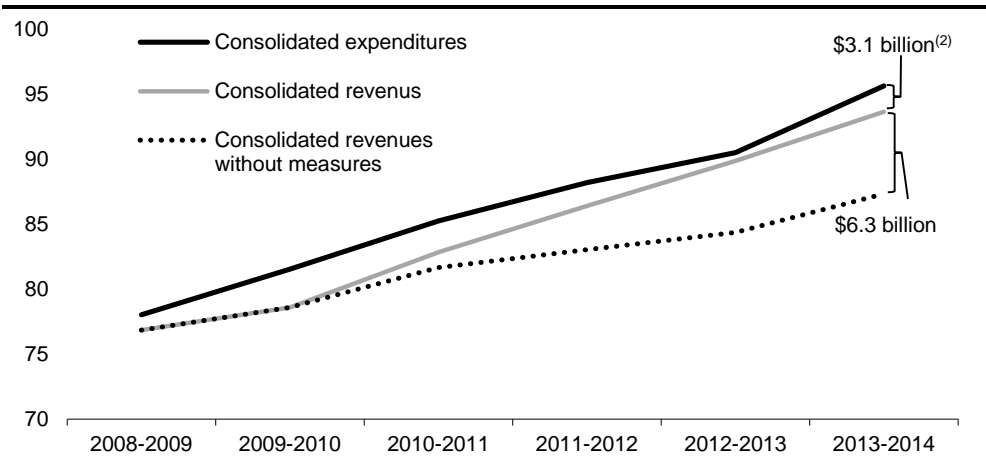
- The economic situation in 2012-2013 and 2013-2014 was less favourable than had been forecast in Budget 2010-2011, which has had an impact on government revenues.

Growth in revenues was slower despite the measures implemented since 2010 as part of the efforts to restore fiscal balance.

- In 2013-2014, the budget deficit totalled \$3.1 billion.
- Without the measures implemented to increase revenues, the gap between revenues and expenditures in 2013-2014 would total roughly \$9 billion.

CHART 10

Trends in consolidated expenditures and revenues⁽¹⁾ with and without the measures introduced to increase revenues
(billions of dollars)



Note: The financial impact of the measures on revenues is that estimated when the measures were announced.

(1) Consolidated revenues include Hydro-Québec's extraordinary loss of \$1 876 million on the closure of the Gentilly-2 nuclear power plant in 2012-2013.

(2) The deficit for 2013-2014, i.e. the gap between consolidated revenues and expenditures, plus payments to the Generations Fund, is \$3.1 billion.

Source: Calculations of the Ministère des Finances du Québec.

3.4 The factors explaining slower growth in revenues

Several factors explain the slower growth observed in revenues. For the future, structural factors are combined with cyclical factors.

3.4.1 Cyclical factors

Certain cyclical factors affect Québec's economic growth:

- global economic growth has been weaker since the 2008-2009 recession;
- this slower growth is combined with the lower inflation recently observed.

❑ Fragility of the global economy

Nearly five years after the end of the 2008-2009 recession, the situation of the global economy remains fragile. After the rebound observed in 2010, global economic growth has slowed, due to the continuing effects of the last financial crisis.

Economic activity in Québec, strongly tied to that in other North American economies, reflects this context of sluggish recovery following the recession.

TABLE 8

Trends in economic growth (real GDP, variation in percentage)

	Average 2000-2008	2009	2010	2011	2012	2013
World	4.1	-0.4	5.2	3.9	3.2	3.0
United States	2.3	-2.8	2.5	1.8	2.8	1.9
Canada	2.6	-2.7	3.4	2.5	1.7	2.0
Québec	2.1	-0.6	2.3	1.8	1.5	1.1

Sources: Institut de la statistique du Québec, Statistics Canada, IHS Global Insight, International Monetary Fund and Ministère des Finances du Québec.

❑ Low inflation

Most advanced economies experienced low inflation in 2013. Québec was no exception in this regard, as growth in prices declined substantially.

In the case of Québec, slow growth in prices was unexpected. It can be explained by, among other factors, moderate growth in domestic demand, stiffer competition in the retail trade and a context of surplus supply, also evident at the international level.

Low inflation has had an impact on nominal GDP growth, on which growth in government revenues depends.

TABLE 9

Trends in real and nominal GDP in Québec (per cent)

	Average 2000-2008	2009	2010	2011	2012	2013
Real GDP	2.1	-0.6	2.3	1.8	1.5	1.1
GDP deflator	2.1	1.2	2.1	2.9	2.1	0.8
Nominal GDP	4.2	0.6	4.5	4.7	3.6	1.9

Sources: Statistics Canada and Institut de la statistique du Québec.

3.4.2 Structural factors

Certain structural factors will limit Québec's long-term economic growth. Essentially two factors must be noted.

- Demographic changes directly affect Québec's economy, and they are already under way.
- Weaker potential growth among our main trading partners will have an impact on the whole of Québec's economy and on its capacity to create wealth.

❑ Demographic changes: a reduction in the number of people of working age

According to the data of the Statistics Canada Labour Force Survey, the population age 15 to 64, i.e. those who participate most actively in the labour market, grew by only 0.1% in 2013 in Québec (+0.6% in Canada).

Due to the aging of the population, the potential labour pool in Québec is expected to shrink in coming years, unlike Canada, where it will continue to expand.

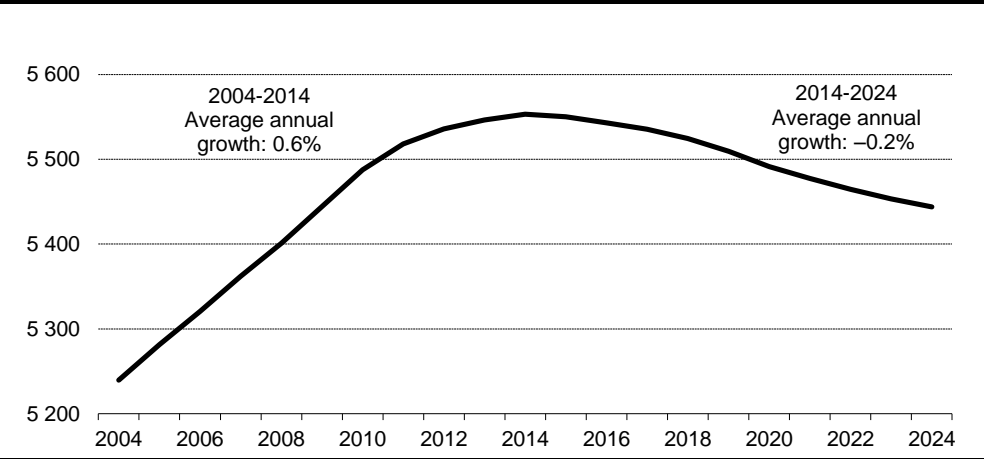
- From 2014 to 2024, the population age 15 to 64 should decline by an average of 0.2% per year in Québec.
- In Canada, average growth of 0.3% per year is expected.

In 2013, Québec's population age 10 to 14 was 393 237, whereas its population age 60 to 64 was 521 769.

- Over the coming years, the massive number of workers expected to retire will lead to a decline in the potential labour pool.
- The number of young people arriving at working age will be insufficient to replace this generation.

CHART 11

Change in the number of individuals age 15 to 64 in Québec (thousands of individuals)



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

❑ **Weaker potential growth among Québec's main trading partners**

Québec's economy moves in step with that of its main trading partners. In the short term, growth in real GDP may exceed potential growth, in particular due to the drop in underutilized production capacities still present in the economy.

Moreover, after the 2008-2009 recession, potential growth in real GDP in Canada and the United States was revised downward, due to a weaker demography and the effects of the financial crisis.

- The Bank of Canada recently evaluated the potential growth in real Canadian GDP in the medium term at 2.0%.
- The Congressional Budget Office estimates that the potential growth in real GDP in the United States should be 2.0% in the medium term.
- By way of comparison, the average growth observed from 2000 to 2007 was 2.8% in Canada and 2.6% in the United States.

In this context, a number of economists refer to a “new normality,” a situation in which economic growth will henceforth be weaker than that observed before the 2008-2009 recession, particularly in advanced economies.

Demographic change and lower potential growth among our partners will limit economic growth in Québec in a long-term perspective.

3.5 Current forecasts regarding trends in government revenues

It would be possible to maintain steadier economic growth in Québec in the future provided bold policies produce results as regards labour market participation, immigration and productivity.

However, despite the progress that will be accomplished regarding labour use and productivity, Québec's demographic profile is expected to detract from economic growth over the coming years.

Thus, the projections of the Ministère des Finances point to a reduction in Québec's economic growth potential, even taking into account a more effective use of production capacities.

TABLE 10

Contribution of factors to Québec's economic growth (average annual percentage change)

	Average 1982-2012	2013	2016-2020	2021-2025
Real GDP	2.0	1.1	1.7	1.3
Factor responsible for growth				
– Potential labour pool ⁽¹⁾	0.6	0.1	–0.3	–0.2
– Employment rate ⁽²⁾	0.6	1.1	1.0	0.5
– Productivity ⁽³⁾	0.8	–0.1	0.9	1.0

Note: Since figures are rounded, they may not add up to the total shown.

(1) Population age 15 to 64.

(2) Total number of workers as a proportion of the population age 15 to 64.

(3) Real GDP per job.

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

4. ANSWERS FOR THE FUTURE

The government has mapped out a number of approaches that could be taken in future efforts to meet the challenge of public finances.

- These approaches essentially address the nature of the solutions that must be brought to bear in response to economic challenges.
- As of now, the government is announcing the creation of two committees to advise it in the definition and implementation of forthcoming government policy directions.

4.1 Nature of the solutions that must be brought to bear in response to economic challenges

To meet the economic challenges of the future, Québec must mobilize the levers at its disposal to stimulate economic growth.

❑ Ongoing adaptation by the labour market

In recent year, the labour market in Québec has succeeded in adapting to demographic changes. Thanks to its robust labour market, Québec has substantially narrowed and even closed the gaps with Canada, particularly as regards the participation rate and the employment rate.

Progress in the labour market is still possible in the coming years, particularly in the category of experienced workers. Employment rates for the population age 55 and over are still lower than those of Canada.

In 2013, the employment rate:

- for the population age 55 to 59 was 67.9% in Québec, compared to 69.5% in Canada;
- for the population age 60 to 64 was 41.8% in Québec, compared to 50.0% in Canada;
- for the population age 65 to 69 was 17.8% in Québec, compared to 24.4% in Canada.

In addition, immigration could be used better and more extensively, particularly by more readily recognizing diplomas and professional experience.

TABLE 11

Participation rate and employment rate by age group in 2013 (percentage rate, difference compared to Québec in percentage points)

	Employment rate			Participation rate		
	Québec	Canada	Difference	Québec	Canada	Difference
Age 15 to 24	58.1	55.1	3.0	66.8	63.8	3.0
Age 25 to 54	81.7	81.5	0.2	87.4	86.6	0.8
Age 55 to 59	67.9	69.5	-1.6	72.9	74.0	-1.1
Age 60 to 64	41.8	50.0	-8.2	46.3	53.7	-7.4
Age 65 to 69	17.8	24.4	-6.6	18.8	25.5	-6.7
Age 70 and over	4.7	6.4	-1.7	5.0	6.7	-1.7

Source: Statistics Canada.

❑ Raising productivity

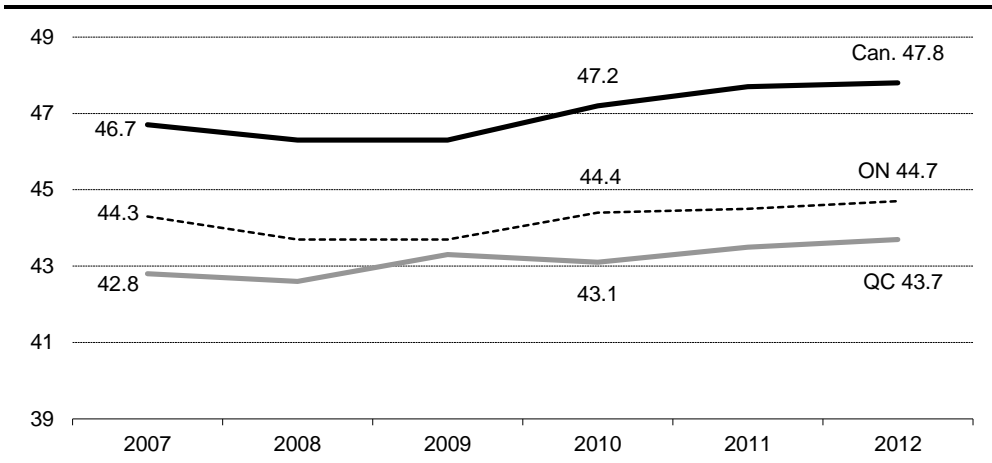
In a context in which progress as regards employment is henceforth more difficult to achieve due to a decline in the potential labour pool, growth in productivity remains the principal means to maintain our standard of living.

The challenges facing Québec as regards productivity are substantial. Despite gains achieved in recent years, there are still productivity gaps with our main partners.

- The productive potential of businesses should be maximized, thanks to more efficient utilization of available or underutilized resources.
- Investment by businesses should be further stimulated, particularly in sectors favourable to innovation, the engine of economic growth.

CHART 12

Labour productivity in the business sector (dollars per hour worked, in real terms)



Source: Statistics Canada.

Measures taken by the government to support the economy¹

The government's goal is to revive economic activity while laying the foundations for economic growth that is both sustained and lasting. In the first days of its mandate, the government took steps in that direction and announced two measures to foster economic recovery and job creation:

- the introduction of the LogiRénov tax credit for home renovation;
- the \$42-million increase in the budget allocated to silvicultural work, raising the total envelope to \$225 million.

The government also intends to take steps to restore investor confidence and boost the productivity of the economy.

An economic recovery plan in Budget 2014-2015

As part of Budget 2014-2015, the government is proposing major initiatives for Québec's economic recovery in five areas:

- providing new support for investors and exporters, especially for SMEs, particularly by fostering regulatory streamlining, sustaining innovation and encouraging business start-ups. To this end, the budget provides for:
 - across-the-board tax measures that will make it possible to provide financial maneuvering room for SMEs to invest,
 - creation of the Créativité Québec program with a \$150-million envelope to support innovative projects;
- immediately implementing the maritime strategy, by providing for the development of port and river infrastructures and the introduction of incentives to foster the modernization and renewal of vessels in Québec. The government is announcing, in particular:
 - its intention to implement a high-value-added logistical hub in Montérégie,
 - the creation of a tax-free reserve for work carried out in Québec shipyards;
- relaunching the Plan Nord, in particular by strategic investments to foster the economic development of and access to the territory;
 - creation of Capital Mines Hydrocarbures, with capital of \$1 billion,
 - launching a study to develop a new rail line to improve access to the Labrador Trough,
 - investments of \$100 million to train Aboriginal people;
- banking on natural resources by restoring confidence in the mining industry, reviving the forest industry, implementing the necessary oversight measures to ensure responsible development of Québec's oil potential, as well as banking on electricity as a source of economic growth;
- investing in infrastructures, while controlling the debt and taking into account Quebecers' ability to pay.

¹ All the measures of the plan for Québec's economic recovery are presented in Section B of the Budget Plan.

4.2 Government policy directions: creation of two committees

Although necessary, these efforts alone will not be sufficient, in themselves, to achieve a pace of economic growth guaranteeing the sustainability of public finances.

We must ensure that the tax system fosters lasting economic growth.

- This is the backdrop against which the government is announcing the creation of the Québec Taxation Review Committee.
- We must also ensure that the various tax measures granted to assist individuals and businesses are appropriate and provide society with the expected benefits. The Québec Taxation Review Committee will also examine this issue.

It is essential to examine the basket of public services and ensure that taxpayers' money is well spent.

- We must therefore examine whether existing programs are appropriate.
- We must also analyze the way programs are delivered.

This is the backdrop against which the Ongoing Program Review Committee has been announced.

☐ A transparent approach fostering social dialogue

The government wishes to set up a consultation mechanism that will enable dialogue with the population before the committees formulate their recommendations.

Review of programs and examination of the tax system will go hand in hand with a social dialogue focusing on sensitive issues that raise concerns for society.

4.2.1 A committee to examine Québec's tax system

The Québec Taxation Review Committee will propose means to improve the tax system so that it fosters lasting economic growth and will ensure that government support granted through the tax system achieves the targeted objectives.

More generally, the work of the Québec Taxation Review Committee will be aimed at opening up a social dialogue on the means to fund public services and proposing approaches for optimizing Québec's tax system.

In particular, the committee will be mandated to answer the following questions:

- How can we increase the effectiveness, fairness and competitiveness of Québec's tax system while ensuring funding for public services?
- Should certain tax expenditures be reviewed?
- Where does Québec stand in relation to global trends in taxation, particularly when compared to its geographic neighbours such as the United States and the other Canadian provinces?
- Is it possible to improve the balance between different modes of taxation?
- How can we more strongly encourage work, savings and investment?
- How can we encourage a contribution and a redistribution of wealth that is fair for all Quebecers?

4.2.2 A committee for ongoing program review

The committee will be mandated to examine whether existing programs are appropriate, as well as the way they are delivered.

In the course of its work, it will examine the following questions:

- Is it appropriate for the government to fund each of the public services currently included in the basket of public services?
 - In particular, are programs established in the past still justified in the present context?
- Are the programs effective?
 - Do they achieve their objectives?
- Are the programs efficient in providing services?
 - More particularly, are the processes, structures and modes of delivery managed rigorously?

Government spending has an impact on economic growth. The committee will thus also have to consider this factor in its work, so as to ensure that program review is not done at the expense of economic growth.

Special attention will thus have to be paid to programs that stimulate investment, as well as programs making it possible to respond to demographic change by stimulating the birth rate or encouraging immigration.

