

# BUDGET

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June 12, 2003

## *PROVINCIAL BUDGET SPEECH OF JUNE 12, 2003*

- *Tax measures*
- *Economic Viewpoint*

**INFORMATION BULLETIN**



**Desjardins**  
Fédération des caisses  
du Québec

*Office of the Vice-president, Tax Service  
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June 12, 2003

**Y**ves Séguin, Minister of Finance, tabled his 2003-2004 budget this afternoon. The budget announces a tax increase for the Desjardins caisses as well as a suspension of the reduction in the rates of capital tax for all corporations. Announced also are significant cuts with respect to many credits granted to businesses. No measure affecting individuals were announced. Finally, most of the measures announced in the March 11 budget were not incorporated.

### Highlights

#### Measures concerning Desjardins - Enterprises

##### New measures

- Elimination of the reduced tax rate for savings and credit unions
- Suspension of the reduction in the rate of capital tax for financial institutions
- Elimination of eligible deduction in calculating paid-up capital for saving and credit unions
- Elimination of the tax advantages related to accelerated depreciation
- Elimination of the income tax exemption for CRCD
- Temporary limits on capitalization assistance of CRCD
- Clarification on share purchase costs and with respect to cost of borrowing for CRCD
- Applicable cap on deductible entertainment expenses
- Reduction of certain tax measures
- Reduction of the R&D tax assistance

##### March 11 Budget: incorporated measures

- Relaxation of investment requirements imposed on CRCD and other mutual fund corporations

##### March 11 Budget: eliminated measures

- Refundable tax credit for the hiring of new graduates in remote resource regions
- Improvement of the tax credit for on-the-job training in remote resource regions

#### Measures concerning enterprises

##### New measures

- Reduced tax assistance in various sectors
- Elimination of the tax advantages related to accelerated depreciation
- Suspension of the reduction in the rate of capital tax for corporations
- Changes to the increase of eligible deductions in calculating paid-up capital
- Elimination of eligible deduction in calculating paid-up capital for certain financial institutions
- Elimination of the two-year tax holiday on capital tax
- Other various measures

##### March 11 Budget: incorporated measures

- Other measures

##### March 11 Budget: eliminated measures

- Deductibility of the rebates paid by a cooperative (other than a credit union)

#### Measures concerning individuals

##### March 11 Budget: incorporated measures

- Medical expenses paid for dependants
- More eligible adoption expenses for individuals residing in outlying regions
- Flow-through shares
- Foreign workers

##### March 11 Budget: eliminated measures

- Improvement of the tax credit for the housing of a parent
- Refundable tax credit for maternity or adoption leaves taken by self-employed workers
- Refundable tax credit for new graduates working in remote resource regions
- Interest on student loan for individuals residing in remote resource regions
- Tax relief for employee transit passes
- Deduction for employee transit passes

## MEASURES CONCERNING DESJARDINS - ENTERPRISES

### New measures

Elimination of the reduced tax rate for savings and credit unions

Currently, a reduction of 3.15 % of the taxable income of a caisse is applicable as long as its cumulative earnings have not reached an amount equal to 4/3 of its maximum cumulative reserve.

For fiscal years ending after June 12, 2003, this reduced rate is eliminated. For the fiscal years overlapping this date, the elimination will be calculated in proportion to the number of days of the year commencing on budget date.

This measure represents an annual cost of approximately \$9.0M for the entire Desjardins cooperative network.

### **Suspension of the reduction in the rate of capital tax for financial institutions**

A progressive reduction in the rate of the capital tax of financial institutions was announced in the November 1, 2001 budget. The rate was to gradually decrease from 1.28% to 0.6% by 2007.

In the current budget, the applicable rate for 2003 is set at 1.2% and will be maintained for the following years.

In the end, the suspension of this reduction represents an annual cost of \$7.5M for the entire Desjardins cooperative network.

### **Elimination of eligible deduction in calculating paid-up capital for saving and credit unions**

In assessing their capital tax, savings and credit unions can make a basic deduction of \$300,000 in calculating their paid-up capital.

This deduction is eliminated for the years ending after budget date. For the years overlapping the date, the elimination will be made in proportion to the number of days commencing on June 12, 2003.

This measure represents an annual cost of approximately \$2M for the entire Desjardins cooperative network.

### **Elimination of the tax advantages related to accelerated depreciation**

Currently, businesses can benefit from a 125% accelerated depreciation on the purchase of certain new equipment (mainly computer equipment).

This measure is eliminated for purchases made after June 12, 2003, except if the goods are bought within a year and in accordance with an undertaking contracted no later than June 12, 2003.

Accordingly, computer equipment will from now on be depreciable at a declining rate of 30%, like in the federal system.

This measure represents an annual cost of \$1.0M for the entire Desjardins cooperative network.

### **Elimination of the income tax exemption for CRCD**

Currently, CRCD does not pay Québec income tax. For the fiscal years ending after June 12, 2003, this corporation will no longer benefit from Québec tax exemption.

For the years overlapping the budget date, an exemption will be granted in proportion to the number of days of the fiscal year before the budget date.

The same measure will apply to the Fonds FTQ and Fondation.

### **Temporary limits on capitalization assistance for CRCD**

Measures are introduced to temporarily limit the capitalization assistance of certain funds. For CRCD, the authorized capital for the period between March 1, 2003 and February 29, 2004 is cut in half. The maximum issue for the period is accordingly set at \$75M.

An equivalent measure was introduced for the Fonds FTQ, for which no limit existed. The maximum issue for its 2003-2004 year will be limited to \$600M. As regards Fondation, the limit is set at \$50M for this fiscal year.

### **Clarification on share purchase costs and with respect to cost of borrowing for CRCD.**

In the current budget, clarification is given with respect to CRCD, Fonds FTQ and Fondation share purchase costs. They no longer give entitlement to tax credits.

Clarification is also given that, commencing in 2003, interest on loans to invest in these funds are not deductible even if these investment funds change their policy as regards to the payment of dividends.

### **Applicable cap on deductible entertainment expenses**

Currently, a business can deduct 50% of its food and entertainment expenses incurred in the year.

For the years ending after the date of the current budget, the deductible entertainment expenses will be limited to 1% of annual sales.

For the years overlapping the date of the budget, a pro rata calculation will be made based on the number of days of the fiscal year after the date of the budget.

### **Reduction of certain tax measures**

The tax benefits related to certain measures are reduced by 25%:

- tax credit for on-the-job training (from 40% to 30%) for expenses incurred after June 12, 2003 for training that begins after that date;
- exemptions applicable to international financial centres (IFC), including the partial tax holiday for IFC employees.

Finally, it was announced that the following programs, that were to end in the near future, will not be renewed while the assistance for taxpayers who are still entitled to the measures will be reduced by 25%:

- refundable tax credit for training specialized IFC employees;
- refundable tax credit for fund managers;
- refundable tax credit for financial analysts specializing in the securities of Québec corporations or in financial derivatives;
- refundable tax credit for communications between corporations and investors;
- refundable tax credit fostering the participation of investment dealers on the Nasdaq stock market;
- deduction relating to an independent trader of eligible financial derivatives.

### **Reduction of R&D tax assistance**

A business that does research and development (R&D) in Québec can benefit for various refundable tax credits. In the context of a reassessment of the level of tax assistance of all preferential measures granted to businesses, the tax credit rates for R&D will be reduced by 12.5%. So, for Desjardins, the 20% applicable rate on salaries incurred as part of a R&D project will be brought down to 17.5%.

This amendment applies to eligible R&D expenses incurred after June 12, 2003, with respect to R&D work carried after that date.

### **March 11 Budget: incorporated measures**

#### **Relaxation of investment requirements imposed on CRCD and other mutual fund corporations**

In the March 11, 2003 budget, various amendments were brought to the 60% standard in order to relax to investment rules imposed on the Québec mutual fund corporations (CRCD, FTQ and Fondaction), particularly with the adding of investments in joint partnerships as eligible investments.

This measure is incorporated.

### **March 11 Budget: eliminated measures**

#### **Refundable tax credit for the hiring of new graduates in remote resource regions**

In the March 11 budget, a tax assistance to be granted as a 20% refundable tax credit for an eligible employer operating a business in a remote resource region in Québec was announced. The credit was to be based on the eligible salaries paid to eligible employees for a period of 52 weeks, up to a maximum of 8,000\$ per eligible employee.

This tax credit will not be maintained in the future. However, it will apply to an eligible job for which an individual was hired no later than June 12, 2003.

#### **Improvement of the tax credit for on-the-job training in remote resource regions**

In the March 11, 2003 budget, the credit for on-the-job training, which allows a business to claim 40% of the eligible training expenses, was broadened to include training in remote resource regions.

Accordingly, the cap on eligible expenses, which stood at \$500 or \$625 a week depending on the eligible study program, was increased to \$1,000 and \$1,250 respectively. In addition, the maximum eligible hourly rate of the trainee was increased from \$15 to \$25.

These measures will not be maintained in the future. They will only apply to training that began after March 11, 2003 but no later than the date of the current budget.

## MESURES CONCERNING ENTERPRISES

### New measures

#### Reduced tax assistance in various sectors

For several years, several tax measures were added to Québec's tax legislation in order to help various sectors of the economy.

In the current budget, several measures are eliminated, reduced by 25% or are the object of a moratorium that begins today.

Accordingly, the tax benefits related to many measures are reduced by 25%. The main measures affected include:

- the refundable tax credit for on-the-job training (from 40% to 30% for corporations and from 20% to 15% for other taxpayers);
- the refundable tax credits for the Vallée de l'aluminium, for the Gaspésie and certain maritime regions of Québec and for processing activities in resource regions;
- the refundable tax credit for the production of multimedia titles;
- the five-year tax holiday for new corporations (75% instead of the 100% exemption);
- the ten-year tax holiday for manufacturing SMEs in remote resource regions (75% instead of the 100% exemption);
- the five-year tax holidays for certain foreign employees;
- the deduction for securities options;
- the refundable tax credit for design;
- the tax credit for resources;
- the tax advantage related to the purchase of eligible CIP units;
- the refundable tax credit for the declaration of tips.

No other new project will be able to benefit from the following profitable tax measures:

- innovative projects in certain designated sites (other than in the biotechnology sector);
- carrying out activities in certain designated sites;
- carrying out eligible activities in the E-Commerce Place and the Cité de l'optique;
- increasing the payroll in the Technopôle Angus;
- e-business activities carried out in certain designated sites;
- development of biotechnology in certain designated sites;
- development of nutraceuticals and functional foods;
- investments in the Innovation centres;
- foreign trade zone at Mirabel;
- five-year tax holidays granted to certain foreign employees.

In case of a change of control in a corporation benefiting for one of the measures, these advantages will be terminated, unless the corporation acquiring the control benefited itself from the measure before the change.

In addition, a moratorium is tabled with respect to the following tax measures, which will result in no new eligibility certificate being granted by the government as long as it has not tabled its position on the program;

- the tax holiday on major investment projects;
- the Québec stock savings plan (QSSP);
- Québec business investment companies (QBIC);
- Québec Cooperative Investment Plan (CIP).

#### Elimination of the tax advantages related to accelerated depreciation

The measure that aims to eliminate the accelerated depreciation mentioned in the previous section applies to all businesses. Aside for applying to computer equipment, it also applies to equipment used in manufacturing or processing.

#### Suspension of the reduction in the rate of tax on capital for corporations

In the November 1, 2001, budget, a progressive reduction of the tax on capital of corporations other than financial institutions was announced. The rate was to decrease gradually from 0.64% to 0.3% by 2007.

In the current budget, the applicable rate in 2003, i.e. 0.6%, will be maintained for the following years.

### **Amendments to the increase of eligible deduction in calculating paid-up capital**

In the November 1, 2001 budget, the creation of a deduction in calculating the paid-up capital of a corporation other than a financial institution was announced. This \$250,000 deduction in 2003 was to increase by the same amount every year reaching \$1M in 2006.

Instead, this deduction will be increased to \$600,000 for 2004 and the following years.

However, starting in 2003, a corporation whose paid-up capital in the previous year exceeded the maximum deduction amount for that year will have its deduction deducted by \$1 for every \$3 in excess.

### **Elimination of eligible deduction in calculating paid-up capital for certain financial institutions**

With the budget speech of March 31, 1998, a deduction was introduced in calculating the paid-up capital of certain financial institutions. In particular, a bank could deduct, in calculating its paid-up capital for a taxation year, an amount equivalent to \$500M, if its world assets, for the previous taxation year, were under one hundred billion dollars.

This measure will be eliminated for the taxation years ending on or after the date of the current budget. However, for the fiscal years overlapping the date, the elimination will be in proportion with the number of days the fiscal years commencing on the date of the budget.

### **Elimination of the two-year holiday capital tax**

With the budget speech of March 25, 1997, a tax on capital holiday with respect to new investments in certain sectors was introduced. This tax on capital holiday is granted as a deduction, in calculating the paid-up capital of a corporation that is not a financial institution, based on the eligible purchase costs incurred by it for an eligible asset.

A corporation can benefit from this deduction with respect to eligible purchase costs incurred by it in a taxation year for the taxation year during which these expenses were incurred and for the following taxation year.

This tax holiday is eliminated with respect to assets acquired after the date of the current budget.

### **Other various measures:**

- amendments with respect to refundable tax credits for processing activities in resource regions, for the Gaspésie and the Vallée de l'aluminium;
- clarification concerning the concept of eligible employee with respect to various refundable tax credits;
- 12.5% reduction of the assistance with respect to the film production and other types of production.

### **March 11 Budget: incorporated measures**

#### **Other measures**

- clarification concerning the control of a corporation for the application of a tax credit;
- clarification concerning the transfers from Farm Income Stabilization Account;
- consolidation of certain responsibilities with Investissement Québec;
- simplification of the refundable tax credit for corporations specializing in the production of multimedia titles;
- eligibility of certain corporations that do not pay tax for various tax incentives;
- certain tightening measures aiming to ensure a portion of the funding of the new Québec film and audiovisual production policy.

### **March 11 Budget: eliminated measure**

#### **Deductibility of the rebates paid by a cooperative (other than a credit union)**

The March 11 budget proposed to allow eligible cooperatives to deduct an amount of excess rebates. In short, the added rebate was to be equivalent to the proportion of its residual surplus in proportion to the business conducted with the members.

This measure will not be incorporated.

## MESURES CONCERNING INDIVIDUALS

### March 11 Budget: incorporated measures

#### **Medical expenses paid for dependants**

The current tax system grants a non refundable tax credit to offset part of the medical expenses paid by a taxpayer, when these expenses exceed a certain level of income. As a rule, individuals who pay eligible medical expenses for themselves, their spouse and the dependants living regularly with them can deduct, in calculating the income tax to be paid, an amount equal to 20% of the portion of the expenses that exceeds 3% of the household income.

However, when individuals include in calculating their eligible medical expenses paid for the benefit a dependant other than their spouse, whose income is higher than the amount of essential needs recognized for the application of basic tax credit (\$6,150 in 2003), the amount of the non refundable tax credit for medical expenses to which the taxpayer is entitled must be reduced by an amount representing 58% of the income of the dependant that exceeds the amount of recognized essential needs.

The government chose to maintain the measure announced, which aims to better recognize the contribution of individuals providing support of their family and to simplify the tax system. So, individuals will not be required, starting in the 2003 taxation year, to reduce the otherwise determined non refundable tax credit for medical expenses.

#### **More eligible adoption expenses for individuals residing in outlying regions**

The tax system grants to individuals adopting a child a refundable tax credit equal to 30% of the eligible adoption expenses paid by them or their spouse, if the adoption process is completed. The amount of eligible adoption expenses to this tax credit is limited to \$20,000. Taxpayers who adopt children can therefore benefit from a refundable tax credit of up to \$6,000.

The eligible adoption expenses include the travel and living expenses of the parents when they travel abroad to pick up the adopted child and bring him or her back home, the travel expenses of the adopted child to allow him or her to reach the new home as well as those of the person escorting the child when the parent do not accompany the child during the trip.

The tax legislation will be amended to provide for the travel and living expenses that will have been paid by the parents to pick up an adopted child escorted only to a large Québec urban centre. They will be considered eligible expenses for the application of the refundable tax credit for adoption expenses.

This amendment applies to final adoption judgments rendered after December 31, 2000 or where applicable, to certificates of registration of an adoption issued by the clerk of the Court of Québec after that date.

This measure was fully incorporated in the last budget.

#### **Flow-through shares**

The March 11, 2003 provincial budget announced that a flow-through share system, that was to end at the end of 2003, was renewed until the end of 2004. This measure is maintained by the government; however, like other tax measures, the assistance is reduced by 25%.

#### **Foreign workers**

The amendments announced on March 11 with respect to foreign employees and their eligibility to five-year tax holidays are maintained.

### March 11 Budget: eliminated measures

#### **Improvement of the tax credit for the housing of a parent**

In the March 11 budget, a refundable credit for the housing of a parent was transformed into a tax credit for caregivers. In addition, it was to be increased to \$600.

These measures were not incorporated.

#### **Refundable tax credit for maternity or adoption leave taken by self-employed workers**

According to the March 11 budget, the government was to introduce a tax assistance of up to \$5,070 as a refundable tax credit for the year in which a self-employed worker gave birth to a child or adopted one.

This measure was not incorporated.

**Refundable tax credit for new graduates working in a remote resource region**

According to the March 11 budget, an “eligible individual” residing at the end of the year in an “eligible region” could have benefited for a refundable tax credit of 40% of his or her yearly salary, up to a cumulative amount of \$8,000.

An “eligible individual” is a person that has successfully completed a training leading to a professional, college or university level diploma and who received a salary during the year from an “eligible job”. In general, the job was the one filled within 24 months of graduating insofar as this training was related to the job held and the work place was located in an “eligible region”.

This tax credit will not be maintained in the future. However, it will apply to an eligible job for which an individual was hired no later than the day of the current budget.

**Interest on student loan for individuals residing in remote resource regions**

In order to motivate young graduates to settle in a remote resource region following their studies, the tax assistance for interest paid on a student loan was to be doubled for each of the years of residence in the region.

This measure was not incorporated.

**Tax relief for employee transit passes**

The measure aimed to make the payment of an eligible transit pass by an employee or the reimbursement by the employer non taxable, if the individual purchased the pass to commute between his or her regular place of residence and his or her place of work, was not incorporated.

**Deduction of employee transit passes**

As well, the measure aiming to allow employees to deduct any amount paid in the year to purchase an eligible transit pass was not incorporated.

# ECONOMIC VIEWPOINT

## Québec Budget 2003

June 12, 2003

### A neo-liberal consolidation budget

#### Highlights

The minister of Finance, Yves Séguin delivered the first Charest government speech today. It is above all an “upgrading” budget, but also a commitment to transparency. Despite the budget shortfall recently disclosed by the Breton report, the balance of public finances has been maintained for the year, without any new tax increases for the taxpayers. What is apparent in the budget is the serious commitment to realign public finances, especially with respect to the significant tax burden of Quebec taxpayers and the high level of Quebec’s debt. A change in direction based on reduced interventions by the State and greater focus placed on its essential responsibilities is at the centre of the document delivered this afternoon. All in all, the budget meets immediate needs. Only next year will the government’s real mid-term plan be known.

- The budget’s first area of intervention is the tightening of the government’s budget expenditures while priority is given to the health sector and to a lesser degree, education.
- The Charest government’s second area of intervention is cutting and tightening tax spending, particularly with respect to businesses.
- Minister Séguin also wants to increase the performance of public corporations and create new relationships with local and regional bodies.

#### Summary of Budgetary Transactions

In millions of \$	01-02	02-03e	03-04e
Own-source Revenues	41,004	43,403	45,365
- Ann. Var. in %	-4.4	5.9	4.5
Federal Transfers	9,305	9,303	9,584
- Ann. Var. in %	14.2	0.0	3.0
<b>Total Budgetary Revenues</b>	<b>50,309</b>	<b>52,706</b>	<b>54,949</b>
- Ann. Var. in %	-1.4	4.8	4.3
Operating Expenditure	-43,976	-45,570	-47,437
- Ann. Var. in %	4.5	3.6	4.1
Public Debt Charges	-7,261	-7,136	-7,512
- Ann. Var. in %	-4.5	-1.7	5.3
<b>Total Budgetary Expenditures</b>	<b>-51,237</b>	<b>-52,706</b>	<b>-54,949</b>
- Ann. Var. in %	3.2	2.9	4.3
Reserve for Health Education, etc...	950	--	--
<b>Budgetary Balance</b>	<b>22</b>	<b>0</b>	<b>0</b>
Program Spending-to-GDP Ratio (%)	18.5	18.2	17.9
Total Debt Service to Budgetary Revenues (%)	14.4	13.5	13.7
Total Debt-to-GDP Ratio (%)	45.8	44.7	43.7
Dept Ratio representing accumulated deficits to GDP (%)	36.6	34.7	n/a
Net Debt-to-GDP Ratio (%)	40.2	38.7	n/a

e: estimates. n/a: not available.  
Source: Ministère des Finances.

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## A budget based on credible assumptions but without any breathing room

Overall, the Liberal government's first budget is based on realistic economic and financial assumptions, and credible budgetary propositions, but little else. First of all, the budget projections are limited to the fiscal 2003-2004. While conceding that the budget shortfall will continue in fiscal 2004-2005, minister Séguin does not indicate how he will manage to stick to the zero-deficit objective. Moreover, there are no economic forecasts for 2004. So, in our view, this budget appears to be largely an "upgrading" budget.

The economic growth assumptions were obviously brought down in comparison to the Marois budget of March 11. So, the real GDP growth forecast for 2003 was set a 2.5%, which is 1% less than what had been forecast in the Marois budget. Although this forecast is more or less the same as ours, 2.6%, we believe that the Minister could have chosen a more conservative growth forecast, 2.0% for instance. This would have been entirely justified in view of the fact that Quebec's economy has slowed down significantly since the end of 2002, the value of Canadian dollar has risen and the rebound of the American economy is delayed from quarter to quarter. Furthermore, the government did not set aside any contingency reserve as was the case in the Federal budget. However, with respect to interest rates, our forecasts are slightly lower, mostly for the long-term rates, which should mean lower interest charges on the debt.

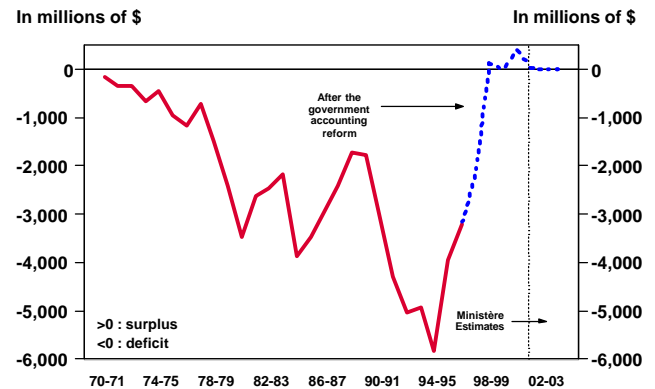
## Economic and financial forecast

	2003			2004		
	Budget		Desjardins Group	Budget		Desjardins Group
	Marois (March 11)	Séguin (June 12)		Marois (March 11)	Séguin (June 12)	
Québec nominal GDP (%)	5.5	5.2	5.9	4.6	n/a	5.3
Québec real GDP (%)	3.5	2.5	2.6	3.2	n/a	3.3
Canadian 90-day Treasury Bonds (%)	3.0	3.2	3.2	4.4	n/a	4.2
Canadian 10-year Bond (%)	5.2	5.2	4.5	5.8	n/a	5.3

n/a: not available.  
Sources: Ministère des Finances and Desjardins Group, Economic Studies.

Nevertheless, despite a "budget shortfall" estimated by the government at \$4.3B, the financial balance for 2003-2004 has been maintained. The zero-deficit objective could be maintained through spending cuts, the utilization of the \$809M budget reserve in the Marois March 11 budget and a series of tax measures. In the end, the budget expenditures will only grow by 4.3% during fiscal 2003-2004, which is lower than

## The budget remains balanced



Source: Ministère des Finances.

Quebec's nominal GDP growth of 5.2%. In addition, spending increases at the same rate as revenues (see table on page 1).

Despite some gaps, the government's financial situation has improved considerably these last few years, especially with respect to financial ratios (GDP-to-debt, GDP-to-expenditures etc.). Fiscal 2003-2004 will not be an exception in this regard. Insofar as the current government formally commits to maintaining the financial balance over the upcoming years, the financial consolidation of Quebec will continue. Something we can celebrate.

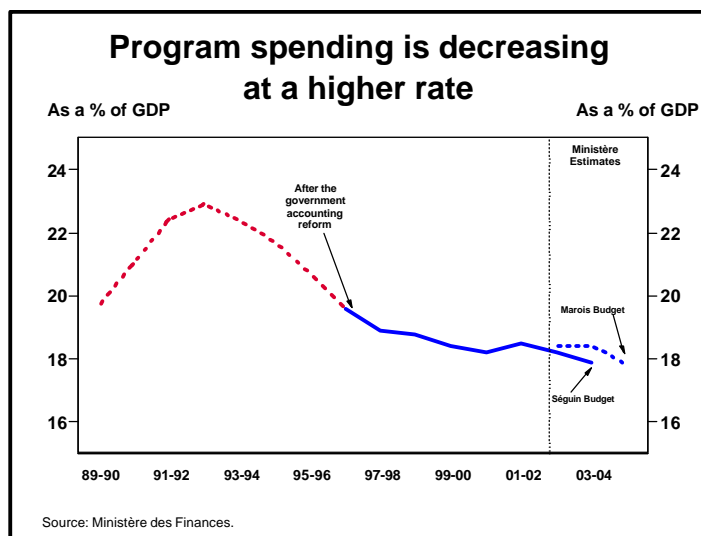
## The Breton report sets the tone for the consolidation measures

The Breton report, published in April, mentioned a \$4,3487M budget shortfall for fiscal 2003-2004. As such, today's budget focuses on measures aimed at absorbing the shortfall.

On the one hand, the level of program spending initially announced in the March 11 budget will be cut by \$793M and measures were introduced to avoid the potential \$354M spending overruns, particularly in the health and social services sector, as feared in the report. Moreover, the March 11 budget included some initiatives that were never adopted by the National Assembly due to the election call in the spring. So, with only a few exceptions, these projects were cancelled by the new Charest government, which accounts for some \$400M in savings in the current year for the Québec's public finances.

Firstly, the ministère des Finances proposes a series of measures aimed at increasing revenues for Québec. First, several tax measures, estimated at \$759M over a full year, have been proposed. They include a cuts totaling \$626M, part of many tax breaks for businesses. In addition, the rate decrease of the tax on capital, announced in November 2001, has been deferred and even eliminated in some cases, a

measure that represents \$198M. However, since fiscal 2003-2004 started a few months ago, the impact of these measures on the 2003-2004 results only amount to \$139M. Secondly, additional measures will be introduced to fight tax evasion and undeclared work: the Charest government plans to recover \$50M. Thirdly, the estimated net income of public corporations (Hydro-Québec, Loto-Québec and SAQ) in 2003-2004 has been increased, which should result in \$695M in additional revenues for the government. Fourthly, improvements to the method used to calculate the consumption-tax revenue as well as a change to the schedule for refunds under the youth allowance program should provide a \$605M gain in 2003-2004.



Minister Séguin is also using the \$809M reserve that the former government had established in its March 11 budget to fund health care in 2003-2004 and 2004-2005. Following the disclosure of the preliminary data of the Statistics Canada census last March, the Breton committee identified a shortfall of a little over one billion dollars. Due to a Statistics Canada error, the decrease in Federal transfers in 2003-2004 should be less than had been estimated initially. So, the Québec government should be getting \$293M more than forecast in the Breton report. Finally, the review of the budget parameters such as the appreciation of the Canadian dollar and the decrease of interest rates will help save \$248M overall in the current year.

Despite these adjustment measures, Quebecers will nevertheless benefit from an increase in program spending. Health and social services should receive a \$1,287M infusion in 2003-2004. Education will also receive part of the money with an increase of \$397M in the budget of the ministère de l'Éducation. Other initiatives affecting the funding of infrastructure work in municipalities (+ \$130M), the development of new spaces in daycares (+ \$20M), care for autistic children (+\$18M) and help for the housing issue (+ \$10.7M).

**MEASURES TO ABSORB THE BUDGETARY SHORTFALL  
IN 2003-2004  
(in millions of \$)**

<b>Budgetary Shortfall as at April 15, 2003 according to the Breton Report</b>	<b>-4,387</b>
<b>Expenditure measures</b>	<b>1,547</b>
- Reduction in program spending	793
- Absorption of potential spending overruns	354
- Cancellation of the budgetary measures announced on March 11, 2003	400
<b>Revenue measures</b>	<b>1,489</b>
<b>Fiscal measures</b>	
- Tightening of tax expenditures	626
- Tax on capital	
- Deferral of tax reduction	198
- Increase in the exemption from \$250,000 to \$600,000	-65
- Impact of the fiscal measures over a full year	759
- Gains on measures deferred to subsequent years	-620
Stepping up of tax recovery activities	50
Improvement in the performance of government corporations	
- Hydro-Québec	600
- Loto-Québec	75
- Société des alcools du Québec	20
Other budgetary-receipt measures	605
<b>Utilization of the budgetary reserve in 2003-2004</b>	<b>809</b>
<b>Offsetting of the negative impact of the census data on federal transfers</b>	<b>294</b>
<b>Review of estimates</b>	<b>248</b>
<b>Total amount of measures</b>	<b>4,387</b>
<b>Budget balance</b>	<b>0</b>

Source: Ministère des Finances.

**Despite its austerity,  
the budget proposes new expenditures**

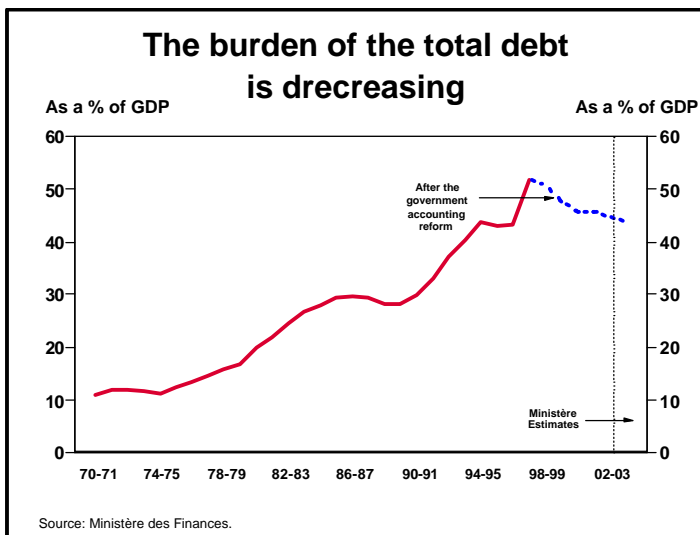
Measures	Costs
Budget increase for the ministère de la Santé et des Services sociaux	1,287 million
Budget increase for the ministère de l'Éducation	397 million
Funding of infrastructure work	130 million
Creating new spaces in daycare	20 million
Care for autistic children and other developmental disorders	18 million
Measures to counter the housing issue	10.7 million
Help for young recipients of employment assistance	5 million

Source: Ministère des Finances.

## Impact on financial markets

The first Séguin budget will undoubtedly please the financial markets and credit rating agencies. The Charest's government commitment to reduce Quebecers' high level of taxes and the government's excessive debt level will be well received. Despite the improvement of public finances over the last few years (steadily decreasing taxes, balanced budget for the past six years and a significantly improved economic climate) by the former government, there was never any plan to cut Québec's public debt. In addition, today's budget confirms the fact that the financial ratios will keep improving overall. Incidentally, to underline this improvement, Moody's upgraded the Province of Québec's credit rating from A1 stable to A1 positive.

However, to completely make up the budget shortfall mentioned in the Breton report, the minister of Finance had to use the \$809M reserve in the last Marois budget. With still nine



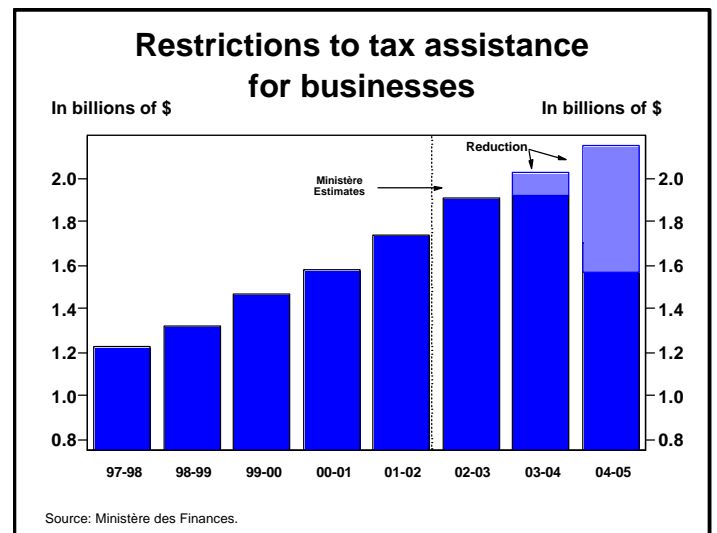
months to go before the end of the fiscal year, unexpected events related to business conditions or the financial environment could disturb the fragile balance of public finances. All in all, there is still a rough road ahead before we reach a first rate financial status.

## Conclusion: a budget of transition and realignment of the State's role.

The new government's first budget is largely an "upgrading" budget for public finances in order to maintain the zero-deficit objective. This is a first essential step to implementing the liberal program. Accordingly, Minister Séguin tabled a restrictive budget today. In addition, the ministère des Finances is

charting on a significant change of direction, where the State will adopt a lower profile, by announcing a series of restrictions to tax relief for businesses. The economic climate in Québec has deteriorated since the end of 2002 and despite the controversy surrounding the \$4.3B shortfall, it is obvious that the government was headed straight for an unquestionable deficit.

As such, the Charest government is to be congratulated for immediately taking the bull by the horns in order to avoid falling back into the vicious circle of deficits. Bear in mind that Québec remains always the province with the highest debt in comparison to the size of its economy (after Nova Scotia) and that its citizens are among the highest taxed citizens in North America. Even if great progress has been made in the past



five years, the overall tax outlook remains unsteady and the government cannot be undisciplined, nor make any error. In addition, the fiscal imbalance condemned by Liberals and péquistes alike continues to undermine the balance of public finances in Québec. With program costs increasing more rapidly than revenues, the provincial governments will have to be very inventive to avoid any future budget deficits.

In this context, we would feel considerably more secure if the government had been a bit more conservative in its economic assumptions, namely as regards growth forecasts. In addition, it is highly unfortunate that the present budget does not include projections for fiscal 2004-2005 or a budget reserve. This gives a lack of vision to the budget with respect to the government's broad economic directions. The cuts to regional assistance and investment promotion leave us in a void. However, a clear realignment towards a less interventionist state is already clear and the burden of proof is on the government.