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PROVINCIAL BUDGET SPEECH
NOVEMBER 1, 2001

1. Fiscal Comments
2. Economic Comments

Tax Division
Audit & Tax Service
Economic Studies

INFORMATION BULLETIN



Fédération des caisses
Desjardins du Québec

FISCAL COMMENTS

This afternoon, Pauline Marois, minister of State for the Economy and Finance of Québec, tabled her 2002-2003 budget. No sensational tax measures are announced, except for a significant reduction of the tax on capital for corporations starting in... 2003. For taxpayers, their main advantage in the budget is to discover that the tax cuts already announced for 2002 are maintained.

MEASURES AFFECTING DESJARDINS AS A BUSINESS

Reduction of the rate of tax on capital starting in 2003

Financial institutions, including the caisses, are currently subject to a 1.28% rate of tax on capital.

Starting in 2003, the rate will be gradually reduced, reaching 0.6% in 2007.

Reduction of the rate of tax on capital applicable to financial institutions (%)

Current	2003	2004	2005	2006	2007
1.28	1.2	1.05	0.9	0.75	0.6

If the taxation year straddles two calendar years, the rates will be weighed reflecting the number of days of the taxation year in each of the calendar years.

Elimination of the minimum amount of tax on capital

The amount of tax on capital may not currently be less than \$250 for one taxation year. For taxation years ending in 2003, the threshold will be eliminated.

Deferral of tax instalments for the fourth quarter of 2001 for SMEs

Already in September, the ministère des Finances announced a deferral of tax instalments for the month of October and of payments of outstanding taxes.

These measures affect all corporations whose paid-up capital on tax on capital does not exceed \$15 million. Accordingly, all caisses are affected by these measures that were covered in the October 22 Fiscalité Express.

In this budget, the ministère des Finances is broadening these measures.

The corporations affected will also be able to defer their November and December instalments to the months of May and June 2002 respectively.

In addition, the corporations whose taxation years end before April 1, 2002 may pay their balance to the province no later than 6 months after the end of their fiscal year. As for caisses, additional information will be forwarded to you in a new Fiscalité Express.

Reduction of the number of instalments of deductions at source

Employers, whose average monthly withholding paid to the province does not exceed \$1,000 for the preceding year may remit the amounts on a quarterly rather than monthly basis. Accordingly, deductions at source must be paid on April 15, July 15, October 15 and January 15 for tax deductions of the previous quarter.

This new measure applies to any remuneration paid after 2001. In addition, the current rule that allows very small employers who pay amounts less than \$1,200 on an annual basis to make a single payment will be maintained.

MEASURES AFFECTING INDIVIDUALS

Announcement of the indexation rate for 2002

This budget provided the opportunity of announcing that the indexation rate used to establish the 2002 tax credits and brackets will be 2.7% rather than the 1.8% planned originally.

With a view to providing support to low-income households, a single taxpayer entitled to this credit for 2001 will benefit from a \$100 increase and a taxpayer with a spouse will benefit from a \$200 credit.

The amount of the increase will be paid to them in December 2001.

Increase in the exemptions granted to determine premiums under the drug insurance plan

As a rule, all persons whose coverage is provided by the RAMQ in a given year must, in filing their income tax return for that year, pay a premium to finance the Québec prescription drug insurance plan.

Extension of the measure affecting donations of publicly traded securities

The measure that allowed taxpayers who make donations of publicly traded securities to recognized charitable organizations to be taxed only 25% of the capital gains realized through the donations was scheduled to end on December 31, 2001. Indeed, when making such a donation, taxpayers are deemed to dispose of their securities at their fair market value.

To calculate the premiums, minor adjustments are brought to the amounts of the deductions applicable against income in 2001. For instance, the annual premiums for a couple without children will be reduced by \$11.50.

On October 12, the Federal government made the measure permanent. The provincial government will bring its measure in line with the Federal government's measure.

Increase of the December 2001 instalment of the QST credit

Taxpayers entitled to the 2001 QST credit on the basis of their 2000 income typically received half of the amount of QST credit in August 2001. The other half will be paid in December 2001.

Increase in the tobacco tax

The special tobacco tax increases from 5.3 cents to 6.55 cents per cigarette starting November 2, 2001. This increases the price of a carton of cigarettes by \$2.50.

MEASURES AFFECTING BUSINESSES

Reduction of the tax on capital starting in 2003

If the taxation year straddles two calendar years, the rates will be weighed reflecting the number of days of the taxation year in each of the calendar years.

Reduction of the rate

Corporations are currently subject to a 0.64% rate of tax on capital.

Throughout the caisse network, the estimated minimum savings in 2007 should be \$10 million.

Starting in 2003, the rate will be gradually reduced, reaching 0.3% in 2007:

Deduction in the calculation of the paid-up capital

Reduction of the general rate of tax on capital (%)

A new deduction is introduced in the calculation of the paid-up capital for corporations that are not financial institutions or tax-exempt corporations that remain subject to tax on capital.

Current	2003	2004	2005	2006	2007
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0.64	0.6	0.525	0.45	0.375	0.3
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The maximum deduction will be \$250,000 in 2003, raising by increments of \$250,000 every year until 2006 when it will reach \$1 million.

However, from 2003 to 2005, the deduction of a corporation whose paid-up capital in the previous year exceeds the maximum amount of deduction for the year will be reduced by \$1 for every \$3 in excess.

Example:

Taxation year:	December 31, 2003
Paid-up capital – previous year :	\$310,000
Maximum deduction amount:	\$250,000

Since the paid-up capital of the previous year (\$310,000) exceeds the maximum amount for 2003 (\$250,000), the deduction is reduced to:

	\$250,000
Less: $(310,000 - 250,000) / 3 =$	<u>(20,000)</u>
	<u>\$230,000</u>

If the taxation year straddles two calendar years, the rates will be weighed reflecting the number of days of the taxation year in each of the calendar years.

Elimination of the minimum \$250 tax threshold

As mentioned earlier, the annual \$250 threshold will be eliminated for the taxation years ending in 2003.

Broadening of the ten-year tax exemption for small and medium-sized manufacturing enterprises in remote regions.

Last March, the government implemented a complete tax holiday aimed at stimulating economic development in some regions. The ten-year tax holiday affects income tax, tax on capital and the employer's contribution to the HSF.

In this budget, the holiday is improved retroactively to March 30, 2001, by raising the thresholds under which a corporation may claim the holiday.

Broadening of the tax credit for processing activities in remote regions

Likewise, the refundable tax credit for processing operations in remote regions was broadened to allow businesses to change their reference year for the purposes of calculating this credit.

Broadening of tax credits for the Vallée de l'aluminium and the Gaspésie

The same refundable tax credit rules for processing operations in remote regions apply to the Vallée de l'aluminium and Gaspésie.

Other credits for specific groups

The government announces or clarifies once again in the budget several tax credits or holidays for specific groups: the E-Commerce Place, the knowledge-based economy, the Mirabel Zone, the Cité de l'optique, the Technopôle Angus and the Cité de la biotechnologie et de la santé humaine du Montréal métropolitain.

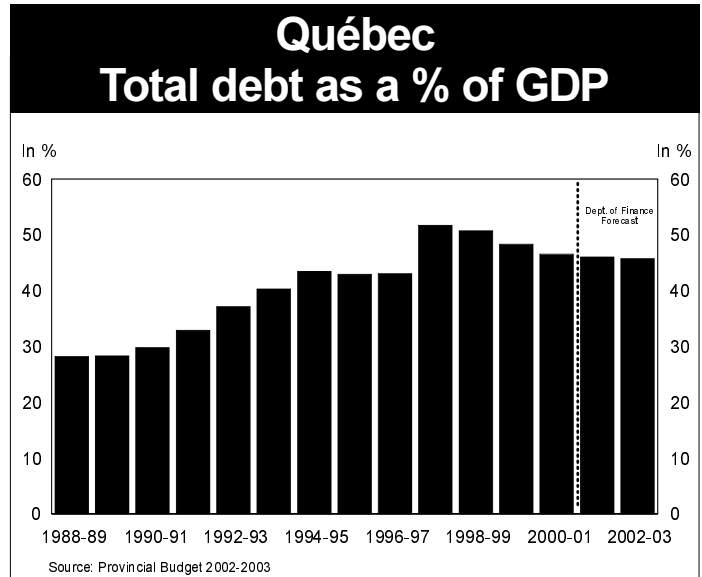
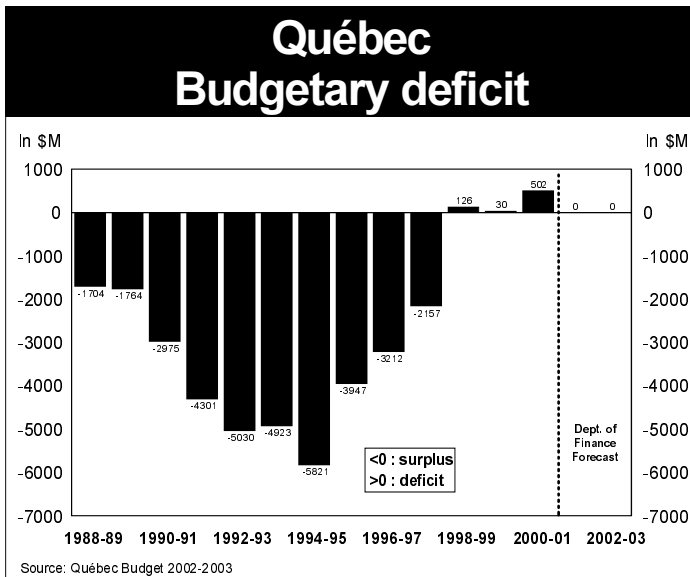
ECONOMIC COMMENTS

A revitalization budget involving many risks...

Highlights

Pauline Marois, deputy Prime minister and minister of State for the Economy and Finance, tabled her second budget today in a context that is far more difficult than her first one. Underlying the budget is a plan to kick-start the economy by supporting jobs and economic growth as much as possible. As in March, the prospects of an upcoming election and the desire of the Landry government to give itself a more social image prompted it to designate other expenses for underprivileged Quebecers and remote regions. Despite the many new measures, the government reaffirms that the budget will once again be balanced. However, because of the current uncertainties on the geopolitical scene and the confidence of economic agents, reaching a zero deficit in the current and next year is far from certain. Here are the main points in the budget:

- According to the government, the use of the \$950 million balance in the budget reserve will help to maintain a balanced budget in 2001-2002. A zero deficit is also forecast for 2002-2003;
- A \$641 million action plan is implemented. There are four initiatives in the plan:
 - 1) using \$75 million to accelerate public-sector investments
 - 2) pumping \$43 million to ensure personal security
 - 3) earmarking \$367 million for consumers, namely through an increase of the QST credit paid next December and increasing the indexation rate of the personal income structure from 1.8% to 2.7% and
 - 4) designating \$156 million mainly to support private investments
- A reduction of the tax on capital for Québec businesses from 0.64% to 0.3% by 2007;
- A \$2.50-per-carton increase of the tobacco tax;
- Many measures affecting businesses in the new economy throughout Québec, as well as those located in the E-Commerce Place, were extended and broadened;
- An amount of close to \$500 million will also be set aside for the construction and renovation of 40,000 low-cost housing units over the next few years.



The climate of a recession casts a gloom over the state of the public finances

The steady economic growth of the last few years allowed the government of Québec to restore the integrity of public finances. Thanks to conservative budget assumptions, Quebecers got used to the government of Québec balancing expenditures and revenue and even announcing budget surpluses in some years.

Following the terrorist attacks of September 11, most forecasters revised the extent of the economic slowdown by incorporating a small recession in their scenario. In this context, we were eagerly expecting today's budget to update the state of public finances in the new economic environment. At first glance, Quebecers seem to have nothing to worry about, given that the ministère des Finances plans to maintain a balanced budget during the 2001-2002 and 2002-2003 fiscal years.

For Québec, the new budget forecasts real GDP growth of 1.1% in 2001, 1.7% in 2002, taking into account the impact of the new measures announced in this budget, and 1.9% in 2003. These estimates are somewhat similar to our most recent growth scenario for the Québec economy with an expected growth of a 1.1% in 2001, 1.6% in 2002 and 3.5% in 2003. Please note that these forecasts imply a small recession during the second half of 2001, given only 1.1% of real GDP growth that year. However, taking into account the

uncertainties lingering over the geopolitical events and their impacts on the confidence of consumers and businesses, the risk of a longer recession until the middle of 2002 is possible. Should this materialize, economic growth could be weaker than forecast in Québec in 2002. From this angle, the estimates of the ministère des Finances for 2002, although they do not seem unrealistic, cannot be seen as conservative, which is not in keeping with previous budget years.

In addition, the government of Québec chose to use the \$950 million reserve that it set aside. It earmarked \$280 million to current expenditures and \$670 million to ensure a balanced budget. The loss of this "nest egg" is exposing public finances even more to the risks of economic circumstances.

As for revenue, the slowdown of the Québec economy in the past few months brought a decrease in the government's own-source revenue in 2001-2002. With a recession knocking at our doors, this trend should continue in the coming months and impede public finances. The operating expenditures are slightly up in comparison with the previous forecasts, especially

for health and social services, while the debt servicing benefits from the lower interest rates that should bring savings of \$508 million to the government.

By examining the latest budget forecasts, one discovers that the ministère des Finances now has its back against the wall, without any more leeway. The risk that the government falls back into budget deficits for the 2002-2003 year is not to be excluded, despite the reassuring estimates by the ministère des Finances.

Québec Economic and Financial Outlook						
	Budget 2002-2003 Forecast			Desjardins October 2001		
	2001	2002f	2003f	2001	2002f	2003f
Nominal GDP - Québec (%)	3.3	3.0	3.2	3.2	3.5	5.5
Real GDP - Québec (%)	1.1	1.7	1.9	1.1	1.6	3.5
3-mo. Canadian T-bills (%)	3.9	3.0	4.4	3.6	3.2	4.5
10-year Canadian bonds (%)	5.5	5.5	6.2	5.0	5.3	6.0
F: Forecast						

Sources: Québec Budget 2002-2003; Mouvement Desjardins.

Summary of Budgetary Transactions (in \$ millions)

	1998-99	1999-00	2000-01	2001-02 ^(f)	2002-03 ^(f)
Own-source Revenue	38,605	41,047	42,856	40,298	42,691
- Ann. Var. in %	7.7	6.3	4.4	-6.0	5.9
Federal Transfers	8,090	6,352	8,161	9,660	9,247
- Ann. Var. in %	35.1	-21.5	28.5	18.4	-4.3
Operating Expenditures	-39,382	-39,997	-41,959	-43,506	-44,582
- Ann. Var. in %	7.5	1.6	4.9	3.7	2.5
Operating Balance	7,313	7,402	9,058	6,452	7,356
Budgetary Reserve	--	--	-950	0	0
Reserves used for financing new spending	--	--	--	280	0
Reserves used for maintaining a balanced budget	--	--	--	670	0
Public Debt Charges	-7,187	-7,372	-7,606	-7,402	-7,356
- Ann. Var. in %	-2.1	2.6	3.2	-2.7	-0.7
Budget Balance	126	30	502	0	0
Non-budgetary Excess Amounts	397	687	-1,018	-707	-645
Net Financial Requirements	523	717	-516	-707	-645
Program Spending to GDP Ratio (%)	18.7	18.6	18.5	18.5	18.4
Debt-to-GDP Ratio (%)	50.7	48.3	46.5	46.0	45.7

Source: Dept. of Finance Forecast, Budget 2002-2003. ^(f) : Forecast

A \$100 Christmas gift for 2.5 million Quebecers

In this budget, minister Marois introduced several new tax measures for individuals and businesses. Their main objective is to stimulate domestic demand in Québec to offset the effects of the economic slowdown. Granted, most of the new tax measures introduced by the minister can be implemented quickly and their effects will be felt in the coming months. Taking into account that the Québec economy is seemingly already in a recession, the implementation of these new tax measures comes at the right moment. In concrete terms, here are the details of these measures:

1) Hiking the QST credit by \$100

All Québec taxpayers who in August 2001 received an instalment of the Québec sales tax (QST) credit, i.e. 2.5 million Quebecers 18 years or older, will receive an additional \$100 over and above the instalments they already received. This additional amount will be paid out in the last instalment in December 2001. So, \$250 million will be pumped into the Québec economy just before the Christmas season, boosting consumer spending.

2) Increasing the indexation rate in the tax structure

In the last budget, the return to a full indexation of the personal tax structure had been pushed earlier, i.e. in January 2002. In today's budget (November 1), minister Marois increases the indexation rate: 2.7% rather than the 1.8% initially announced. This measure will allow the taxation tables and other taxation parameters, such as tax credits, to increase from year to year reflecting inflation rates. This measure will get us out of the distorted increases, as tax brackets remained the same for several years, causing many taxpayers to jump from one tax bracket to the next. As a result, while their wages increased, taxpayers saw a larger part of their income being taxed in the higher tax bracket. This revision of the tax structure should have a beneficial

impact of \$59 million for all taxpayers for the 2001-2002 and 2002-2003 years.

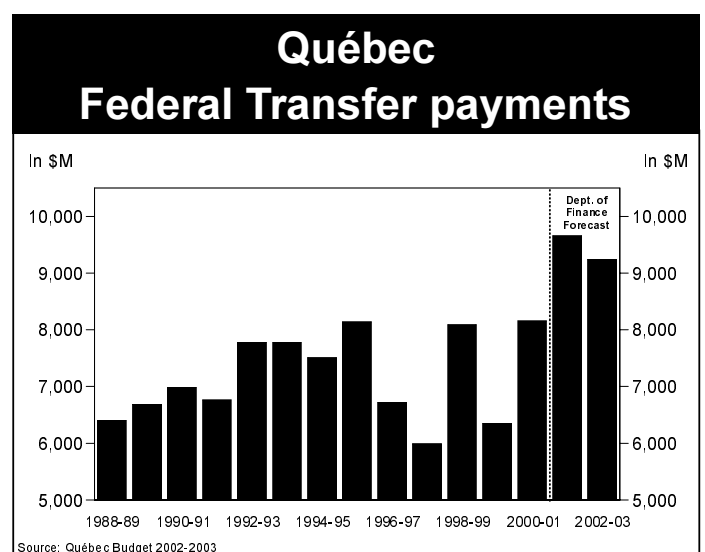
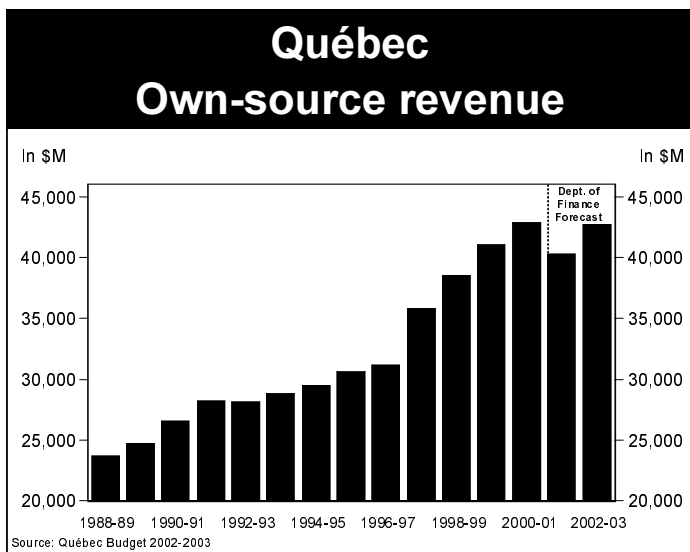
3) Increasing the tobacco tax

By mutual agreement with the Federal minister of Finance, Paul Martin, the government of Québec will increase the provincial tax on tobacco products by some 23% starting November 2, 2001. This increase will result in a \$30 million increase in tax revenue in 2001-2002 and 2002-2003.

4) Other measures aimed at businesses

A 6-month deferral of tax instalments for the fourth quarter is announced. This will definitely relieve businesses in the short term. However, it does not really change things given that businesses will have to face up to their obligations in 2002. In addition, a reduction of the tax on capital was announced. By 2007, this tax should decrease by 50%. The first reduction should apply on January 1, 2003, as the tax rate decreases from 0.64% to 0.6%. This represents a \$40 million saving in fiscal 2002-2003. Finally, the number of manufacturing SMEs eligible to a tax holiday will be increased. This measure represents \$11 million over the next two fiscal years.

Of course, all these new measures are in addition to those announced in previous budgets. For instance, the tax rates on personal income decreased significantly last July. As a result, Québec taxpayers will benefit from a cumulative decrease of the tax burden of \$2.7 billion in 2001-2002 and \$3.5 billion in 2002-2003.



A budget with an ambitious revitalization plan, but with limited short-term impacts

Minister Marois used the budget to introduce an ambitious \$3-billion acceleration in public investments. Some \$500 million of this amount will be earmarked for the construction and renovation of housing units, \$400 million will go to health and social services, \$400 million to education and \$400 million to the road-network repairs. The problem is that very few of these projects will be launched in the short term. They will be of little use in helping the Québec economy weather the current recession climate.

Indeed, very few new expenditure measures will be brought forth during the current and 2002-2003 budgets. In addition to the tax measures announced for individuals and businesses and commented in the previous section, the government of Québec still proposes some expenditure initiatives for the 2001-2002 and 2002-2003 fiscal years. The expenditure measures should contribute to alleviate the negative effects of the current economic sluggishness: 1) the government will pump \$43 million to finance several decisions in order to ensure personal security; 2) the indexation of welfare benefits will add \$58 million in the wallets of the less fortunate; 3) a \$75-million acceleration of public-sector investments; and 4) \$156 million comprised of several measures aimed at supporting private investments, such as financial support for businesses, support for the social economy, various kick-starting measures and tax measures for businesses (tax on capital and tax holidays). In total, the ministère des Finances will pump \$641 million to support the Québec economy in 2001-2002 and 2002-2003.

Conclusion: a revitalization project and a balanced budget, but no leeway ...

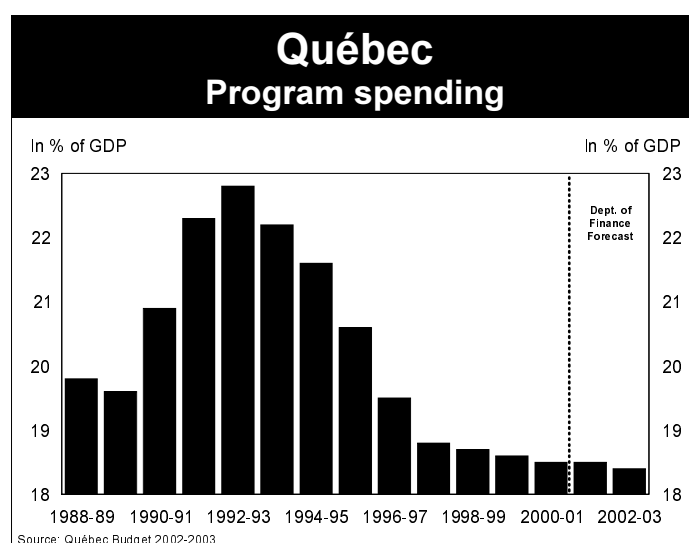
The main thrust of the budget exercise was to offset the recession, support jobs and foster a revitalization of economic activity in 2002. It is obvious that the government does not have the large means needed to do so. The strong decreases of the North American guide rates, the tax breaks South of the border and the revitalization of the American economy expected in mid-2002 should play a more significant role than the various measures in the Marois budget.

Nevertheless, within the rather limited means, the proposed measures offer some measure of relief and should provide some help in supporting consumption and promoting investments in Québec. According to the government, these measures should increase the real GDP by 0.7% in 2002. However, the government plan cannot prevent the recession that we see occurring, which could last until the end of winter.

Finally, it is obvious that the deterioration of the economic context greatly hampered the financial situation of the Québec government. The government has no more reserves to face an economic situation that could even worsen. Because of the complexity of the geopolitical situation, the government's scenario of economic forecast presents many risks. A harsher and longer recession would undoubtedly put government finances in the red.

Québec	
Cost of the government's action plan for 2001-2002 and 2002-2003	
<small>(in millions of dollars)</small>	
Ensuring personal security	43
Transfers for consumers	367
QST credit	250
Indexation of income tax system	59
Indexation of social assistance benefits	58
Acceleration of public-sector investments to support private investments and other measures	75
Measures aimed at businesses	51
Financial support for businesses	71
Support for the social economy	8
Measures to redress the economy	10
Other measures	16
Total	641

Source: Québec Budget 2002-2003



Source: Québec Budget 2002-2003