

Budget

EXPRESS

March 19, 2009

QUÉBEC PROVINCIAL BUDGET SPEECH

- **Tax Measures**

A budget without major new fiscal measures

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Unnerving numbers!

The deficit, the debt and the recession have the government in a corner



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This afternoon, Québec's Minister of Finance, Ms. Monique Jérôme-Forget, presented her 2009-2010 budget to the National Assembly. There are only a few fiscal measures in this budget, the most important of which is an increase in the Québec sales tax (QST) from 7.5% to 8.5% taking effect on January 1, 2011. There is also a slight decrease in corporate taxes for certain companies.

MEASURES AFFECTING DESJARDINS

Increased limit of the amount of income eligible for the reduced tax rate

As in the case of the federal government, Québec is increasing the income limit upon which companies are taxed at the minimum 8% rate from \$400,000 to \$500,000; income exceeding this amount is taxed at a rate of 11.9%.

The measure takes effect on March 20, 2009, therefore the increase will be pro-rated according to the number days in the taxation year after March 19, 2009.

Accelerated capital cost allowance (CCA) for computer equipment

Québec is harmonizing its capital cost allowance for computer equipment with that of the federal government. Therefore, computer equipment and system software purchased by a company, which were depreciable at the rate of 55%, will now be depreciable at the temporary CCA rate of 100%. This measure applies to eligible computer equipment and system software purchased after January 27, 2009 and before February 2011. The 100% rate will not be subject to the half-year rule. As such, a company may deduct the full cost of eligible computer equipment, including system software, in the year it was acquired.

RRSP or RRIF losses after death

Québec is harmonizing its policy with that of the federal government with regard to the measure concerning

RRSP or RRIF losses after death, which was announced in the last federal budget.

The tax legislation will allow, upon final disbursement of assets held in a deceased annuitant's RRSP or RRIF, retroactive reporting of investment losses that occur following death. The amount that may be carried back to the year of death is generally calculated as the difference between the amount in respect of the RRSP or RRIF included in the income of the annuitant and the total of all the amounts paid out of the RRSP or RRIF after the death of the annuitant.

This measure applies to RRSPs or RRIFs of deceased annuitants where the final distribution of investments held in RRSPs or RRIFs takes place after 2008.

Streamlining of the Québec education savings incentive (QESI)

Grant for 16 or 17 year-old beneficiaries

Currently, if the beneficiary of a Registered Education Savings Plan (RESP) is 16 or 17 years of age at the end of the year, certain requirements must be met in order to ensure that the contributions qualify for the QESI.

To simplify the work of RESP trustees, the minimum contribution requirements stipulated for a child 16 or 17 years of age at the end of a given year shall, with respect to any contribution made after 2008, be replaced by a requirement under which a Canadian education savings grant has been granted regarding this type of contribution.

Taxation DivisionTransfers between institutions

Currently, a trustee cannot alienate to another trustee the QESI amounts to be received from the government, which complicates the transfer of RESPs between institutions.

Effective on March 20, 2009, a trustee may transfer to another trustee the QESI amounts to be received, subject to certain conditions.

In addition, the government intends to implement measures in 2011, which will facilitate the transfer of assets from a non participating RESP to a participating RESP, to enable the QESI to be granted with respect to contributions made to a non participating plan after February 20, 2007 and before January 1, 2011. Details concerning these measures will be announced at a later date.

MEASURES AFFECTING INDIVIDUALS

Increase in the QST taking effect in 2011

The QST will increase from 7.5% to 8.5% on January 1, 2011. Because this tax rate applies to the consideration plus the GST, the real QST rate will increase from 7.875% to 8.925% taking effect in 2011, assuming that the GST remains at 5%.

To be more specific, the increase in QST to 8.5% will apply to all taxable supplies on which the tax will become payable effective on January 1, 2011. The QST includes many provisions that determine the moment at which the tax becomes payable by the purchaser of the taxable supply of goods and services.

In general, the QST is paid by the purchaser on the first of the two following dates; the day on which the consideration of the supply is paid or the day on which this consideration is due.

To take this increase into account, the refundable QST credit will be increased accordingly. As a result, for the 2009 taxation year, the maximum value of this tax credit is \$356 for couples, \$299 for individuals living alone and \$178 in other cases. For the 2011 taxation year, increase will be \$150 for couples, \$125 for individuals living alone and \$75 in other cases.

Enhanced credits for childcare costChanges to the credit rate table

A new rate table for purposes of calculating refundable tax credits for childcare costs comes into effect for the 2009 taxation year.

The new table, which includes 33 family income brackets instead of 50, stipulates that when an individual's family income does not exceed \$31,520

(\$30,795 in 2008), the applicable rate is 75%. Afterward, the degressive rate drops to 26% for family incomes exceeding \$140,450 (\$85,535 in 2008).

The credit may be paid in advance upon request. The payment is generally based on the credit granted for the previous year. For 2009, credits paid in advance will be adjusted to take the new table into account.

Increased limit for childcare expenses for children under 7 years of age

The limit applicable to childcare expenses for children under 7 years of age at the end of a year, starting in the 2009 taxation year, will increase from \$7,000 to \$9,000.

Eligibility for the childcare expense credit paid during parental leave

Currently, individuals who received benefits under the Québec Parental Insurance Plan (QPIP) are not entitled to the refundable childcare credit expenses that were incurred during their parental leave.

Effective in 2009, eligible childcare expenses will include those incurred during the period during which the individual or the individual's spouse receives benefits under QPIP or another similar plan.

Increase in the tax credit for shares issued by Fondation (CSN)

Currently, individuals who are first purchasers of shares issued by a workers fund are entitled to a non-refundable tax credit equal to 15% of the price of the shares, for an annual maximum total \$750 tax credit, which represents a \$5,000 share purchase. A similar credit is granted for federal income tax purposes.

Taxation Division

To enable Fondation to achieve optimal capitalization, the rate of the tax credit for the acquisition of shares issued by Fondation will temporarily be increased to 25% for any shares purchased after May 31, 2009 and at the latest at the end of the financial exercise during which Fondation achieves a capitalization of at least \$1.25 billion dollars. However, there will be a limit placed on the number of shares issued annually.

Refundable tax credit on new green vehicles

To encourage the purchase or long-term rental of new vehicles that do not exceed the most stringent greenhouse gas emission standard, i.e. 5.27 litres of gasoline per 100 km, a refundable tax credit has been introduced.

In short, this take credit will be granted to individuals or companies that purchase or rent a new green vehicle on a long-term basis between January 1, 2009 and December 31, 2015. The value of the tax credit is determined based on the vehicles environmental performance.

Refundable tax credit for the acquisition or lease of a new green vehicle (Dollars)

	2009	2010	2011	2012	2013	2014	2015
Gasoline consumption from 3 to 5.27 l/100 km	2 000	2 000	1 500	1 000	500	0	0
Diesel consumption from 2.58 to 4.54 l/100 km	- ¹	2 000	1 500	1 000	500	0	0
Gasoline consumption from 0.01 to 2.99 l/100 km	- ²	3 000	3 000	2 250	1 500	750	0
Diesel consumption from 0.01 to 2.57 l/100 km	- ²	3 000	3 000	2 250	1 500	750	0
Low-speed vehicle (LSV) using no fuel	4 000	4 000	4 000	4 000	3 000	2 000	1 000
Vehicle, other than an LSV, using no fuel	- ³	- ³	8 000	8 000	6 000	4 000	2 000

¹ It is not expected that a vehicle in this category will be on the Québec market during the year. However, in the event such a vehicle is acquired or leased in 2009, an amount of \$2 000 will be allowed for the purposes of calculating the tax credit.

² It is not expected that a vehicle in this category will be on the Québec market during the year. However, in the event such a vehicle is acquired or leased in 2009, an amount of \$3 000 will be allowed for the purposes of calculating the tax credit.

³ It is not expected that a vehicle in this category will be on the Québec market during the year. However, in the event such a vehicle is acquired or leased in 2009 or 2010, an amount of \$8 000 will be allowed for the purposes of calculating the tax credit.

When a recognized green vehicle has been rented on a long-term basis during a calendar year between 2009 and 2015, the amount of the tax credit for this vehicle will be calculated by applying a rate, which varies according to the length of the continuous rental period, to the amount that would otherwise have been granted had the vehicle been purchase at the same moment.

Rates applicable for the purposes of calculating the tax credit depending on the length of the long-term lease contract (Per cent)

Continuous lease		Applicable rate	Continuous lease		Applicable rate
at least	and less than		at least	and less than	
12 months	24 months	25	48 months	60 months	70
24 months	36 months	40	60 months	72 months	80
36 months	48 months	55	72 months	—	85

Improvement to the SME Growth Stock Plan

Briefly, individuals residing in Québec on December 31 of a given year can deduct from their taxable income the adjusted cost of eligible shares that they have included in their SME Growth Stock Plan (called «Accro-PME»). However, the deduction cannot exceed 10% of an individual's total income for the year.

This plan's name has been changed to "Stock savings plan II". In addition, the following changes have been made:

- The plan will be extended by five years until December 31, 2014;
- The deduction for a share will be increased from 100% to 150% of the cost of this share. This tax benefit will be temporary. It will apply to shares purchased between March 20, 2009 and December 31, 2010;
- The minimum holding period will be reduced by one year; the holding rule will now apply until December 31 of the year of purchase, and until December 31 of the two subsequent years. This change will take effect beginning in the 2009 calendar year.

MEASURES AFFECTING BUSINESSES

Increased limit on the amount of income eligible for the reduced tax rate

The measure mentioned above for Desjardins regarding the increased limit on the amount of income eligible for the reduced 8% tax rate applies to other companies.

Accelerated capital cost allowance

The measure mentioned above for Desjardins regarding the accelerated capital cost allowance for computer equipment also applies to other businesses.

In addition, Québec is harmonizing its policy with that of the federal government, which stipulates that manufacturing and processing companies are entitled to an accelerated 50% capital cost allowance (CCA) calculated using the straight-line method, for assets purchased until December 31, 2011. However, a rate of 25% (half-year rule) will apply in the purchase year.

Other corporate tax measures

- Introduction of a ten-year income tax holiday for new companies dedicated to marketing intellectual property;
- Extension to the forestry and mining sectors of the refundable tax credit for training labour in the manufacturing sector;
- Introduction of a five-year royalty holiday for new natural gas wells;
- Increased refundable tax credits for the production of Québec shows and sound recordings;
- Adjustments of refundable tax credits for film dubbing and book publishing;
- Improvement to the tax credit for Québec film and television production;
- Modification of the refundable tax credit for e-business development announced in the 2008 budget;
- Modification of the definition of a design activity eligible for the refundable tax credit;
- Option for companies governed by the *Mining Duties Act* to produce financial statements in a currency other than Canadian dollars.

OTHER MEASURE

Costs claimed by Revenu Québec

The government has decided to apply the user-pay principle to taxpayers whose files must be processed by Tax Collection of Revenu Québec.

First, \$93 in costs will be levied on all taxpayers who have not paid their tax liability within the prescribed time limit and whose file is under initial review by a Tax Collection official. The same will apply in the case of failure to produce an income tax return or make deductions at source.

Also, the government will claim fees for the registration and cancellation of legal movable or immovable hypothecs. In the case of a registration, the fees will be \$75 for a movable hypothec and \$185 for an immovable hypothec. Fees for cancellation will be \$20 and \$130 respectively.

The amount of these costs will be reviewed annually on April 1. All these costs will be added to the taxpayer's tax liability. The amounts charged will be paid to the Fonds de perception of Revenu Québec.

Budget Analysis

March 19, 2009

BUDGET 2009-2010

Unnerving numbers!

The deficit, the debt and the recession have the government in a corner

The Québec government's 2009-2010 budget is confusing. On one hand, the fact that there are so few measures to directly stimulate the economy is disappointing. This puts the future recovery in jeopardy and leaves Québec's economy to cope with the current crisis on its own. On the other hand, the size of the deficits—\$7.7B over two years—is food for thought. The \$16.5B increase in the net debt over the same period—a jump of 12.8%—is a strong reminder that, in the past, a heavy mortgage was placed on the government's freedom to act and that further action in this direction is problematic. In the coming years, tough decisions will have to be made to clean up the public finances.

Table 1
Summary statement of transactions

In \$M	Preliminary	Forecasts		Projections		
	2008-2009	2009-2010	2010-2011	2011-2012	2012-2013	2013-2014
Own-source revenues	48,555	47,371	49,127	51,487	53,948	56,295
- Variation (%)	-1.8	-2.4	3.7	4.8	4.8	4.4
Federal transfers	13,924	14,841	14,890	14,702	15,031	15,270
- Variation (%)	2.2	6.6	0.3	-1.3	2.2	1.6
Total budgetary revenues	62,479	62,212	64,017	66,189	68,979	71,565
- Variation (%)	-1.0	-0.4	2.9	3.4	4.2	3.7
Program spending	-57,400	-59,989	-61,879	-63,829	-65,840	-67,915
- Variation (%)	4.7	4.5	3.2	3.2	3.2	3.2
Debt service	-6,589	-6,104	-6,646	-7,663	-8,876	-9,439
- Variation (%)	-6.2	-7.4	8.9	15.3	15.8	6.3
Budgetary reserve	2,006	295	0	0	0	0
Generations Fund	-701	-715	-880	-957	-1,038	-1,126
Net results of consolidated entities	205	355	563	688	748	873
Impact of the plan to restore fiscal balance	---	---	1,065	2,933	4,759	6,130
Budgetary balance	0	-3,946	-3,760	-2,639	-1,268	88
Net debt	129,032	136,986	145,570	n.a.	n.a.	n.a.
Net debt in % of GDP	42.5	45.2	46.2	n.a.	n.a.	n.a.

n.a.: not available

Source: Ministère des Finances du Québec

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NOTE TO READERS: The letters **k**, **M** and **B** are used in texts and tables to refer to thousands, millions and billions respectively.

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A PLAN BASED ON CHANCE

The economic situation is swiftly deteriorating. Moreover, Québec's 2009-2010 budget is based on real GDP variation of -1.2%, while the latest private sector forecasts are now calling for a range of -2.0% to -2.5%. Earlier this week, the Federal Reserve announced that it would print money to kick start the economy, which signals that a number of monetary and government authorities worldwide are now looking at last-resort solutions.

The 2009-2010 budget bets that the efforts made by other governments, especially the Obama plan and actions taken by the federal government, will ripple through to our economy. None of the measures announced in this budget will be able to jump start Québec's economy. The much-awaited energetic, swift recovery plan with substantial multiplier effects has not materialized. It is now fairly clear that Québec's economy will continue to decline, and that it will take some time for it to recover from the recession.

It would be dishonest to say that nothing is being done. This budget does contain actions to support businesses and workers, and to get Québec ready for the recovery. In all, the new economic support measures announced will cost the government a total of \$242M in 2009-2010 and \$237M in 2010-2011. We had hoped for more. The government is

supporting, encouraging, enhancing, preserving and extending a variety of programs and funds, but it is not taking direct action. Supporting the unemployed and people in need of training is a good thing. It would be even better to keep them from losing their jobs. It is important for businesses to have access to capital, and for the government to proffer its lending capacity to make liquidity available. However, the current economic conditions are not propitious for investment, because demand for goods and services is collapsing.

In our opinion, this inaction could cost Québec a great deal over the medium term. The province is now operating below potential; rapid, effective government intervention could have taken the economy towards its output capacity more quickly. To date, the government's investments have enabled Québec to handle the situation better. They have shown that the government's direct action could have an influence on economic activity.

A BRUTAL RETURN TO BUDGET DEFICITS

According to preliminary figures, the budget will be balanced in fiscal 2008-2009, but \$2.0B of the \$2.3B in the reserve will have to be used to achieve the balance. The Québec government's financial situation will deteriorate substantially in subsequent years. Deteriorating economic conditions,

Table 2
Plan to restore fiscal balance (millions of dollars)

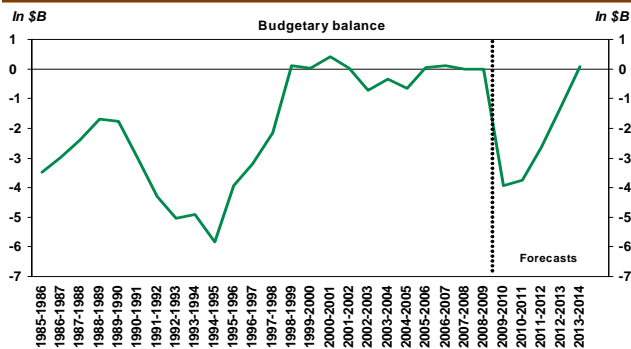
	2009-2010	2010-2011	2011-2012	2012-2013	2013-2014
Budgetary balance with maintenance of program spending growth at 3,2%	-3,946	-4,825	-5,572	-6,027	-6,042
Revenue measures					
Stepping up of efforts by Revenu Québec to counter tax evasion and avoidance	0	200	300	600	900
Indexing of all non-indexed user fees as of January 1, 2011 ⁽¹⁾	0	15	75	135	195
Increase in the Québec sales tax rate from 7,5% to 8,5% as of January 1, 2011 ⁽²⁾	0	400	1,215	1,215	1,265
Subtotal of revenue measures	0	615	1,590	1,950	2,360
Other revenue or expenditure measures to be identified	0	450	1,343	2,809	3,770
Total of measures	0	1,065	2,933	4,759	6,130
Budgetary balance for the purposes of the <i>Balanced Budget Act</i>	-3,946	-3,760	-2,639	-1,268	88

⁽¹⁾ With the exception of rates for childcare services; ⁽²⁾ Taking into account offsetting for low - or middle-income households.

Source: Ministère des Finances du Québec

among other factors, will take independent income down 2.4% and trigger a 4.5% increase in program spending in 2009-2010. Forecast deficits total \$3.9B for 2009-2010 and \$3.8B for 2010-2011, something that has not been seen since 1995-1996. Despite the economic recovery anticipated in 2010, the Québec government's budget will stay in the red until at least 2012-2013 (graph 1).

Graph 1 – Back to budget deficits



Source: Ministère des Finances du Québec

Clearly, the Ministère des Finances seems to be grappling with a structural deficit. To climb out of it, the government is tabling a plan to get back to a balanced budget by fiscal 2013-2014. However, with a \$6.1B shortfall, achieving this target is far from certain. Intensifying efforts to combat tax evasion, indexing fees as of January 1, 2011, and increasing the QST by 1% at the same time should, of course, help get the budget back into balance. However, we cannot rule out the possibility that this may not happen. Not only does the government still have to find a way to mop up \$4B, but it is also far from clear that combating tax evasion will yield the hoped-for results.

The plan to restore a balanced budget also counts on limiting growth in program spending. As of 2013-2014, the government projects that the program spending to GDP ratio will be back at 18.5%, similar to where it was before the recession. To do so, growth by program spending will be restricted to 3.2% a year as of 2010-2011. Yet program spending growth has not been this low in ten years. Can the government do it? Among other things, that will depend on the strength of the economic recovery.

OPTIMISTIC ECONOMIC ASSUMPTIONS

Formulating a budget is a gruelling process that takes several weeks. The budget's economic assumptions were thus drawn up some time ago. Given the current context of enormous economic and financial upheaval, the Ministère des Finances' projections now seem somewhat out of step. The projections

feature a 1.2% contraction in real GDP for 2009, followed by a rebound of 1.9% for 2010. As the Ministère des Finances is anticipating slight price growth this year, Québec's nominal GDP could fall by 0.1% in 2009.

However, economic conditions have deteriorated substantially in the last few weeks. For example, almost 52,000 jobs have been lost in Québec since December and the jobless rate rose to 7.9% in February from last fall's 7.2%. Most forecasters have therefore revised their economic scenarios for Québec's GDP downward recently. Our own projections call for Québec's real GDP to shrink by 2.3% this year, followed by an increase of just 1.1% in 2010. The decline in energy prices noted since last summer and the current recession will put downside pressure on prices. We therefore believe that consumer prices will fall 0.5% on average in 2009. This forecast is well below the Ministère des Finances projection, which is banking on price growth of 0.4%.

These differences have an impact on nominal GDP, which could slide much more sharply than the government expects. Our scenario therefore calls for nominal GDP to contract by 2.8% in 2009, a difference of 2.7% from the budget's outlook. The gap persists in 2010, and would total 0.9%. This difference could have substantial repercussions for government revenues and expenditures. It is acknowledged that, in general, every 1% decrease in nominal GDP leads to a decline of about \$500M in the budget balance. If our economic scenario proves to be accurate, about \$1.5B more than forecast could be lopped from the balance for fiscal 2009-2010. In the end, the deficit could total over \$5B in 2009-2010 and 2010-2011.

PUBLIC DEBT: WIPING OUT THE LAST FEW YEARS' GAINS

Over the next few years, the budget deficits and the infrastructure investments will have a sizeable impact on the Québec government's debt. In the best case scenario, the combined deficits will total almost \$12B by 2012-2013. For the next two budget years alone, this will result in a 12.8% increase or \$16.5B in the net debt. The net debt to GDP ratio will rise to 46.2% in 2010-2011, a real deterioration from the low of 37.7% recorded in 2004-2005 (graph 2). As budget deficits will be maintained beyond 2011, the debt to GDP ratio will no doubt beat its record of 47.0% set in 1997-1998. This means that the efforts made in the last few years to clean up the public finances will be completely wiped out. Debt growth will, of course, have an impact on debt service. Moreover, as interest rates are now extraordinarily low, we will inevitably see interest rates go up somewhat in the next few years. In the end, debt service will increase by

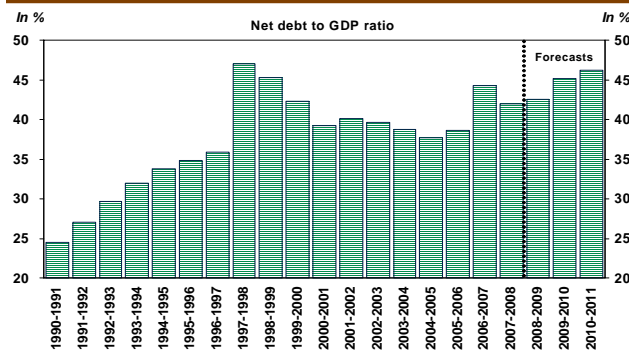
Table 3
Québec Economic Outlook

<i>Variation in % (unless indicated)</i>	2008	2009p	2010f
Real gross domestic product			
Ministère des Finances forecasts	0.8	-1.2	1.9
Desjardins forecasts	0.8	-2.3	1.1
2008-2009 budget	1.5	2.0	2.2
Gross domestic product			
Ministère des Finances forecasts	2.4	-0.1	3.9
Desjardins forecasts	2.2	-2.8	2.6
2008-2009 budget	3.2	3.5	3.9
Housing starts (in thousands)			
Ministère des Finances forecasts	47.9	38.8	37.3
Desjardins forecasts	47.9	38.0	40.0
2008-2009 budget	44.6	38.5	38.5
Consumer prices			
Ministère des Finances forecasts	2.1	0.4	2.0
Desjardins forecasts	2.1	-0.5	1.5
2008-2009 budget	1.4	1.8	1.7
Job creation (in thousands)			
Ministère des Finances forecasts	30.0	-62.9	29.5
Desjardins forecasts	30.0	-72.0	-20.0
2008-2009 budget	45.0	34.2	35.8
Unemployment rate (%)			
Ministère des Finances forecasts	7.2	8.9	9.1
Desjardins forecasts	7.2	8.7	9.5
2008-2009 budget	7.0	6.9	6.7

f: forecasts

Sources: Ministère des Finances du Québec and Desjardins, Economic Studies

Graph 2 – Debt's relative size will increase



Sources: Ministère des Finances du Québec and Desjardins, Economic Studies

about 15% a year during fiscal 2011-2012 and 2012-2013. Almost 13% of budget revenues will have to be channelled to debt service in 2012-2013, compared with 10.5% in 2008-2009.

THE MARKETS MAY BE CONCERN BY THE DEBT

The return to public deficits is not a surprise—it had been widely anticipated in the financial markets. Québec's debt

will of course climb substantially in the next few years, but this is also true for the governments of most industrialized countries. In the United States, President Obama's recovery plan and actions by the Federal Reserve will also make the public debt grow substantially. In Canada, the latest federal budget paved also the way for an increase in government debt.

Unlike the situation in the United States or for Canada's federal government, much of the deterioration in Québec's public finances is not due to implementing a substantial economic recovery plan, but rather to the impact of the economic problems on government spending and revenues. This difference shows how fragile Québec's public finances are—in Québec, reaching a balanced budget has always been more of a struggle. Fears of a larger structural deficit in Québec could eventually become a concern for investors and impact rate spreads between federal and Québec bonds.

PAINFUL DECISIONS IN THE FUTURE

The rapid deterioration in Québec's financial situation has done away with the government's leeway. The government seems to be throwing up its hands given the extent of the

economy's decline, and relying on actions taken by other governments to limit the carnage. It opted to avoid further inflating the debt, which is already up 12.8% in just two years, and returning to a level that is close to the record set at the end of the 90s in terms of percentage of GDP.

The saddest conclusion to be drawn from this budget exercise is that Québec's financial situation is so difficult, even dismal, that the government is paralyzed. The Balanced Budget Act will even have to be suspended to allow the government to table a budget deficit in 2009-2010 and 2010-2011 without having to offset it with surpluses in subsequent years.

The budget contains a plan to return to a balanced budget in 2013-2014. The means are still vague, but fee increases and an increase in the QST will certainly be on the menu. It will take a lot more than that, however, as about 60% of these means have yet to be identified. Under the circumstances, all of the government's methods and services will no doubt have to be overhauled. Decisions will be needed and, given the speed at which the debt is mounting, they could be very painful ones.