Institut du Québec

Will Red-Ink Budgets Be a Thing of the Past?

Challenges and Choices for Quebec

At a Glance

- The outlook for Quebec's public finances is improving, thanks to better prospects for economic growth and to fiscal consolidation currently under way.
- If the government manages to carry out its fiscal reforms and to reduce the growth in health spending from 5.2 per cent to 4.2 per cent on a sustainable basis, Quebec will see an end to budgets written in red ink.
- Quebec could soon choose whether to invest in economic or social development projects or to reduce the tax burden on individuals and businesses, and be able to do so without getting bogged down in a debt spiral.

A full French version of this publication follows this English executive summary.

A partnership with

The Conference Board of Canada

HEC MONTRÉAL

EXECUTIVE SUMMARY MARCH 2015

Executive Summary

This report draws a picture of Quebec's economic and budget situation, nearly one year after the Institut du Québec (IdQ) first published *Choc démographique et finances publiques : Pour un contrat social durable* (*Demographic Shock and Public Finances: For a Sustainable Social Contract*).

The conclusions of that previous report were clear. Despite its budgetary difficulties and the aging of its population, Quebec can preserve the essential components of its social contract, subject to three conditions. First, the government must eliminate its annual deficit of over $3 billion in the short term; how and when it does so is up to the government. Second, over the longer term, it must reduce annual growth in health care spending from 5.2 per cent to 4.2 per cent. And third, once the short-term budget reforms have been accomplished, it must "cap" its new public programs. Meeting these three conditions would allow the government to maintain services at a constant level (that is, spending could increase only in line with inflation and demographic changes).

As the current government prepares to bring down its second budget, the simulations carried out using the economic model of The Conference Board of Canada clearly indicate that the situation has changed since we published that previous report, even though the demographic issues remain the same. There are two reasons for this change:

- The government has managed to meet its program spending targets for 2014–15. And while the 0.7 per cent spending growth targets for 2015–16 will be even more daunting, the government appears determined to meet them and to balance its budget.
- The outlook for the Quebec economy over the next three years has been revised upward thanks to vigorous growth in the United States economy and the sharp depreciation of the loonie against the U.S. dollar. Together, these factors will make Quebec exports more competitive and allow them to increase at a healthy clip.

Over the longer term, the government must reduce the annual growth in health care spending from 5.2 per cent to 4.2 per cent.

Given the encouraging spending outlook and steadier-than-expected economic growth, Quebec is set to put an end to budgets being written in red ink.

If Quebec wants to get this transition off to a successful start, it will have to stabilize its public finances in the short term and take full advantage of the strength of the U.S. economy. However, the real change in Quebec will not start happening until 2017. Even then, it will occur only if the government succeeds in cutting the growth in its health care spending from 5.2 per cent to 4.2 per cent, and does so on a sustainable basis. Other countries have managed it, and Quebec can do so as well if all the players involved work together toward this goal. At that point, for one of the few times in its history, and despite the pressures that the aging population will exert on health care costs and on the labour force participation rate, Quebec would be able to:

- maintain the level of its services to the population;
- reduce its debt burden;
- create the financial flexibility that would allow it to cope with unexpected economic downturns;
- choose to invest in economic or social development projects, or to ease the tax burden.

Creating financial flexibility for the long term will avoid the need for the government to periodically carry out public finance reform exercises, according to the ups and downs of the economy. If the provincial government does succeed in reining in the growth in health care system costs, Quebecers will then be able to make future choices—such as new development projects or tax cuts—without having to worry about increasing the public debt or compromising the level of public services. This would be a historic turning point that would enable Quebec to flourish as never before.

Budget surpluses projected starting in 2017 could be used in various ways. They can be used to pay off debt, to reduce the tax burden on individuals and businesses, or to carry out new economic or social development projects.

Three simulations have been conducted by The Conference Board of Canada to show the long-term impact that these choices would have on public finances. Each has advantages and drawbacks for the economy. And they are all achievable without compromising the ability of future generations to make their own decisions.

Pursuing the reform of public finances in the short term, reaping the benefits of the improvement in the economy, and keeping health care expenditure growth at 4.2 per cent will enable current and future generations to maintain the level of public services without driving Quebec back into a deficit. At the same time, Quebecers will be able to make their own choices about how to use the budgetary flexibility that has been created.

Institut du Québec

Un partenariat entre

Le Conference Board du Canada

HEC MONTRĒAL

3000, chemin de la Côte-Sainte-Catherine
4e étage, bur. 4.311
Montréal (Québec) H3T 2A7
Tél. : 514-340-6449
institutduquebec.ca

PUBLICATION : 6949
PRICE: Complimentary