Montreal Economic Institute
Ideas for a More Prosperous Nation

ViewPoint on the debt of the Quebec government

by Youri Chassin | March 2011

The Quebec government's 2011-2012 Budget states that the public sector debt has risen to 235 billion dollars on March 31, 2011, an increase of 13 billion over last year.[1] Representing 74% of GDP, this debt is even more of a concern in the context of the aging of the population and of current deficits.

For each of the past two Quebec budgets, the MEI has published a *Viewpoint* on the debt of the Quebec government that explained various concepts related to debt and compared the public indebtedness of the provinces. Continuing the tradition, this *Viewpoint* presents Quebec's public debt situation. It also sketches a picture of one of its components, which is surely the least well-known and the most misunderstood: the retirement plans liability for public sector employees.

THE PUBLIC SECTOR DEBT

Although there exist several definitions of the debt, the most comprehensive measure of the collective indebtedness of Quebecers is the public sector debt. It includes the government's direct debt financed on the bond market, the retirement plans liability for public sector employees that we will examine below, the debts of municipalities, of Hydro-Québec and of other government enterprises, as well as the health and social services and education networks. In other words, the public sector debt encompasses all of the long-term financial obligations guaranteed by the Quebec government.

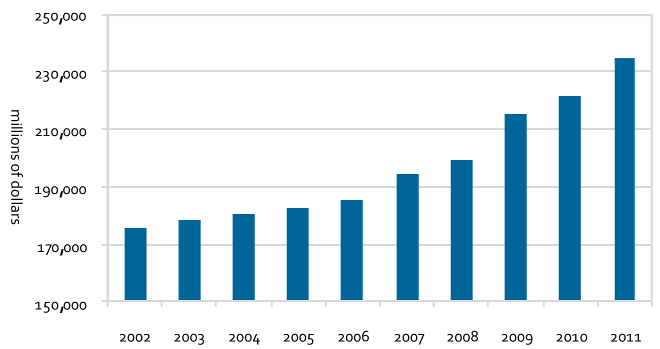
Table 1
Components of the public sector debt (millions of dollars)

	March 31 2010	March 31 2011	Variation
-Government's gross debt	163,318	173,429	+ 6,2%
Consolidated direct debt	*136,074*	*147,666*	*+ 8,5%*
PLUS Retirement plans liability	*67,989*	*71,371*	*+ 5,0%*
LESS Retirement Plans Sinking Fund (RPSF)	*(38,200)*	*(42,278)*	*+ 10,7%*
LESS Generations Fund	*(2,677)*	*(3,409)*	*+ 27,3%*
-Hydro-Québec's debt	36,385	37,671	+ 3,5%
-Municipalities' debt	19,538	20,636	+ 5,6%
-Universities's debt (other than the Université du Québec and its constituent universities)	1,749	1,511	- 13,6%
-Other government enterprises' debt	697	1,463	+ 109,9%
Total (Public sector debt):	**221,687**	**234,710**	**+ 5,9%**

Source: Ministère des Finances du Québec, *2011-2012 Budget Plan*, pp. D.14 et I.15.

Compared to last year, the public sector debt grew by $13 billion, mainly due to the government's gross debt which increased $10.1 billion. We can see that the retirement plans liability for public sector employees also increased $3.4 billion. Since the budget deficit is not the public sector debt's only growth factor, it is easy to understand why that debt has kept rising uninterruptedly in recent years, even when the government was declaring balanced budgets.

Figure 1
The rising public sector debt



Source: Ministère des Finances du Québec, *2004-2005 to 2011-2012 Budget Plans*.

THE RETIREMENT PLANS LIABILITY FOR PUBLIC SECTOR EMPLOYEES

The public sector debt includes a little known and frequently misunderstood component: the *retirement plans liability* (RPL), as it is officially called. While the other components of the public sector debt come from deficits generated by the financing of social programs and infrastructure, the retirement plans liability represents the amounts the government has failed to set aside year after year to pay the retirement benefits promised to its employees.

The retirement plans for the public service and for the health and social services and education networks theoretically accumulate the contributions of employees and employers, which are deposited with the Caisse de dépôt et placement du Québec, in order subsequently to pay out predetermined retirement benefits. Actuaries estimate that the benefits that will need to be paid out to current retirees and employees in coming decades amount to 118 billion dollars, of which 76.9 billion dollars will need to be covered by the government as employer.[2]

1. Ministère des Finances du Québec, *2011-2012 Budget Plan*, p. D.14.
2. As of March 31, 2009, which are the most recent data available. See: Vérificateur général du Québec, *Rapport 2010-2011 : Vérification de l'information financière et autres travaux connexes*, p. 9-9.

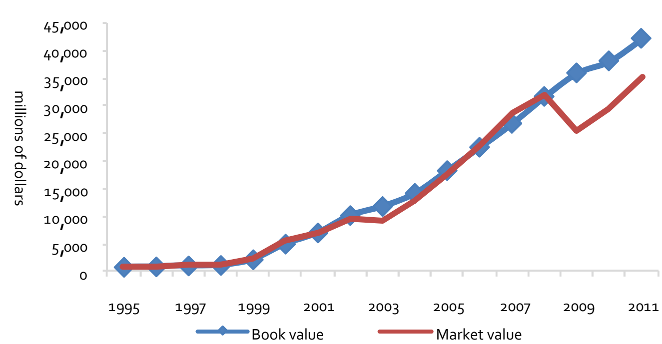
The gap between assets (that is to say, the funds set aside that accumulate a certain return) and future obligations estimated by actuaries constitutes a debt that the government must record on its financial statements.[3] This is the retirement plans liability. On March 31, 2011, the government stated that this liability amounted to $71.4 billion.[4] From this amount, the government deducts the balance of the Retirement Plans Sinking Fund (RPSF) in order to include in its debt the *net* retirement plans liability, which is $29.1 billion.

THE RETIREMENT PLANS SINKING FUND

In order to meet its obligations to its employees, the Quebec government created the RPSF in 1993. In the 1999 collective agreement, it set a goal that the RPSF would reach the equivalent of 70% of its obligations in 2020. This fund is particular in that it is financed by loans. In other words, in order to reimburse the actuarial retirement plans liability, the government is increasing its direct debt.

Figure 2

Evolution of the book value and of the market value of the RPSF



Source: Ministère des Finances du Québec, *2011-2012 Budget Plans*, p. D.22.

Why borrow from Peter to pay Paul? The government is counting on leverage by estimating that the return on the amounts placed in the RPSF will be greater than the interest paid on Quebec bonds, which would allow it to come out ahead in theory. An uncertainty remains, however: with the return really be higher than the interest rate paid on the government's loans? The risk of borrowing to play the stock market is taken on in concrete terms by all taxpayers through the debt. Following the disastrous returns of the Caisse de dépôt et placement du Québec in 2008, the leveraging strategy has shown itself to be riskier than some might initially have been thought it to be. The RPSF lost a quarter of its market value that year. This loss was not recorded by the government, which uses a book value for the RPSF that adds the value of the loans used to finance it with its expected returns. The market value of the RPSF is thus nearly $7 billion lower than this book value.

A PUBLIC SECTOR DEBT THAT IS COMPLEX, BUT THAT CONCERNS US ALL

Accounting tricks can be confusing, but they have serious real world consequences. To be sure, the RPSF has only a small impact on government finances since the loans taken out to fund it are offset by its own value, and the interest on those loans are supposed to be cancelled out by the returns obtained by the amounts placed in the RPSF. What is not reflected in the government's finances is that the RPSF's composition implies a financial risk in the event of returns that are lower than the interest paid by the government on its debt.

The RPSF also masks the fact that the costs of public sector employees' retirement plans were not covered by the governments that negotiated them. Politicians have long preferred to "push the problem down the road" and leave the burden to others. This is the very principle behind deficits that pile up to finance consumption rather than investment, sometimes referred to as "grocery debt."

In the future, the funding of retirement plans should be included in the government's current expenses since, just like salaries, they make up a part of public sector employees' total remuneration. As for the retirement plans liability that has piled up in recent decades, there is good reason to question the RPSF strategy that relies on leverage because of the financial risks taken on by Quebec taxpayers.

3. See Figure 2 in the 2010-2011 Report of the Vérificateur général du Québec (p. 9-6), which illustrates the accounting adjustments explaining the difference between the 76.9 billion dollars of actuarial obligations and the gross retirement plans liability.
4. This amount represents the retirement plans liability from which the retirement plans assets other than the RPSF have already been subtracted. Ministère des Finances du Québec, *2011-2012 Budget Plan*, p. I.15.

Youri Chassin holds a master's degree in economics from the Université de Montréal and spent a term in Mexico City during his studies. He was an economic analyst at the Quebec Employers' Council (CPQ) and an economist at the Center for Interuniversity Research and Analysis on Organizations (CIRANO). His interest towards public policy issues goes back to his university days during which he collaborated with the Quebec Federation of University Students (FEUQ), with the Conseil permanent de la jeunesse and with Force Jeunesse. He is the author of several studies on public finance, youth employment, universities and taxation. He joined the Montreal Economic Institute in November 2010.