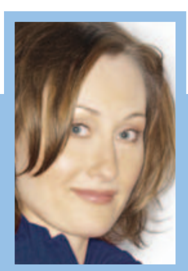
Montreal Economic Institute
Ideas for a More Prosperous Nation

ECONOMIC NOTE

September 2006

# TAXATION AND THE ROLE OF THE STATE: A REPORT CARD ON THE CHAREST GOVERNMENT

April 2007 will mark the fourth anniversary of Jean Charest's election as premier of Quebec. In the autumn prior to the election, a Quebec Liberal party congress had adopted an "Action Plan for the Next Liberal Government."[1] A year after the election, the new government published a "Modernization Plan."[2] Has the Liberal government kept the promises it made in those proposals? This Economic Note presents a summary of its achievements, with a particular focus on its promises to provide tax relief and to reduce the role of the state.



This Economic Note was prepared by Tasha Kheiriddin, executive vice-president of the Montreal Economic Institute.

## Taxes and spending

Taxes were the area where the 2002 Action Plan was most explicit (p. 22): "Beginning with the very first budget it tables, a Quebec Liberal Party government will launch a plan to reduce personal income taxes by $1 billion annually over a 5-year period." This promise has not been kept. The Liberal government's first budget, introduced on June 12, 2003, contained no tax cuts. The next three budgets cumulatively reduced the tax burden by about $626 million (at the end of the 2006-2007 fiscal year). This, compared to the $3 billion required to meet the pledge in the Action Plan (if one leaves out the first budget), amounted to about one-fifth of the promised objective.

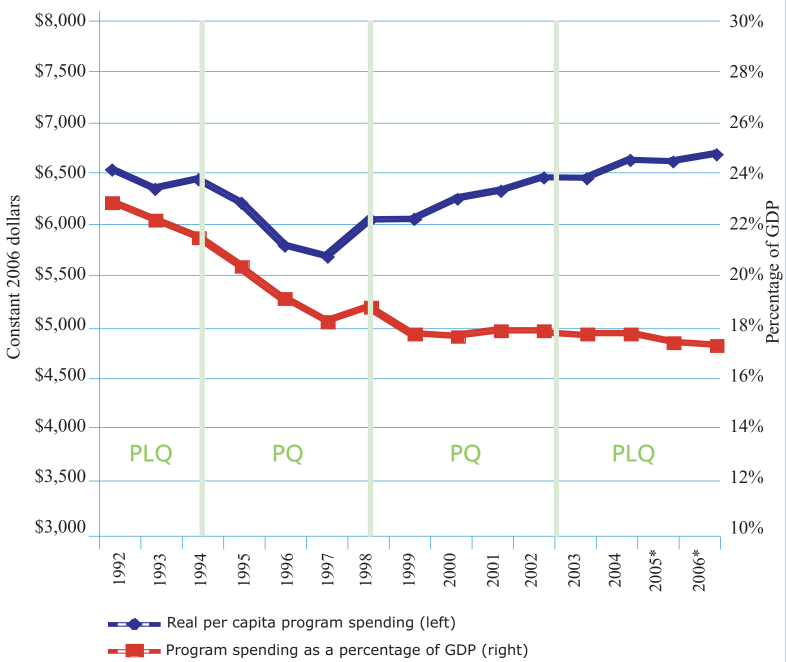
It should be noted that, in its official documents, the government inflates personal income tax cuts by adding refundable tax credits and amounts resulting from the indexing of tax brackets.[3] The tax credits, related mainly to the new child support and work premium programs, consist of subsidies to families and low-income wage-earners. They are distributed even to persons who pay little or no tax (this is what "refundable" means). It is thus misleading to refer to them as a tax cut. As for the indexing that existed in the tax system before the current government was elected, it merely prevents real taxes from rising with inflation, and it is obviously incorrect to regard this absence of an increase as tax relief.

The only reductions in the last four years come not from a decrease in taxation rates but from the effects of simplifying the tax regime (merging the general tax regime and the so-called simplified one, starting January 1, 2005) and from introducing a $500 deduction for workers (rising to $1,000 on January 1, 2007). Of course, these tax cuts constitute decreases only when compared to expected increases in total revenues and are not a reduction in absolute terms. Revenues from personal income tax have effectively gone up 11% since 2002-2003.

Moreover, taxpayers have had to put up with a hidden tax increase in the form of "parental insurance," which is not an insurance system at all since contributions are taken from all wage-earners and self-employed workers regardless of whether they are potential parents or not.

1. Quebec Liberal Party, *A Government at the Service of Quebecers: Let's reinvent Quebec – together*, September 2002, available at http://www.plq.org/doc/platform/planactiona.pdf.
2. Treasury Board, *Modernizing the State: Promoting quality services to the population. Modernization Plan 2004-2007*, Government of Quebec, May 2004, available at http://www.tresor.gouv.qc.ca/en/publications/modernisation/plan_modernisation-bref_en.pdf.
3. See the two tables on page 2, section 3, *2006-2007 Budget. Additionnal Information on the Budgetary Measures*, March 2006, available at http://www.budget.finances.gouv.qc.ca/budget/2006-2007/en/pdf/AdditionnalInfoMeasures.pdf. The total amount of real tax reductions ($626 million) can be calculated by adding the following figures: $219 million resulting from the introduction of the simplified tax regime in 2004-2005; $337 million from the 2005-2006 budget ($300 million for the deduction for workers and $37 million from other measures); and $70 million from the 2006-2007 budget (the higher deduction for workers and two other modest measures, less $5 million resulting from the refundable tax credit rebate for keeping an elderly person at home).

FIGURE 1
Trends in Quebec government program spending, 1992-1993 to 2006-2007




* Forecast
Note: The year in abscissa refers to the beginning of the fiscal year (which runs from April to March).

Source : Treasury Board, *2006-2007 Expenditure Budget*, Vol. IV, Government of Quebec, 1st quarter 2006, table B.1, p. 100, available at http://www.tresor.gouv.qc.ca/en/publications/budget/06-07/06-07_vol4_en.pdf.

On the business side, some tax relief has been adopted, including elimination of the capital tax for small and medium enterprises (SMEs) and lower rates for other companies, as well as a drop in tax rates on the profits of SMEs. However, the 2005-2006 budget raised tax rates on large companies. Also, new water and petroleum royalties to finance debt reduction are nothing more than new taxes. Overall, corporate income tax revenues have jumped 16% since 2002-2003.

In his budget speech on June 12, 2003, the Finance minister stated: "I am announcing today that this Budget enables us to achieve a zero deficit for 2003-2004[.] … [T]he objective is clear: a zero deficit will be maintained next year and every year thereafter."[4] In fact, two of the last four years have been marked by slight deficits, even excluding the extraordinary losses of the Société générale de financement. The accumulated surpluses (providing for financing of potential future deficits, in accordance with the *Balanced Budget Act*) stood at $1.177 billion on March 31, 2003, but had fallen to $155 million as of March 31, 2006.[5]

Because of capital spending, the public sector debt has kept on rising since March 31, 2003, although it has fallen as a proportion of GDP (from 74% to 67% in the last three years). The main credit rating agencies have raised the government's rating. And the ratio of program spending to GDP fell from 18.1% to 17.7% between 2002-2003 and 2005-2006 (with a forecast of 17.6% for 2006-2007). It should be noted, however, that this reduction is due solely to the rise in GDP (with real spending up) and that the two preceding Parti Québécois governments had presided over an even greater reduction in the ratio, which had stood at 21.3% in 1994-1995 and 18.9% in 1998-1999, as shown in Figure 1.

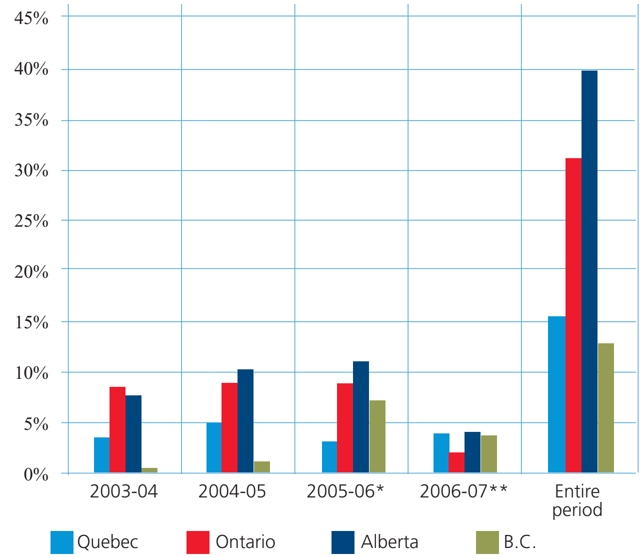
This graph also shows that real per capita program spending under the Charest government continued rising as it had started to do late in the first of two recent Parti Québécois mandates, though at a slower pace. Since 2003-2004, it has gone from $6,445 to $6,651 (at the end of the current fiscal year). It can only be said that the Charest government has reduced spending growth compared to the PQ government that immediately preceded it.

The government states: "This year Quebec is again doing better than the rest of Canada in controlling its budget." As the latest Expenditure Budget explains, only Prince Edward Island has a

*The three budgets cumulatively reduced the tax burden by about $626 million, compared to the $3 billion required to meet the pledge in the action plan.*

4. Ministry of Finance, *2003-2004 Budget. Budget Speech*, Government of Quebec, June 2003, pp. 2 and 5, available at http://www.budget.finances.gouv.qc.ca/budget/2003-2004a/en/pdf/BudgetSpeech.pdf.
5. Ministry of Finance, *2006-2007 Budget Plan*, Government of Quebec, April 2005, Section 4, p. 4, available at http://www.budget.finances.gouv.qc.ca/budget/2006-2007/en/pdf/BudgetPlan.pdf.

### Figure 2
**Variations in program spending by several provincial governments**




* Estimate.
** Forecast.
Sources: Budget documents from the provincial governments mentioned.

lower growth rate in program spending than Quebec.[6] But as can be observed in Figure 2, this is correct if we only focus on the 2005-2006 fiscal year.[7] The picture changes somewhat when the four years of the Charest government (including forecasts for 2006-2007) are taken into account and compared with the larger Canadian provinces. Over that entire period, the British Columbia government did a better job of controlling spending. For 2006-2007, it is forecast that program spending by the Quebec government will rise more quickly than similar spending in Ontario and British Columbia.

*It can only be said that the Charest government has reduced spending growth compared to the PQ government that immediately preceded it.*

## Economic interventionism

The government's Modernization Plan spoke of a "questioning of business aid programs" and promised to submit each subsidy program to a sunset clause and a triennial review. These mechanisms have not been instituted. Total provincial subsidies to business nonetheless declined slightly, from $1.01 billion in 2003-2004 to $984 million in 2004-2005 (longer comparable data series are not available).[8] Tax advantages were also reduced in the government's first two budgets for a total amount of more than $600 million.[9]

The Société Innovatech du Grand Montréal (a state-owned venture capital company) has been privatized, and the government has converted, or is converting, three other entities of the same type into mixed public-private companies.[10] New subsidy programs have been created, however, including the Regional Economic Intervention Fund, as well as refundable tax credits for job creation and, in the latest budget, special subsidies for forestry companies.

On the labour relations front, the Labour Code (Article 45) was relaxed to ease subcontracting. Despite strong union opposition, this measure caused no major upheaval in the labour field.

## "Re-engineering" the state

The 2002 Action Plan promised to update the mission of the state, a goal that would become one of "reorganizing the state" or "re-engineering the state" in the premier's inaugural address on June 4, 2003, and then of "modernizing the state" in the 2004 Modernization Plan. Promises in the Plan included a lightening of government structures (including the abolition of certain bodies) and the re-assessment of some programs.

The government pledged to replace only one civil servant out of two as they went into retirement. Indeed, the number of civil servants, after peaking at 75,800 in 2003-2004, has fallen by 2,500 (in full-time equivalent) since then, with the goal being a 20% reduction over ten years.[11]

A task force was created to assess 60 government bodies in 2004-2005. The ensuing Boudreau report suggested only six outright abolitions, with the other recommendations consisting of modifications or the shifting of mandates to other government bureaucracies.

6. Treasury Board, *2006-2007 Expenditure Budget*, Vol. IV: *Message from the Chair of the Conseil du trésor and Additional Information*, Government of Quebec, 1st quarter 2006, p. vi, available at http://www.tresor.gouv.qc.ca/en/publications/budget/06-07/06-07_vol4_en.pdf.
7. Our data differ slightly from those provided by the Treasury Board, in all likelihood because it did not have all the provincial budgets at its disposal when it published the Expenditure Budget. The differences do not seem to have much effect on our main conclusions.
8. Ministry of Finance, *Public Accounts 2004-2005*, Vol. 2, Government of Quebec, 4th quarter 2005, pp. 1-39, available at http://www.finances.gouv.qc.ca/en/documents/publications/pdf/vol2-2004-2005.pdf.
9. Ministry of Finance, *2004-2005 Budget. Budget Plan*, Government of Quebec, March 2004, Section 7, pp. 5 and 6, available at http://www.budget.finances.gouv.qc.ca/budget/2004-2005/en/pdf/BudgetPlan.pdf.
10. Government of Quebec, *Second Progress Report, Modernization Plan 2004-2007*, May 2006, pp. 19 and 34, available at http://www.tresor.gouv.qc.ca/en/publications/rapport/2nd_report.pdf.
11. *Ibid.*, p. 15.

A second task force, with a mandate to examine 58 other bodies in 2005-2006, produced the Geoffrion report, which again suggested only a half-dozen outright abolitions along with a number of modifications, mergers and redistribution of responsibilities elsewhere in the government apparatus.

The result of the operation is that, in the summer of 2006, 16 bodies were officially abolished by the Charest government.[12] However, in about half the instances, the responsibilities of abolished bodies were transferred elsewhere in the government apparatus. Moreover, since other entities were created to administer new programs, the effect has been even more modest. On June 6, 2006, the government website presented a list of more than 200 agencies, boards and commissions. Abolishing about 20 more of these is still planned, with the list including the Société nationale de l'amiante (national asbestos corporation) and the Société nationale du cheval de course (national racehorse corporation).

*The number of civil servants, after peaking at 75,800 in 2003-2004, fell by 2,500 (in full-time equivalent) since then, with the goal being a 20% reduction over ten years.*

A pledge on regulation in the 2002 Action Plan stated that "a Liberal party government will adopt and implement a program to lighten economic and tax regulations. Any new set of regulations must be reviewed after five years." This promise is not found in the 2004 Modernization Plan.

Regulatory measures have not been cut significantly. In 2005, the number of laws, regulations, decrees and "other acts" by the Quebec government filled 7,552 pages in the *Gazette officielle du Québec*. There are many examples of the regulatory burden being maintained or increased.

The government continues, for example, to defend the agricultural quota system at the World Trade Organization. It supports the Kyoto agreement and its associated regulations. Converting the Revenue Department into an American-style "agency" was presented as a way of "maximizing government revenues."[13]. The *Act respecting the Agence des partenariats public-privé*, adopted in 2004, creates a new bureaucratic structure to promotion public-private partnerships, and it is not clear that it will broaden the long-recognized practice of subcontracting projects to private companies.

The 2005 amendments to the *Tobacco Act* make the controls imposed on smokers even more restrictive. The last budget announced that restaurant owners will soon be required to use cash registers equipped with microcomputers approved by the Revenue Department and enclosed in a secured casing to keep a record of their sales. It also announced a law "to ensure that the State is the sole owner of water in Quebec."

## Modest and ambiguous results

The Quebec Liberal Party had not promised a drastic reduction in the role and size of government even though certain left-wing opponents accused it of seeking "to dismantle the Quebec state." It did, however, promise to cut taxes and lighten the weight of government. Even by this yardstick, it must be concluded from this brief summary that the results have been modest and ambiguous at best.

12. Comité d'évaluation des ressources didactiques (Didactic resources assessment committee), Comité d'orientation et de formation du personnel enseignant (Teaching staff orientation and training committee), Comité de santé mentale du Québec (Quebec mental health committee), Commission des programmes d'études (Commission on study programs), Conseil québécois de la lutte contre le cancer (Quebec council to combat cancer), Fonds central pour le bénéfice des personnes incarcérées (Central fund for the benefit of incarcerated persons), Société de la faune et des parcs du Québec (Quebec wildlife and parks corporation), Comité aviseur du Fonds de lutte contre la pauvreté par la réinsertion au travail (Advisory committee on the fund to combat poverty through reinsertion in the labour market), Comité consultatif de la Régie du bâtiment du Québec (Consultative committee of the Quebec construction board), Conseil de surveillance des activités de la Sûreté du Québec (Council to oversee the activities of the Quebec provincial police), Observatoire québécois de la mondialisation (Quebec globalization observatory), Protecteur des usagers en matière de santé et de services sociaux (Health and social services ombudsman), Sidbec [defunct steel producer], Société de développement de la Zone de commerce internationale de Montréal à Mirabel (Development corporation for the Montreal international trade zone at Mirabel), Société du parc industriel et portuaire Québec-Sud (Quebec South industrial park and port corporation), Société Innovatech du Grand Montréal (Innovatech corporation of Greater Montreal).
13. Government of Quebec, "Revenu Québec, nouvelle agence gouvernementale pour maximiser les revenus de l'État," press release issued on June 30, 2004, available at http://www.revenu.gouv.qc.ca/eng/ministere/centre_information/discours/2004-06-30.asp.

Montreal Economic Institute
Ideas for a More Prosperous Nation

Montreal Economic Institute
6708 Saint-Hubert Street
Montreal, Quebec
Canada H2S 2M6
Telephone (514) 273-0969
Fax (514) 273-2581
Web site www.iedm.org

The Montreal Economic Institute (MEI) is an independent, non-profit, non-partisan research and educational institute. It endeavours to promote an economic approach to the study of public policy issues.

The MEI is the product of a collaborative effort between entrepreneurs, academics and economists. The Institute does not accept any public funding.

One-year subscription to the MEI publications: $98.00.





Printed in Canada

Illustration:
Benoit Lafond

Graphic Design:
Valna inc.