VIEWPOINT

Montreal Economic Institute

Ideas for a More Prosperous Nation

The debt of the Quebec government

by Youri Chassin | November 2012

Exceptionally, the 2013-2014 budget has been tabled in November. Continuing its tradition, the MEI is therefore publishing a *Viewpoint on the debt of the Quebec government* that also explains what the Generations Fund is and the impact its abolition could have.

Based on estimates from the 2013-2014 Budget of the Quebec government, the public sector debt will reach 257.6 billion dollars on March 31, 2013, an increase of 11.4 billion dollars since March 31, 2012.

This amount is significantly higher than the official budget deficit of 1.5 billion dollars. Other than the deficit, the public sector debt increased mainly due to infrastructure spending (6.5 billion dollars).[1]

While there are several definitions of indebtedness, the notion of public sector debt represents the most exhaustive measure because it includes all the long-term financial obligations guaranteed by the government in the name of current and future taxpayers.

Figure 1
Evolution of Quebec's public sector debt (in billions of dollars)

Source: QDF (Budget Plans from 1995-1996 to 2013-2014). Note: MEI projection for 2013.

The Generations Fund gamble

The Generations Fund is a financial reserve created in 2006 by the Government of Quebec with the aim of reimbursing a part of its debt. It currently stands at about 5 billion dollars.[2] During the election campaign, the Parti Québécois committed itself to abolishing the Generations Fund by allocating it to debt reimbursement.[3] To evaluate the impact of this decision, it is important to understand two mechanisms incorporated into the functioning of the Fund.

First, the Generations Fund is not used to reimburse the debt each year, but rather constitutes a financial asset whose management is entrusted to the Caisse de dépôt et placement du Québec. The decision to take the sums collected in the Fund and invest them in the financial markets reflects the hope that the return will be greater than the interest that could have been saved by reducing the debt.

1. Quebec Department of Finance, *2013-2014 Budget Plan*, p. D.7.
2. Quebec Department of Finance, *2013-2014 Budget Plan*, p. D.31.
3. Parti Québécois, *L'avenir du Québec est entre vos mains*, electoral platform of the Parti Québécois, Améliorer l'efficacité de l'état québécois, committment 35.

This mechanism did not work in 2008-2009, a year in which the Fund's return was -22.4% due to plummeting stock prices. For the four other years for which data is available, the return was equal to or greater than the cost of new borrowing.[4]

Betting on a long-term return greater than the interest paid on new loans is a wager that is supported by the scientific literature,[5] but it nonetheless constitutes a financial risk. Moreover, the accumulation of money in a Fund entails political risks. Indeed, a government could always decide to use the money for other purposes rather than to reimburse the debt, especially during a crisis. It could also invest it on the basis of a policy of interventionism in the Quebec economy instead of aiming to maximize its return.

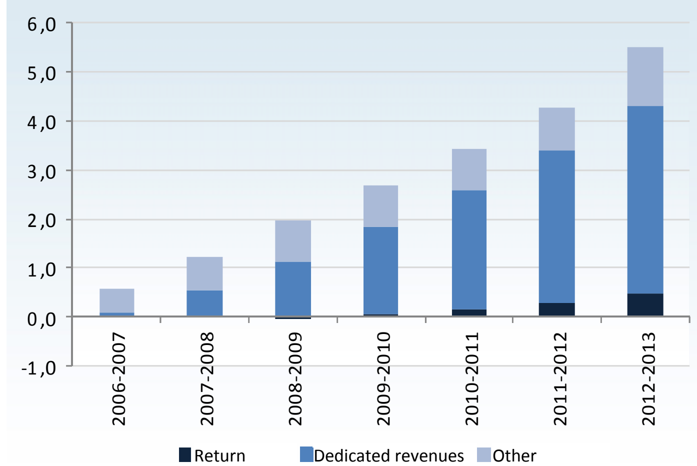
The Parti Québécois is proposing, with the possible abolition of the Generations Fund, to not take the chance that the return on the markets might be lower than the interest paid on new borrowing. This solution also avoids the political risk of the Fund being used for other purposes and of an investment policy that does not maximize returns.

Revenues dedicated to debt reimbursement

Second, the Generations Fund is fed by revenues dedicated to debt reimbursement: water-power royalties, a part of mining royalties, and certain exceptional sums.[6] The sums paid into the Generations Fund are deducted from budget revenues. In practice, a government with a balanced budget would actually have had a surplus, if we take into account the sums set aside in the Generations Fund.

If the Fund is abolished, what happens to the revenues that are systematically paid into it? If these revenues are redirected toward the government's consolidated fund, which serves to collect revenues and to pay general government expenses, there will no longer be any revenues dedicated to debt reduction.

Figure 2
Value of the Generations Fund by revenue source (in billions of dollars)



Source: QDF , *Public Accounts 2007-2008* through *2010-2011*, Volume 1, p. 25 or 26 or 37; QDF, *2012-2013 Budget Plan*, p. D. 31.
Note: The "Other" category includes exceptional sums, budget surpluses and unclaimed property paid into the Fund.

These royalties will then serve to cover regular expenses or to finance new expenses.

However, if these revenues previously paid into the Fund are allocated to debt reimbursement each year in a transparent manner, the debt reduction effort will continue. The Parti Québécois seemed to favour this second option during the election campaign, even adding eventual oil and gas royalties.[7] Thanks to these successive debt reductions, the government will save on interest paid. If this interest saved was also used to pay down the debt, the logic behind the Generations Fund would be respected, without its attendant financial risk and political risks.

Given the worrying size of its debt, the Quebec government should devote, for purposes of debt reduction, amounts similar to those paid into the Generations Fund.

4. Quebec Department of Finance, *2012-2013 Budget Plan*, March 2012, p. D. 32.
5. Roger G. Ibbotson and Rex A. Sinquefield, "Stocks, Bonds, Bills, and Inflation: Year-by-Year Historical Returns (1926-1974)," *The Journal of Business*, Vol. 49, No. 1 (January, 1976), pp. 11-47.
6. Quebec Department of Finance, *2012-2013 Budget Plan*, March 2012, p. D. 30.
7. The Parti Québécois's financial officer did not incorporate any new budget revenues from water-power royalties, which suggests that these royalties were still devoted to debt reduction.

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). He is the author of several studies on public finance, youth employment, universities and taxation.