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SUPPLEMENTARY INFORMATION

BUDGET 2021-2022

Votre gouvernement

Québec

SUPPLEMENTARY INFORMATION

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1. MARGINS OF PRUDENCE, SENSITIVITY ANALYSES AND MAIN RISKS TO QUÉBEC'S FINANCIAL SITUATION

❑ Margins of prudence

The provisions included in the financial framework, which will amount to $4.4 billion by 2022-2023, will make it possible to cover risks that could influence the financial framework and to thus respond to an unexpected decline in revenue or increase in expenditure.

TABLE 1

Margins of prudence
(millions of dollars)

	2020-2021	2021-2022	2022-2023	Total
Contingency Fund reserve	200	200	200	600
Provision for economic risks and other support and recovery measures	1 250	1 250	1 250	3 750
TOTAL	**1 450**	**1 450**	**1 450**	**4 350**

❑ Risks and sensitivity analyses in the context of the pandemic

The current COVID-19 pandemic significantly increases uncertainty regarding parameters and assumptions underlying the establishment of forecasts for the various components of the financial framework. Consequently, the effects of risks and sensitivity analyses could be different than those normally expected, thereby increasing the volatility of the financial impacts presented in this section.

❑ Risks and sensitivity analysis for own-source revenue

■ Risks

The revenue forecasts for 2021-2022 and subsequent years include a certain level of risk and uncertainty given that they are based on assumptions concerning future events, such as the evolution of the pandemic and the repercussions of the public health crisis on economic activity.

For example, the forecast for corporate tax revenue is marked by a considerable level of uncertainty owing to a combination of several economic, decision-making and administrative factors. The legal framework, for example, which enables businesses to make choices regarding taxation, particularly the utilization of deferred losses, the possibility of adjusting instalment payments and the deadline for filing and processing tax returns, affects the recognition of corporate taxes.

Sensitivity analysis

In general, the nominal GDP forecast is a good indicator of growth in own-source revenue excluding revenue from government enterprises given the direct link between tax bases and nominal GDP.

— According to an overall sensitivity analysis, a variation of 1 percentage point in nominal GDP has an impact of about $800 million on the government's own-source revenue.

This sensitivity analysis is based on a revision of each tax base in proportion to the revision of nominal GDP.

— In reality, a change in economic outlook can have a greater impact on some economic variables, as well as greater repercussions on certain tax bases than on others.

Sensitivity analyses set an average historical relationship between the change in own-source revenue and growth in nominal GDP. Accordingly, they may prove inaccurate for a given year depending on the economic situation and yet not lose their validity.

— Indeed, for a given year, economic fluctuations may have various impacts on revenue because of changes in the behaviour of economic agents.

— In these situations, the change in own-source revenue can be greater or lower than the change in nominal GDP.

Sensitivity of own-source revenue excluding revenue from government enterprises to major economic variables

Variables	Variation forecasts for 2021	Impacts for fiscal 2021-2022
Nominal GDP	6.0%	A variation of 1 percentage point changes own-source revenue by roughly $800 million.
Wages and salaries	6.0%	A variation of 1 percentage point changes personal income tax revenue by about $370 million.
Employment insurance	74.1%	A variation of 1 percentage point changes personal income tax revenue by about $7 million.
Pension income	5.5%	A variation of 1 percentage point changes personal income tax revenue by about $60 million.
Net operating surplus of corporations	2.2%	A variation of 1 percentage point changes corporate tax revenue by about $45 million.
Consumption excluding food expenditures and shelter	8.3%	A variation of 1 percentage point changes QST revenue by about $170 million.
Residential investment	10.6%	A variation of 1 percentage point changes QST revenue by about $35 million.

❑ Risks and sensitivity analysis for revenue from government enterprises

■ Risks

The forecasts for government enterprises depend on the information available when they are made. Updating of information may thus have an impact on forecasts.

The evolution and duration of the COVID-19 pandemic represent a risk difficult to assess and may have significant repercussions on government enterprises. In particular, the closing of casinos and gaming halls influence Loto-Québec's revenue, and the level of economic activity has an impact on Hydro-Québec's electricity sales.

It must also be borne in mind that certain variables, such as those concerning weather conditions, are difficult to forecast.

■ Sensitivity analysis

For Hydro-Québec, a variation of:

— 1.0 US¢/kWh in the price of energy on foreign markets changes its annual net earnings by nearly $350 million;

— 1 °C in winter temperatures compared to normal temperatures changes its net earnings by over $100 million.

For Loto-Québec, a variation of 1% in sales changes its net earnings by over $10 million.

For the Société des alcools du Québec, a variation of 1% in sales changes its net earnings by over $20 million.

For Investissement Québec, a variation of 1 percentage point in interest rates changes its net earnings by nearly $5 million.

For the Société québécoise du cannabis, a variation of 1% in sales changes its net earnings by over $1 million.

❑ Risks and sensitivity analysis for federal transfers

■ Risks

The primary risk associated with the equalization forecast concerns the estimation of the per capita fiscal capacity of each province, given that the federal government does not publish forecasts for equalization payments by province.

In addition, the main risks associated with the forecast for revenue from the Canada Health Transfer (CHT) and the Canada Social Transfer (CST) concern the estimation of the value of the special Québec abatement[1] and the estimation of the population of the provinces and territories.

■ Sensitivity analysis

The forecast for revenue from equalization, the CHT and the CST is based primarily on the following economic and demographic variables:

— growth of Canada's nominal GDP;

— growth in wages and salaries used in the forecast for basic federal income tax;

— growth of the net operating surplus of corporations used in the forecast for taxable corporate income;

— Québec's share of the population among the provinces as a whole.

Sensitivity analyses may not apply for a given year because of special economic conditions or changes made by the federal government to the operation of equalization, the CHT or the CST.

In addition, the sensitivity analysis of equalization revenue is based on an increase of 1 percentage point in the growth of Québec's economic variables, without any impact on that of the other provinces.

[1] Québec's revenues from the CHT and the CST are deducted from part of the value of the special Québec abatement (13.5% in the case of basic federal income tax collected in Québec, of which 62% is attributed to the CHT and 38% to the CST).

Sensitivity of federal transfer revenues to major economic and demographic variables

Variables	Forecasts for 2021	Impacts for fiscal 2021-2022
Growth of Canada's nominal GDP	7.7%	An increase of 1 percentage point raises equalization revenue(1) by roughly $20 million.
		An increase of 1 percentage point raises CHT revenue(1) by about $30 million.
Growth in wages and salaries in Québec	6.0%	An increase of 1 percentage point reduces equalization revenue(2) by about $75 million.
		An increase of 1 percentage point reduces CHT and CST revenues by around $45 million.
Québec's share of the population in Canada	22.5%	An increase of 0.1 percentage point raises equalization revenue(2) by about 130 million.
		An increase of 0.1 percentage point raises CHT and CST revenues by approximately $60 million.
Growth of the net operating surplus of corporations in Québec	2.2%	An increase of 1 percentage point reduces equalization revenue(2) by roughly $10 million.

(1) Equalization and CHT envelopes for 2021-2022 were set in December 2020 by the federal government and will not be revised. Increased growth in 2021 would have an impact as of 2022-2023.
(2) Due to the two-year lag in the equalization formula, increased growth in 2021 would have an impact as of 2023-2024. The impact for the years 2021-2022 and 2022-2023 would be nil.

❑ Risks and sensitivity analysis for portfolio expenditures

■ Risks

Several factors can have an impact on government spending. These factors include, in particular:

— changes in target clienteles, such as the student population in educational institutions;

— technological changes, which particularly affect spending in the health sector;

— changes in the general level of prices, which affect each of the government's portfolios differently;

— the emergence of new needs among Quebecers.

■ Sensitivity analysis

The financial framework's forecasts take into account:

— budgetary choices, which stem from the prioritization of certain sectors over others in the allocation of spending;

— economic and demographic variables, which are tied to price factors (inflation) and demographic factors (changes in population).

The following tables show the sensitivity of portfolio expenditures at the budgetary level as well as in regard to economic and demographic factors.

— It should be noted that such data constitute indications and that impacts may vary depending on the nature and interaction of risk factors.

▪ Budgetary choices

Spending may vary according to the choices made by the government in allocating its available budgetary resources. For example, a variation of 1% in the expenditure of the Santé et Services sociaux portfolio would lead to a variation of about $520 million.

Sensitivity of spending to a variation of 1% in each portfolio
(millions of dollars)

	Impacts for fiscal 2021-2022
Santé et Services sociaux	520
Éducation	180
Enseignement supérieur	90
Other portfolios	410
TOTAL	**1 200**

- **Economic and demographic variables**

The analysis carried out makes it possible to estimate the sensitivity of portfolio expenditures to basic socioeconomic variables.

- ***Prices***

Public spending is influenced by the price of services offered by the government. The change in the price of such services is closely tied to the change in the general level of prices in the economy, that is, inflation.

The results show that a variation of 1% in prices would lead to a variation of about $540 million in spending, or 0.4 percentage point in total spending.

— Following the signing of the next collective agreements of government employees, the government will be able to lower the risks on spending related to prices, as the “compensation” component of its expenditures will be based on the term of the agreement.

- ***Population***

Spending is affected by changes in total population and by changes in the size of the clientele for certain services.

For example, a change of 1% in the total population would change total spending by about $1.0 billion, or 0.8 percentage point.

Sensitivity of portfolio spending to a variation of 1% in each economic and demographic variables
(millions of dollars and percentage point)

		Impacts for fiscal 2021-2022	
Economic and demographic variables		($million)	(percentage point)
Prices			
Inflation	**Total spending**	**540**	**0.4**
Population			
Total population	**Total spending**	**1 020**	**0.8**
	By portfolio:		
	– Santé et Services sociaux		0.8
	– Éducation		0.8
	– Enseignement supérieur		0.8
	– Other		0.8
0-4 years	Total spending	100	0.1
5-16 years	Total spending	160	0.1
17-24 years	Total spending	160	0.1
Ages 65 and over	Total spending	300	0.2

❑ Risks and sensitivity analysis for debt service

■ Risks

The main risk associated with the debt service forecast is a higher-than-anticipated increase in interest rates or a lower-than-anticipated return on the Retirement Plans Sinking Fund (RPSF).[2]

The RPSF is an asset that was created for the purpose of paying the retirement benefits of public and parapublic sector employees, and it is managed by the Caisse de dépôt et placement du Québec.

The income of the RPSF is applied against debt service. Therefore, a lower-than-expected return on the RPSF would lead to an increase in debt service.

■ Sensitivity analysis

A greater-than-anticipated rise in interest rates of 1 percentage point over a full year would increase the interest expenditure by about $540 million.

A return of 1 percentage point less than the anticipated return on the RPSF would lead to an increase of about $20 million in debt service the following year.

A change in the value of the Canadian dollar compared with other currencies would have no impact on debt service because the government's debt has no foreign currency exposure.

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2 With its investment policy, which is based on a long-term horizon, the RPSF should generate an annual return of 6.35%.

❑ Main risks to the financial situation

Margins of prudence and main risks to Québec's financial situation

Margins of prudence	Risks	Estimated impacts
Financial framework	**Economic variables**	
Provisions for economic risks and other support and recovery measures: – $1.3 billion per year from 2020-2021 to 2022-2023	Impact of external variables on the Québec economy	
	– Variation of 1 percentage point in US real GDP	Impact of 0.45 percentage point on Québec's real GDP
	– Variation of 1 percentage point in Ontario's real GDP	Impact of 0.42 percentage point on Québec's real GDP
	Own-source revenue	
	Global slowdown	
	– Variation of 1 percentage point in Québec's nominal GDP	Impact of $800 million on own-source revenue
	– Typical recession (average)	Impact of $8.1 billion on own-source revenue
	Government enterprises	
	Variation of 1 °C in winter temperatures compared to normal temperatures	Impact of $100 million on Hydro-Québec's net earnings
	Federal transfers	
	Variation of 0.1 percentage point in Québec's population in Canada	Impact of $190 million on federal transfer revenues
Portfolio expenditures	**Portfolio expenditures**	
Contingency Fund reserve: – $200 million per year from 2020-2021 to 2022-2023	Unforeseen expenditures in government programs	Undetermined impact
	Variation of 1 percentage point in the total population	Impact of $1 020 million on spending
	Additional variation of 1 percentage point in technology-related costs for healthcare	Impact of $380 million on spending
	Variation of 1 percentage point in the general level of prices	Impact of $540 million on spending
	Natural disaster	Undetermined impact
	Public capital investment completion rate for a given year (5% difference)	Impact of $45 million on spending (depreciation and interest)
Debt service	**Debt service**	
	Variation of 1 percentage point in interest rates	Impact of $540 million on debt service(1)
	Variation of 1 percentage point in the return on the RPSF	Impact of $20 million on debt service

(1) Upon maturity, on the 5th year, the impact of a greater-than-anticipated rise in interest rates of 1 percentage point would increase debt service by $1.9 billion.

2. NET FINANCIAL SURPLUSES OR REQUIREMENTS

Net financial surpluses or requirements represent the difference between the government's cash inflow and disbursements. These net financial surpluses or requirements take into account:

— changes in the budgetary balance on an accrual basis;

— resources or requirements arising in particular from the acquisition or disposal of fixed assets, investments, loans and advances and from other activities such as paying accounts payable and collecting accounts receivable.

TABLE 2

Net financial surpluses or requirements
(millions of dollars)

	2020-2021	2021-2022	2022-2023
SURPLUS (DEFICIT)[(1)]	**–11 986**	**–9 170**	**–5 292**
Non-budgetary transactions			
Investments, loans and advances[(2)]	–2 647	–1 894	–1 235
Capital expenditures[(3)]	–3 262	–4 790	–5 271
Retirement plans and other employee benefits[(4)]	–2 571	–2 916	–3 121
Other accounts[(5)]	–664	1 785	196
Deposits of dedicated revenues in the Generations Fund	–3 014	–3 080	–3 208
Total non-budgetary transactions	**–12 158**	**–10 895**	**–12 639**
NET FINANCIAL SURPLUSES (REQUIREMENTS)	**–24 144**	**–20 065**	**–17 931**

Note: A negative entry indicates a financial requirement and a positive entry, a source of financing.
(1) Balance within the meaning of public accounts.
(2) Investments, loans and advances include mainly investments made by the government in its enterprises and loans and advances granted to entities not included in the government reporting entity.
(3) Forecast net financial requirements associated with net capital investments result mainly from needs arising from the Québec Infrastructure Plan.
(4) The net financial surpluses associated with the retirement plans and other employee future benefits stem from gross employer contributions, employee contributions, benefits and administration costs, employee future benefits, as well as revenues not yet collected from the Retirement Plans Sinking Fund and the funds related to employee future benefits.
(5) Net financial surpluses or requirements for other accounts consist of a series of changes in assets and liabilities, such as accounts receivable and accounts payable.

TABLE 3

Net capital investments
(millions of dollars)

	2020-2021	2021-2022	2022-2023
Investment	7 681	9 222	9 785
Depreciation	–4 333	–4 432	–4 514
Net investment	**3 348**	**4 790**	**5 271**
Less: PPP investments(1)	–86	—	—
NET CAPITAL INVESTMENT	**3 262**	**4 790**	**5 271**

Note: A negative entry indicates a financial requirement and a positive entry, a source of financing.
(1) Investments made under public-private partnership (PPP) agreements correspond to new commitments that are taken into account in the government's gross debt. In accordance with the government's accounting policies, PPP investments are recognized in the government's assets as well as in its debt.