

Provincial Budget Roundup, 1992— Part 2*

David B. Perry, Karin Treff, and Ted Cook**

PRÉCIS

Cet article contient le résumé des budgets de la Saskatchewan et du Québec et il constitue la fin de notre examen des budgets provinciaux de 1992. Ces deux provinces ont réussi à réduire leur déficit budgétaire pour 1992-1993 en poursuivant la compression des dépenses et en augmentant les impôts. Le nouveau gouvernement néo-démocrate de la Saskatchewan a annulé les plans du gouvernement précédent visant l'harmonisation et il a augmenté les taux de la taxe de vente et des impôts sur le revenu des particuliers et des sociétés. Une grande partie du budget du Québec visait les derniers détails de l'harmonisation de la taxe de vente au détail de cette province avec la taxe fédérale sur les produits et services (TPS); la hausse des impôts sur le revenu des sociétés était liée à ce changement.

ABSTRACT

This article summarizes the Saskatchewan and Quebec budgets and completes our survey of the 1992 provincial budgets. Both provinces were able to reduce their budgetary deficits for 1992-93 by maintaining expenditure restraint and increasing taxes. The new NDP government in Saskatchewan, which had earlier cancelled the previous government's plans to harmonize the provincial sales tax with the federal goods and services tax (GST), increased the rates for the sales tax and personal and corporate income taxes. Much of Quebec's budget was devoted to the final details of the harmonization of its retail sales tax with the GST; the increases in corporate income taxes were tied to that change.

SASKATCHEWAN

The first budget presented by the new NDP government in Saskatchewan was delivered on May 7, 1992 by Minister of Finance Ed Tchorzewski, who

* For the budgets of the other provinces, the underlying economic forecasts, and the adjustments made to provincial financial data, see David Perry, Karin Treff, and Ted Cook, "Provincial Budget Roundup, 1992—Part 1" (1992), vol. 40, no. 3 *Canadian Tax Journal* 666-702.

** Of the Canadian Tax Foundation.

had delivered the last budget of the previous NDP government a decade earlier. Although facing what he described as a financial crisis of immense proportion, he was able to reduce the deficit for 1992-93 by restraining expenditures and increasing taxes.

The Economic Setting

The budget speech contained no firm predictions of economic performance for either 1991 or 1992. The minister did note that the outlook for the province's exports was improving with the decline in both the value of the Canadian dollar and interest rates. Housing starts are expected to increase by 33 percent in 1992. According to the Conference Board's winter 1992 forecast, the Saskatchewan economy registered real growth of 0.3 percent in 1991 and will grow by 2.2 percent in 1992. Although the increases for both years are below the national averages, the positive performance indicates that the provincial economy is recovering from the effects of the earlier recession, the bad weather, and the low international prices for its commodities. Further improvements are dependent on improvement in international prices for raw materials and agricultural commodities.

The Fiscal Year 1991-92 in Review

Like many other provincial governments, Saskatchewan re-examined its fiscal policy late in 1991 when it became apparent that the original forecasts for 1991-92 were off the mark. Planned spending on supplies, acquisitions, advertising, and travel was cut and some government offices were closed. In February 1992, the government wrote off nearly \$1 billion in bad debts (which was charged to earlier years and did not affect 1991-92), and integrated the operations of the heritage fund with those of the consolidated fund, in accordance with recommendations of the Financial Management Review Commission.

Budgetary revenue in 1991-92 was \$4,058 million, as shown in table 1, \$496 million below the estimates in the 1991 budget. Personal income tax collections were \$57 million higher than expected, but sales tax revenue fell \$102 million and natural resource revenues were \$114 million short of the earlier estimates. Budgetary expenditures were \$85 million higher than expected because of increases in spending on education (\$8 million), social services (\$6 million), and interest on the public debt (\$19 million). Thus, the original forecast for a deficit of \$265 million was too optimistic; the deficit amounted to \$846 million. Non-budgetary transactions, however, required only \$322 million, \$324 million less than forecast earlier.

Net cash requirements of \$1,168 million were \$252 million above the earlier forecast. New borrowing of \$797 million consisted of \$353 million in promissory notes and \$1.1 billion in long-term debt, offset by a reduction of \$1.2 billion in short-term debentures and \$550 million in outstanding treasury bills.

Table 1 Financial Highlights—Saskatchewan^a

	1992-93 (est.)	1991-92 (prel.)
	<i>millions of dollars</i>	
Budgetary revenue	4,491.5	4,058.3
Budgetary expenditure	5,008.8	4,904.1
Surplus or deficit (-)	-517.3	-845.8
Net non-budgetary transactions	-129.8	-322.3
Net cash requirements	647.1	1,168.1
New borrowing	647.1	796.6
<i>Main revenue sources</i>		
Personal income tax	1,140.1	1,022.6
Corporate income tax and capital taxes	243.1	193.0
Sales tax	610.8	570.7
Resource revenue	349.7	316.5
Federal government transfers		
Equalization	600.0	620.3
Established programs financing	429.6	370.5
Specific purpose	249.8	267.2
<i>Principal expenditure functions</i>		
Health	1,541.6	1,587.4
Education	920.2	911.9
Social services	409.3	384.6
Highways	179.4	198.4
Interest on public debt	760.2	518.9

^aData for 1990-91 not available.

Budgetary Policy for 1992-93

Expenditure restraint continued to be the main theme of Saskatchewan's 1992 budget. Operating expenditure was reduced by 3 percent, but increased interest expenses pushed total expenditure for 1992-93 slightly above the 1991-92 level. Cabinet salaries were cut 5 percent, and some extra allowances for legislative duties were eliminated. Advertising and communication budgets were cut by 29 percent, and 40 boards and commissions were dissolved. New capital projects for health were deferred to 1993; funding for payments to physicians was reduced; and optometric, chiropractic, and drug benefits were cut back. The minister announced the termination of the provincial mortgage protection plan, the Saskatchewan pension plan, and about 20 other programs. The restraint efforts will eliminate more than 500 public service positions.

Prior to the budget, the government announced its plans for transfers to local governments and other agencies for 1992-93 and 1993-94. In 1992-93 transfers to hospitals will be reduced by 2.3 percent; to educational authorities, 1.0 to 3.0 percent; and to urban and rural municipalities, 15.0 and 7.4 percent, respectively. Transfers to municipalities will grow at a lower rate in 1993-94.

The spending cuts were matched by tax increases (described below) as the government made a concerted effort to reduce the deficit.

A number of initiatives to spur the economy and address urgent issues were announced. They include the tax concessions outlined below. Additional funding was provided to increase benefits under the Saskatchewan assistance plan and to help non-profit organizations and local governments set up job creation programs for social assistance recipients. Assistance to seniors, home care programs, and day care centres was increased. The province will spend \$200 million more in 1992-93 to offset reductions in federal assistance to agriculture. It will introduce a program to allow farmers to lease back land seized by lenders in settlement of debt, and will examine other ways of assisting farmers in similar circumstances.

The minister announced his intention to introduce, in June, Saskatchewan savings bonds to allow small investors to benefit from provincial borrowing.

Appendices to the budget outlined provincial tax expenditures and compared provincial tax rates and burdens in the provinces.

Major Tax Changes

A "deficit" surtax of 10 percent was applied to both basic provincial personal income tax and the flat tax, effective July 1, 1992. The effective rate of surtax for 1992 is 5 percent. This surtax raises the effective rate of provincial tax from 50 percent of basic federal tax in 1991 to 52.5 percent in 1992 and 55 percent in 1993. The effective rate for the flat tax increases from 2 percent in 1991 to 2.1 percent in 1992 and 2.2 percent in 1993. To provide tax relief for low- and middle-income taxpayers, the allowance for children was increased from \$200 to \$250, effective as of July 1, 1992. These changes are expected to increase personal income tax revenue by \$60 million in 1992-93. No estimate was provided for the larger increase for 1993-94. The province will continue to press for more flexibility in the federal-provincial tax collection agreements.

The 1991 budget raised the general corporate income tax rate from 15 to 16 percent, effective January 1, 1992. The 1992 budget increased the rate further, from 16 to 17 percent, also effective January 1, 1992. The corporation capital surcharge levied on large resource companies was raised from 2 to 3 percent, effective April 1, 1992. The corporate capital tax on financial institutions was increased from 3.0 to 3.25 percent, effective April 1, 1992. Technical changes were made to the corporate capital tax to protect provincial revenues and enhance the uniformity of treatment among competing firms. The changes to the corporate income and capital taxes will add \$34.2 million to provincial revenue in 1992-93.

The rate of corporate income tax for small businesses was dropped from 10 to 9 percent, effective July 1, 1992. Changes were introduced in the labour-sponsored venture capital corporation tax credits to assist employee investment in small and medium-sized Saskatchewan firms. These changes will reduce provincial revenue by \$1.2 million in 1992-93.

The retail sales tax was raised from 7 to 8 percent, effective May 7, 1992, producing \$65.1 million in additional revenue in 1992-93.

The tobacco tax rate was raised from 6.68 cents to 8 cents per cigarette, and from 4.4 cents to 5.3 cents per gram of cut tobacco, effective May 7, 1992. Both tobacco products and the tobacco tax are now subject to the provincial retail sales tax. These measures will add \$39.6 million to revenue in 1992-93.

The tax on gasoline, gasohol, and diesel fuel was increased from 10 to 13 cents per litre, effective May 7, to produce an additional \$47.3 million in 1992-93. The exemption for gasoline used by farmers and other primary producers was replaced with an annual rebate of up to \$900 per year (\$600 for 1992), effective May 7. The first rebates will be paid in the spring of 1993. The government will reintroduce colouring for diesel fuel in exempt uses (farmers and primary producers) as of January 1, 1993. In the meantime, diesel fuel will remain exempt. These changes will produce additional revenue of \$56.6 million in 1992-93 but the bulk of the rebates will be paid in 1993-94.

The province will introduce video lotteries, initially in communities near the international border. Liquor-pricing policies will be changed in order to increase benefits to smaller hotels and restaurants. Saskatchewan expects to finalize an agreement with the federal government for the collection of provincial alcohol and tobacco levies at the border. The net revenue gain from these measures is forecast at \$4.2 million in 1992-93.

New retail sales tax exemptions will be phased in for direct agents consumed in manufacturing and processing activities (for example, dies, printing consumables, and processing chemicals). The tax rate on these products will drop to 5 percent effective July 1, 1992, and to 3 percent on July 1, 1993; they will be completely exempt July 1, 1994. This measure will cost the province \$2.8 million in 1992-93 and \$10.0 million when fully implemented.

Summary

Saskatchewan's budgetary revenue will increase by 10.7 percent to \$4,492 million in 1992-93, as shown in table 1. Total budgetary expenditure will rise by only 2.1 percent to \$5,009 million, thereby reducing the 1991-92 deficit from \$846 million to \$517 million.

Non-budgetary requirements will also drop, to \$130 million in 1992-93, and net cash requirements will drop to \$647 million. The budget documents indicated no anticipated short-term borrowing, and forecast a \$200 million reduction in debentures maturing within one year. Long-term debt will rise by \$847 million during 1992-93.

QUEBEC

The last provincial budget in 1992 was delivered to the Quebec national assembly by Finance Minister Gérard D. Levesque on May 14. The budget addressed the problems of unsatisfactory economic conditions and growing deficits, and clarified the final details of the first provincial sales tax to be harmonized with the federal GST.

The Economic Setting

The current recession was not as severe in Quebec as was the 1982 recession; nor was Quebec as hard hit as Ontario. Output fell by 1.1 percent in real terms in 1991, and the unemployment rate rose from 10.1 percent in 1990 to 11.9 percent in 1991. The value of retail sales dropped by 1.6 percent after eliminating the effects of changing from the hidden federal manufacturers' sales tax to the GST. Housing starts dropped 7.1 percent, and non-residential investment dropped 9.7 percent, but the 5.5 percent decline in price levels accounted for more than half of that drop. Private sector investment dropped 17.7 percent while public sector investment in education and health facilities rose 20.7 percent and Hydro Quebec investment increased by 28.3 percent. Exports dropped 0.8 percent in 1991.

The province is anticipating a slow economic recovery in 1992. Real growth is expected to amount to 1.6 percent, which is below the national average. The recovery will be hampered because households are still struggling with the high debt levels built up over the expansionary period, and because growth will be slow in the province's major trading partners. Governments at all three levels will not be able to provide much stimulus because of fiscal restraints. Housing starts will decline in 1992 and non-residential investment will increase by only 2.6 percent because a decline in business investment will offset much of the 12 percent increase forecast for the public sector. Retail sales will increase 3.0 percent and the unemployment rate will decline marginally to 11.8 percent for 1992.

The Fiscal Year 1991-92 in Review

The unexpected extension of the recession held Quebec's budgetary revenue to \$34.5 billion (as shown in table 2), \$374 million below the 1991 budget forecast. Corporate tax collections were \$235 million higher than expected, but retail sales tax collections fell \$198 million below the forecast. Equalization payments from the federal government were \$509 million less than expected; the shortfall was partially offset by \$194 million extra in established programs financing (EPF) and \$148 million in welfare payments. Budgetary expenditures of \$38.7 billion were \$341 million more than first forecast, due largely to overruns of \$190 million in education spending and \$250 million in health and social affairs. Transportation expenditures were \$111 million less than forecast.

The budgetary deficit of \$4.2 billion was \$717 million higher than forecast in the 1991 budget. Non-budgetary transactions produced \$1.9 billion, \$129 million less than expected; net financial requirements were \$2.7 billion, \$475 million more than expected. Long-term debt increased by \$3.1 billion, \$941 million more than anticipated in last year's budget. An appendix to the budget contained a detailed analysis of provincial debt transactions during 1991-92, which showed that the Caisse de dépôt et placement bought at least \$845 million in provincial bonds during the year.

Table 2 Financial Highlights—Quebec

	1992-93 (est.)	1991-92 (prelim.)	1990-91
	<i>millions of dollars</i>		
<i>Budgetary transactions</i>			
Total revenue	36,913	34,522	33,006
Total expenditure	40,703	38,717	35,831
Deficit	-3,790	-4,195	-2,825
<i>Non-budgetary transactions</i>			
Surplus in pension accounts	1,828	1,928	1,874
Other accounts	-156	13	-73
Investments, loans, and advances	-432	-421	-458
Net financial requirements	-2,550	-2,675	-1,482
Net increase in long-term debt	1,854	3,141	1,763
<i>Main revenue sources</i>			
Personal income tax	11,682	11,875	11,579
Corporate taxes	2,273	1,861	1,712
Payroll tax	3,022	2,777	2,641
Retail sales tax	6,160	6,005	4,795
Motor vehicle fuel taxes	1,266	1,122	1,150
Federal government transfers			
Equalization	4,279	3,485	3,653
Established programs financing	1,707	1,520	1,502
Specific purpose (welfare)	1,644	1,522	1,411
Other	255	204	449
<i>Principal expenditure functions</i>			
Education	9,330	9,030	8,556
Health and social affairs	12,790	12,236	11,210
Transportation	2,062	2,060	1,961
Debt servicing	4,918	4,605	4,446

Budgetary Policy for 1992-93

The budget speech concentrated on expenditure restraint, tempered with the need to provide some stimulus to the slow provincial economy. Because the minister was determined to increase employment, he was forced to postpone his plans to achieve a balance on the current account.

The expenditure estimates for 1992-93 tabled in March showed an increase of 5.9 percent. In the budget, the minister announced a further \$150 million cut from the estimates in regard to staff and operating expenditures, although direct education, health, and social services were not affected. The province changed the treatment of contributions to public service pension plans. In past years, the government borrowed funds in excess of current requirements for pensions; these funds will now be deposited with the Caisse de dépôt et placement in order to earn market rates of interest. The government will be able to borrow funds from other sources at lower rates of interest than it would have paid on borrowings from the pension plans. The restraint measures will produce savings of \$315 million from the March estimates and lower the rate of increase for 1992-93 expenditures to 5.1 percent.

The minister announced a number of stimulative expenditure measures in addition to the tax initiatives described below. The province provided funds in the estimates to match federal assistance for road construction, which was expected to be announced later. Additional funds were also allocated for local road construction, care centres for the elderly, assistance for low-income homeowners undertaking renovations, and financing and guaranteeing loans to small and medium-sized businesses (SMBs). Regional initiatives included additional capital backing and administrative grants for regional venture capital corporations. Grants will help more SMBs adopt technological innovation and automation.

The minister announced that the allowance for third and subsequent newborn children will be raised from \$7,500 to \$8,000, payable in quarterly installments of \$400.

The structure of provincial fees will be changed to produce an additional \$89 million in 1992-93. Restraint will also be applied to government corporations to increase profits or reduce losses. The minister plans to put SIDBEC on a profitable basis, and will transfer \$275 million from the automobile insurance corporation stabilization fund to general revenues. A general policy of recovering surpluses from special funds is expected to produce an additional \$25 million in the current fiscal year.

Major Tax Changes

As in past years, the budget contained a lengthy appendix (119 pages this year) that detailed tax changes introduced in the budget. It is not possible to summarize them all, but mention is made of most of the major changes. The reader in search of details is advised to consult the budget document or commercial sources.

Concern over the economic effects of introducing a modified form of the GST during the depths of the recession led the province to postpone the second stage of harmonization from January 1 to July 1, 1992. By budget day, however, the advantages of the GST outweighed any possible negative effects. The minister confirmed that effective July 1, 1992, the provincial retail sales tax would be converted to a modified form of the GST and the federal and provincial administrations would be combined at the provincial level. He outlined a number of areas where the original design was modified to minimize adverse economic effects.

The original plan called for stage 2 of sales tax reform to extend the 8 percent tax to all services, and to introduce full input tax credits or exemptions for almost all business purchases. (On January 1, 1991, the provincial rate was lowered from 9 to 8 percent and extended to most goods taxable under the federal GST and not previously taxed provincially.) In his 1992 budget speech, the minister announced that services and sales of real property would be taxed at a rate of only 4 percent. No input tax credit is allowed for business purchases such as electricity, gas, steam, other combustibles, telephone and telecommunication services, meals, entertainment, motor vehicle fuel, and vehicles used on public roads. No rebate will be provided for the

provincial tax on houses because the 4 percent tax will raise little more than the old tax had from house construction materials. The province will use a rebate system similar to the federal system to lessen the impact on the MUSH sector (municipalities, universities, schools, and hospitals). Municipalities will receive a rebate of 40 percent of tax paid; universities and schools, 30 percent; and hospitals, 19 percent. Rebates will be denied for goods for which no input tax credits are available. Financial services are zero-rated. The provincial refundable sales tax credit was raised.

In view of the reduced revenue from the lower rate of tax, the province imposed an additional tax of 2 percent on corporate taxable active business income beginning July 1, 1992. Because financial services are zero-rated, additional taxes were imposed on the capital of banks and loan and trust companies at 0.35 percent, and 0.15 percent on insurance premiums.

The municipal tax on amusements was eliminated and compensation was provided to municipalities.

The appendix described in detail the transitional and administrative aspects of the new Quebec sales tax system.

The provincial personal income tax system and the parental wage assistance program will be indexed by 2 percent as of January 1, 1993. The thresholds at which personal income tax becomes payable will also be increased at the same time. The province will adjust for the changes in the federal family allowances, tax credits, and refundable tax credits but will not change its own system of tax credits and family allowances. The basic federal child benefit will be modified for Quebec residents to provide \$869 for the first child, \$1,000 for the second, and \$1,597 for subsequent children. The provincial deduction for child care expenses for children who are under 7 or disabled will be increased from \$4,600 to \$5,000 per year, and for children 7 to 15, from \$2,300 to 3,000 per year, effective January 1, 1993. The provincial income tax system will be amended to remove the distinction between legally married and common law couples. Tax credits will become available for taxpayers caring for dependent parents.

A number of tax initiatives were introduced to provide economic stimulus. Flowthrough shares were enhanced by raising the total allowable deduction to 175 percent and allowing a special exemption from taxation for capital gains for such shares. A new program will provide favourable tax treatment for special payments (gain sharing) from SMBs to employees by exempting from tax up to \$3,000 per year or \$6,000 over five years; the SMB will get a 15 percent tax credit on such payments if the plan is registered and the gain-sharing payments are related to the profits of the business.

The high rate of tax credit available to businesses for worker training will be extended for two years beyond the original December 31, 1992 expiry date and enhanced and clarified. Professionals will be allowed to incorporate and will be extended all tax concessions available to corporations as of the later of the effective date of the planned legislation and January 1, 1993. Improvements will be made to the tax credits available for film production,

the Quebec stock savings plan, the cooperative investment plan, and Quebec business investment companies. The maximum credit for investments in provincial labour-sponsored venture capital companies will be raised from \$700 to \$1,000, as of the 1992 tax year. Tax incentives for investment in research and development will be enhanced.

Measures were introduced in the budget to tighten up tax legislation pertaining to corporations, and the definition of paid-up capital for the capital tax will be extended to include bankers' acceptances and contributions to uninsured employee benefit plans. The capital tax threshold was raised from \$1,000 to \$5,000 for tax years ending after budget day. The base for municipal taxes in lieu of property taxes on telecommunications, cable television, and gas companies (collected by the province) will be changed from gross income to net business income only from relevant activities; the tax rates will range from 2 to 11 percent depending on the type of operation and its size, effective for tax years ending after budget day.

The appendix contained a list of federal income tax measures that the province will also introduce. Some had been announced earlier; for example, allowing registered retirement savings plan (RRSP) funds to be used to purchase a home, the use of preferred shares to assist small business financing, postponing increased pension plan contribution limits, including Canada and Quebec pension plan disability pensions in income for RRSP purposes, calculating and changing the method of interest on tax refunds. The budget appendix also outlined additional federal measures that the province will adopt, which include deductions for adapting buildings for the disabled, changes in cumulative net investment losses, capital gains exemption restrictions, additional eligible medical expenses, changes to registered retirement income funds, increased capital cost allowances for trucking and rail operations, and changes in the tax treatment of retirement compensation arrangements.

The changes in the provincial personal income tax system to provide additional assistance to families will cost \$37 million in 1992-93 and \$165 million the following year. Changes in the planned retail sales tax reform were treated as a reduction in tax (from 8 percent as originally planned) of \$272 million in 1992-93 and \$305 million in 1993-94, offset by additional tax collections of \$152 million and \$259 million in the same two years from changes in corporate taxes and \$22 million from the change in the refundable sales tax credits. In the current and following fiscal year \$6 million and \$13 million, respectively, will be lost by dropping the amusement taxes. The cost of enhancing the tax treatment of flowthrough shares is negligible, but \$1 million will be lost by reducing the fuel tax in certain regions. The economic stimulus measures will cost nothing in 1992-93 and \$82 million in 1993-94 in taxes, and \$106 million and \$98 million, respectively, in spending measures. The changes to the capital taxes will generate an additional \$33 million each year, while the increased fees will produce \$89 million in 1992-93 and \$136 million in 1993-94. Harmonizing the provincial income tax system with the new federal measures will cost the province \$2 million in 1992-93 but will

generate an extra \$23 million the following year. In total, the tax changes are expected to raise \$259 million in 1992-93 and cost \$90 million the following year.

Summary

Total budgetary revenue will rise 6.9 percent to \$36.9 billion in 1992-93, and budgetary expenditure will rise 5.1 percent to \$40.7 billion, leaving a deficit of \$3.8 billion, down 9.7 percent from the preliminary figures for 1991-92. Net financial requirements will drop slightly to \$2.6 billion and long-term debt is expected to rise by \$1.9 billion over the course of the year as cash balances will be reduced by \$0.7 billion. No further details were provided on the government's borrowing plans for 1992-93.

Medium-term projections show the budgetary deficit dropping to \$2,750 million by 1994-95, and the current account balance dropping from a deficit of \$2.2 billion in 1992-93 to \$1.0 billion in 1994-95.