

Executive Summary

Quebec Prosperity: Taking the Next Step investigates Quebec's economic performance, both within Canada and relative to US states, and how this is affected by Quebec's economic policies. A key question addressed is why Quebec's economic performance has consistently been lower than its potential: Quebec's people are poorer and more frequently unemployed than they need be.

Quebec's policy structure and its impact on economic performance are examined using empirical, peer-reviewed research on the relationship between various policy choices, on the one hand, and prosperity and job creation, on the other. Quite often it is found that policy-makers in Quebec's government have made policy choices that limit economic potential, while increasing the power and resources of government.

The study concludes with recommendations on policies that could produce a more prosperous Quebec.

Economic performance

Quebec has immense economic opportunity. It possesses attributes that would typically lead to extraordinary levels of prosperity: central location in the world's most dynamic market, urbanization, population density, and access to transportation routes, including one of the world's greatest, the St. Lawrence Seaway, which connects the Great Lakes and the Atlantic Ocean.

Quebec's economic record has disappointed from virtually all perspectives over the last 40 years.

- Quebec has by far the lowest level of prosperity, as measured by per-capita GDP, of any industrialized province or state with a population over 6,000,000.
- Quebec has by far the highest unemployment rate of any large industrialized province or state.
- Unlike most lagging regions in Canada, including Atlantic Canada, and around the world, Quebec has

failed to close the gap with more prosperous regions. In 1961, Quebec's per-capita GDP was 90% of the Canadian average. In 2001, it was still 90% of the Canadian average.

- Far from catching up, job creation in Quebec is consistently lower than job creation in Ontario and the Canadian provincial average. From 1991 to 2001, the number of jobs in Quebec increased by 12.8%, compared to 18.9% in Ontario and 17.3% as the Canadian average.
- Quebec is failing to attract adequate investment to close the gap with the rest of Canada. For example, accumulative net business investment in Quebec is \$29,000 per person, compared to just over \$40,000 in Ontario and a Canadian average of just over \$38,000.

Quebec also suffers from a inflexible labour market.

- Quebec's level of unionization is by far the highest among Canadian provinces and US states. Quebec's level of unionization is from two to 10 times higher than most US states and about 50% higher than in Ontario. High levels of unionization have been shown to reduce investment and job creation.
- Regionally extended Employment Insurance hobbles job creation in parts of Quebec as it does in Atlantic Canada.
- Quebec's minimum wage is too high relative to productivity. This inhibits job creation for young people and other new entrants in the job market.

Size of government

Size of government is a key factor in economic growth. Heavy taxes leave people and businesses less of their money to invest, create jobs, and build prosperity. Similarly,

high government spending crowds out other economic activity by consuming the labour and investment that could build future wealth and generate sustainable jobs. The empirical literature on these subjects is comprehensive and convincing.

Tax burden

- Quebec places the highest total tax burden—the combined tax burden of federal, provincial, and local governments—on its citizens of any jurisdiction in North America (as a percentage of the economy) except for Alaska, an anomaly caused by oil royalties.
- The total taxation gap is particularly striking when Quebec is compared to other large, industrialized states and provinces. For example, Massachusetts is considered a high-tax state but Quebec’s tax burden is almost a third higher. Quebec’s burden is more than a third greater than Alberta’s and over 7% greater than Ontario’s.
- The tax gap is even more striking when one looks at the portion of the tax burden levied by provincial and local governments, since the federal tax structure is the same across jurisdictions.¹ The burden Quebec’s governments place on its citizens is a nearly a third heavier than in Ontario and nearly 50% heavier than in Alberta.

Spending

- Total government spending (as a percentage of the economy) in Quebec surpasses that in any US state or industrialized province. Quebec’s spending is exceeded only by the four Atlantic Provinces, where spending is heavily subsidized by various federal programs, and Manitoba.
- At the sub-national level, Quebec’s spending again exceeds spending only in Atlantic Canada and Manitoba. (Sub-national governments in Canada and the United States cannot be directly compared, as explained in note 1.)
- In the name of “economic development,” Quebec has continued to subsidize businesses—often called “corporate welfare”—more than any other Canadian

province. Such policies have proved to be ineffective in boosting economic growth. However, they remain potent political tools, used to reward friends and penalize enemies. These policies cost each Quebecer around \$500 a year. Recently announced reforms may dramatically change this picture and these reforms should be closely monitored.

Tax policy

Both the overall tax take, discussed above, and the structure of taxes are important. Not all taxes are equal: the cost to the economy of raising an additional dollar of revenue varies from tax to tax. For example, the Organisation for Economic Development and Cooperation (OECD) estimates that sales taxes cost the economy 17¢ for each extra dollar of revenue raised while corporate income tax costs \$1.55. Marginal rates are also important, since high marginal rates discourage extra effort and innovation.

Quebec’s tax structure discourages effort, risk-taking, and investment.

- Quebec’s top marginal personal income-tax rate is by far the highest in Canada. At 24%, it is well above the average of a little over 15% in the other provinces, and substantially above Ontario’s rate of 11.2%, Alberta’s of 10%, and British Columbia’s of 14.7%. The top rate in Quebec also applies to lower incomes than in all other provinces except Alberta, which has a single rate.
- Quebec’s corporate tax rate is tied with Manitoba for the second highest in Canada after Saskatchewan. Businesses in Quebec are ineligible for the reduced “small business” rate at a lower level of income than in all but the Atlantic Provinces.
- Quebec’s small business corporate income tax rate of 9% is well above the average in the other provinces of 5.3% and Ontario’s rate of 6%.
- Quebec relies far too much on the corporate capital tax to raise revenue. This has been called Canada’s

“most destructive tax.” Quebec collects a higher percentage of its revenue from this tax than any province except Saskatchewan.

- Government taxes away 20% of profits realized in Quebec through corporate income and capital taxes, a higher percentage of profits than in any other province. Profits are both the means for further investment and the incentive to make such investments.

International comparisons

This section provides an international perspective on Quebec’s performance and on what policies might be employed to improve this performance.

- Quebec, along with Prince Edward Island, ranks at the bottom of the ratings for economic freedom in North America. Sophisticated statistical testing shows that economic freedom is a key driver of growth and prosperity in North America.
- International evidence shows that lagging regions in developed nations tend to close the gap with more prosperous regions by 2% to 3% a year. Over the past 40 years, Quebec has failed to close the gap with average prosperity in Canada at all.
- Quebec has not adopted policies that other lagging regions have used to catch up and even surpass advanced regions.

Recommendations

To live up to its economic potential—and provide a more prosperous life for its citizens with improved employment opportunities—Quebec should take the following steps.

- Reduce expenditures, with an immediate goal of becoming competitive with the size of government in Ontario and a longer-term goal of becoming competitive with industrialized US states.

- Reduce the tax burden faced by the people of Quebec. Here again, the immediate goal should be to become competitive with Ontario with the longer-term goal of becoming competitive with US states.
- Re-organize the tax structure to make use of economically efficient taxes and reduce the use of inefficient taxes. A good first step would be the elimination of the corporate capital tax.
- Simplify the tax structure, for example, by moving to a single-rate tax as Alberta has.
- Increase flexibility in the labour market. Employees and employers should have more freedom in dealing with each other and with unions.

Quebec has the ability to transform itself from the worst performing of the large industrial provinces and states into one of the most prosperous places on the planet, producing new wealth and employment for its people. The policy changes needed to create this transformation are not mysterious nor are their results unknown. An immense amount of peer-reviewed empirical research has examined the impact of various policy options. As this report shows, Quebec has made unfortunate policy choices in the past. The future could bring much greater prosperity.

Note

- 1 Quebec has assumed responsibility for certain areas that in other provinces are under federal control. Quebec receives an “abatement” from Ottawa to compensate for these extra costs. When this abatement is subtracted from government spending in Quebec it, in effect, subtracts the financial costs of these responsibilities, allowing direct comparison with other provinces. However, direct comparisons between sub-national governments in Canada and the United States are not possible, since the two nations divide responsibilities differently between their federal and sub-national governments. Thus, direct comparisons are possible only when all three levels of government, federal, provincial/state, and local, are considered together.