

CONVERTING QUEBEC'S STRENGTHS INTO PROSPERITY

Executive Summary

Few economies in North America have undergone the degree of post-War change as Quebec, beginning with the Quiet Revolution in the 1960s. The reforms have borne fruit over the past half century. Quebec enjoys a high quality of life, its culture and language have flourished and the income gap in the province between Francophones and Anglophones has all but been eliminated. What's more, Quebec has built up an enviable list of assets – a highly-diversified economy and high quality of life to name a few – that will stand the province in good stead in the future.

Yet there have been growing calls within Quebec for residents and businesses to embrace change once again. In spite of its numerous strengths, the province's standard of living – as measured by GDP per capita – continues to languish behind that of the rest of Canada (ROC). But the greater concern lies on the horizon. Although the forces of demographics and globalization will be felt in all corners of the world, Quebec's economy is poised to experience particularly pronounced impacts, which could further constrain living standards well into the future. This last point raises a number of questions:

Why does Quebec experience a prosperity gap?

Recently, the Ontario Institute for Competitiveness and Prosperity carried out an in-depth analysis of the issue. The Institute measured Quebec's prosperity gap with the ROC at \$6,300 for every man, woman and child in the province. As importantly, the gap was decomposed into two main components: output per hour worked, which is commonly referred to by economists as "productivity", and total hours worked per person.

"Productivity" accounts for 38% of prosperity gap

"Productivity" is a concept that is often misinterpreted. For many, an unproductive society can be perceived as one where its residents are not working hard enough. This belief is not only simplistic but incorrect. Instead, "productivity" is driven by the interaction of a number of complex structural barriers that are usually erected at the societal, rather than individual, level. For example, the In-

stitute looks at a number of measurable elements of "productivity" in its study, including the mix of industries, education attainment, the degree of urbanization and how much investment in machinery and infrastructure take place in an economy.

Interestingly, while there tends to be considerable attention placed on Quebec's "productivity" gap with the ROC, the Institute determined that output per hour worked explains only 38% of the difference in prosperity, of which three-quarters is attributable to industry mix, education attainment and capital investment.

What are the trade-offs in working less?

At the same time, 62% of the prosperity gap is explained by reduced hours worked. In contrast to "productivity", this concept is more straight-forward. In many instances, work schedules are determined by individual choice.

We emphasize that there is nothing wrong with a jurisdiction making a choice to work fewer hours, especially in light of the fact that increased leisure is an important contributor to well-being. At the same time, however, it cannot then expect to have the same standard of living or quality of public services as others that record greater number of hours worked – that is, unless the fewer hours spent on the job is counter-balanced by a higher level of "productivity". And notwithstanding the fact that all Canadian jurisdictions confront the "productivity" challenge to varying degrees, Quebec records both lower hours and output per hour than in the ROC. As we have highlighted, the latter development largely reflects societal factors in the province.

More than \$8,000 per household if gap closed

We acknowledge that the usual measure of prosperity or standard of living – GDP per capita – is an imperfect measure of well-being, which focuses on activities that have a dollar value attached to them, ignores the trade-off between leisure and work and doesn't take into account the impact of economic growth on the environment. Despite

its imperfections, there is a compelling argument that increased prosperity increases society's ability to preserve and protect its quality of life. In addition to generating higher government revenues that could be used to strengthen public services, closing the prosperity gap with the ROC would provide a boost to the average household after-tax income in Quebec of at least \$8,000 per year, which could be used to fund housing costs, tuition fees and other essential goods and services.

It is not Quebec's current prosperity performance that is found worrisome to those leading the call for change. Rather, it is the potential risks to the standard of living from an aging population, rising health costs and heightened emerging competition in manufacturing that are found to be greatest cause for concern.

Required policy mix not ground-breaking

The necessary mix of policies required to adequately head off these risks is far from ground-breaking. Quebec can parlay its comparative strengths into prosperity by taking such actions as investing further in education, strengthening its system of infrastructure, opening up opportunities for trade and by knocking down barriers to working and investing. We discuss these areas in detail on pages 14-24. Certainly, comfort can be taken in the fact that many of these policies – at least in broad strokes – are supported by the majority of Quebecers. And the provincial and federal governments have responded in kind by implementing measures in recent budgets that chip away at them.

Still, we share the view of those advocating change that the scope and pace of reforms remain too slow to achieve meaningful results. In order for this to occur, there needs to be a fundamental change in perspective. **For one**, a greater sense of urgency is required. But while clarion calls for a new direction are being dampened by the fact that the economy is not currently in crisis, an objective of this study is to raise awareness that the potential storm clouds are not a long way off. In fact, based on status-quo projections, Quebec's labour force will begin to shrink in only 6 years.

Second, it will be critical for residents to recognize that governments will only be in a position to address the province's vulnerabilities – and, at the same time, live within their means – by better targeting assistance to those individuals most in need. Here, we are not just putting into question the traditional practice of providing large subsi-

dies to the business sector and to all Quebecers for electricity rates and tuition fees, but advocating a major shift in approach towards “user pay” in funding government infrastructure and other services.

Subsidies, in particular, generate benefits for households and businesses, but come at a heavy cost to the treasury – both directly and in terms of the opportunity cost of not allocating the funds to alternative areas. Electricity subsidies come at a particularly high price of more than \$5 billion per year, excluding the opportunity cost. There is also a fairness argument, as non-users of power end up paying a good chunk of the bill generated by heavy users. Support to low-income earners could be provided through redistribution mechanisms.

Action will pay off handsomely

More widespread use of such a “user pay” strategy in Quebec would pay off handsomely through a system better grounded in efficiency, accountability and fairness. In addition, it could be a major weapon in the arsenal in achieving the all-important goals of sustainable development and a cleaner environment. While many in the province will undoubtedly balk at the idea of paying more for government services up front, we would hope that one of the ultimate objectives will be to reward taxpayers over time by cutting the income-tax burden, which remains one of the key barriers to working, saving and investing in Quebec.

Bottom Line

Quebec is blessed with significant strengths. Making some tough choices today will help to leverage these strengths, head off the risks looming on the horizon and help to achieve a higher standard of living for the benefit of residents. Above all, a wealthier Quebec will assist in protecting its distinct way of life. Although citizens and government will need to spearhead the drive for change, the business community must also step up to the plate.

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