Chambre de commerce
du Montréal métropolitain
Board of Trade of Metropolitan Montreal

The City of Montreal and the Quebec Budget:

To have the tools to contribute more to Quebec's wealth

Provincial Pre-Budget Submission 2005-2006

Presented to

Michel Audet

Minister of Finance

by

The Board of Trade of Metropolitan Montreal

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- ***That the Quebec government help students financially by adding one dollar to its current contribution for each dollar increase in tuition fees;***
- ***That mechanisms be set up allowing the private sector to partner with students – former, current and future – to help them pay higher tuition fees.***

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That the Government of Quebec ensure the rapid construction of the two university superhospitals in Montreal.

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- ***Increase efforts to actively encourage small and mid-sized exporters to participate in border security programs (C-TPAT, FAST-EXPRES);***
- ***Set up effective measures for small and mid-sized exporters grappling with the high cost of complying with the new customs standards;***
- ***Make the investments announced in roads leading to border crossings.***

Recommendation 1.2.2:

That the Government of Quebec immediately and completely abolish the capital tax, a tax measure considered to be highly detrimental to business productivity, the competitiveness of financial institutions and job creation.

Recommendation 2:

That the Government of Quebec immediately begin working closely with the representatives of the federal government and of Quebec's cities to find ways to increase and diversify their revenue sources. This reflection process should proceed rapidly and culminate in new, predictable, recurring and diversified revenue sources for the City.

Recommendation 2.1.1.:

That the governments of Quebec and Canada, in conjunction with municipal administrations, jointly and actively participate in setting up "public works, private capital" partnerships to finance value-added urban infrastructures.

Recommendation 2.1.2.:

> ***That the governments of Quebec and Canada each contribute to the Montreal Harbourfront development project, notably, by placing a priority on the planned investments in the Harbourfront and in so doing, give the project real impetus.***

Recommendation 2.2.1.:

> ***That the Government of Quebec share one percentage point (1/7.5) of QST revenues with the cities of Quebec without increasing the tax burden of Greater Montreal residents.***

Recommendation 2.2.2.:

> ***That, as of the next budget year, the Government of Quebec grant municipalities a full refund of the QST***

Recommendation 2.2.3.:

> ***That the compensation in lieu of taxes paid by the Government of Quebec to the municipalities equal 100% of the local taxes on the property value of all the buildings it owns, as of the next budget year.***

Recommendation 2.2.4.:

> ***That the Government of Quebec redistribute to the municipalities of Quebec the gasoline excise tax revenues transferred by the Government of Canada without reducing its financial commitments to the municipalities and according to a formula recognizing the specific challenges of the City of Montreal, namely, in the matter of public transit.***

The Board of Trade of Metropolitan Montreal has some 7,000 members. Its primary mission is to represent the interests of the business community of Greater Montreal and to provide individuals, merchants and businesses of all sizes with a variety of specialized services to help them achieve their full potential in terms of innovation, productivity and competitiveness. The Board of Trade is Quebec's leading private economic development organization.

Introduction

Preparing a budget invariably involves making choices, often difficult ones, between a series of priorities and emergencies. This is all the more true given the current precarious state of the Quebec public purse. Sensitive to this fact, the Board of Trade of Metropolitan Montreal took it into consideration while preparing this pre-budget submission it is presenting to the Minister of Finance on behalf of its members.

As such, the Board of Trade's first budget recommendation – which is also reflected in each of the specific recommendations presented hereafter – is that the government of Quebec focus on the concept of the return on public funds allocated for the choices it is about to make. As a general rule, Quebecers would like to see major public services such as health and education maintained and indeed improved and would also appreciate some tax relief. Since the only way to reconcile these two objectives is to increase the collective wealth, we believe the next budget should focus on choices that will most contribute to the enrichment of Quebecers.

In this context, the optimal development of Greater Montreal becomes critically important.

Throughout the world, urban centres are increasingly at the heart of economic growth and wealth creation. Talent and investments are primarily concentrated in cities, hence the fierce competition in this regard. Greater Montreal is no exception and indisputably drives Quebec's economic growth.

According to the Montreal Metropolitan Community, the City – which accounts for 48% of the Quebec population – generates 50% of Quebec's gross domestic product, is responsible for 70% of Quebec exports and sends $25 billion in revenues to Quebec City coffers – or about 55% of the government's autonomous revenues. What's more, the share of provincial income taxes paid by individuals of the metropolitan region is 15% higher than their demographic weight within Quebec.[1] Greater Montreal therefore helps finance public services far beyond its territory.

Given Montreal's apparent "facility" for producing wealth – on the Quebec scale that is – one might be tempted to conclude that Montreal is in need of nothing and that prioritizing the regions is actually the way to go. Unfortunately, when Montreal's performance is compared to that of other cities – in North America or elsewhere – it becomes clear that Quebec does not benefit *enough* from its metropolis.

Indeed, what would Quebec's public finances look like if Montreal's *per capita* GDP were comparable to that of Toronto (+ 19 %) or Boston (+ 56 %)[2]? One thing is certain: all of Quebec would benefit. In this context, Montreal's development should be a priority for all of Quebec. Indeed, from Gaspé to Abitibi, there should be concern that the City is hard pressed to keep up with the competition. Accordingly, the next budget should mark the beginning of an era in which Quebec expects more from *its* metropolis and finally gives it the tools it needs.

In this pre-budget submission, the Board of Trade first puts forward its main expectations with regards to the choices that will be made in the next budget. It then sets out, in greater detail, specific recommendations in keeping with these expectations. These recommendations are grouped under two themes: 1) improve the economic competitiveness of Quebec and the City of Montreal and 2) improve city financing.

[1] Data analysis of the Ministère des Finances du Québec, "Statistiques fiscales des particuliers, Année d'imposition 2000."
[2] Board of Trade of Metropolitan Montreal, *Montreal Health Report,* 2nd quarter 2004.

I. The Board of Trade's expectations

a. A rigorously balanced budget

The Board of Trade expects the next **budget to be balanced.** The government must manage its budget responsibly because returning to a deficit during times of economic growth is neither desirable nor justified. As well, we expect the government to demonstrate exemplary **rigour and transparency** in its management of the public purse. If the population is to continue having faith in the government's ability to manage its finances, the government must present a budget free of creative accounting and combine caution and realism in its forecasts. For example, the constant increase in Quebec's debt over the past few years contradicts the notion that the government is adhering to its zero deficit commitments.

b. Recognize the key role of Greater Montreal

For the Board of Trade, it is paramount that in its next budget the government fully recognize the key role urban centres and their businesses play in the economic growth of Quebec. This recognition should translate into concrete measures targeting the economic growth of Greater Montreal, the economic engine of Quebec whose activities finance public services well beyond its territory. Among these measures, providing cities with access to new, predictable, recurring and diversified revenue sources should be a priority. The same goes for making major investments that contribute directly to the competitiveness of urban centres of the 21st century, such as public transit, road and water systems, infrastructures, cultural activities and knowledge.

c. Train, attract and retain talent

In an era of added value and innovation, Quebec's economic development and the creation of clusters of excellence must of course be backed by appropriate policies, but they must first and foremost be driven by highly talented workers. This is why the next budget must make it possible to deploy huge efforts to train, attract and retain a growing number of talented individuals.

This means giving our educational institutions the support they need to set themselves apart in the highly competitive world of education and university research. We must also do more to attract immigrants, business people and qualified workers and integrate them within Quebec society.

d. Towards a reduction of the tax burden

The Board of Trade acknowledges that the government must **begin working towards reducing the tax burden** of Quebecers. The fiscal environment is an important element of competitiveness, and our tax system competes with that of the other provinces and neighbouring states for workers and companies alike. The Board of Trade therefore endorses a reduction in the tax burden, provided however, that this reduction does not thwart the achievement of the other previously mentioned principles and objectives. Moreover, we would hope that any decision the government makes to reduce the tax burden also takes into account the weight of the debt and its longer term impact on this very same tax burden. Indeed, future generations should not be required to pay the price of immediate tax cuts.

II. Specific recommendations

In this section, the Board of Trade presents concrete proposals aimed at more effectively responding to the budget principles and expectations presented in the previous section. These recommendations revolve around two main themes: 1) improving the economic competitiveness of Quebec and metropolitan Montreal 2) improving city financing.

1. The economic competitiveness of Quebec and metropolitan Montreal

Metropolitan Montreal has many assets just waiting to be further developed so as to allow the region to fully contribute to the economic vitality of Quebec. The following is a series of recommendations formulated by the Board of Trade with a view to improving the competitiveness of the region and its businesses and, by extension, Quebec as a whole.

1.1. Attract, train and retain talent

An economy's innovative capacity is owed to the talented individuals behind the ideas. In a context where economies are increasingly knowledge-based, these individuals and the innovation potential they hold become a precious commodity indeed. Given that this new reality is taking shape in Quebec at a time when demographic growth is waning and the population is aging, the issue of talent cannot be resolved solely by developing local ingenuity. Quebec must be able to compete successfully to attract and keep skilled individuals from around the world who are looking for a better place to live and nurture their creative potential.

1.1.1. Attract and integrate business immigrants

The Board of Trade fully shares the "foremost concern" of the Minister of Relations with Citizens and Immigration (MRCI), Michelle Courchesne, "of providing Quebec with all the possible and necessary tools to retain and integrate immigrants."[3] Indeed, Quebec's demographic situation will make immigration a key factor in Quebec's development and prosperity in the coming years.

The Board of Trade believes that more must be done to draw immigrants to Quebec and integrate them into Quebec society. Indeed, we believe that it is not only a matter of attracting a quality immigrant workforce: active participation in the Quebec economy, and social and cultural life is a determining factor in keeping these individuals here in Quebec. In this regard, we think more can be done, particularly with immigrant entrepreneurs. Indeed, their entrepreneurship makes an especially tangible and structuring contribution to the economy.

In light of the foregoing, it is clear that the MRCI must have the means to achieve its objective. However, in its last budget, the government substantially reduced the funds allocated to this ministry. The Board of Trade is therefore recommending that the government reverse this trend in the next budget and increase the amount it allocates to the MRCI so that it can execute its mission to attract and integrate immigrants, particularly immigrants from the business category.

Recommendation 1.1.1:

That the next budget contain an increase in the amount allocated to the MRCI so that it can fulfill its mission to attract and integrate immigrants.

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[3] Extract of speech by the Minister of Relations with Citizens and Immigration, Michelle Courchesne, "Immigration: a lever for the metropolitan economy," delivered at the Board of Trade on November 18, 2004.

1.1.2. University funding

Montreal is a font of research and education. As such, in addition to the four universities located on the Island, a university campus in Laval and one on the South Shore, the metropolitan region has four major schools and 201 university research centres. Close to 160,000 students pursue their studies in the Montreal region, representing just over 50% of all universities in Quebec. In short, Greater Montreal is the focal point of university activity in Quebec. For example, approximately 75% of all university research and development in Quebec are conducted in the Montreal region.[4] Moreover, the City also ranks first in terms of university research grants awarded in Canada, with $802 million received in 2002.[5]

While they may be a powerhouse in Quebec, the province's universities do not stack up to their counterparts in the world in terms of financial resources. In this regard, there is a consensus in Quebec – underscored once again last winter by the Parliamentary Committee on Education for the Quality, Accessibility and Funding of Universities – that the general operating deficit of Quebec's universities compared with their Canadian counterparts amounted to some $375 million[6] in 2002-2003 and that this shortfall must be immediately addressed.

Believing that the next budget must take concrete action in this regard, the Board of Trade is therefore reiterating the recommendations it made to the Committee[7] calling for a greater contribution from students, the government and businesses.

- We do not think it is right that, by maintaining the freeze and not indexing tuition fees, students are paying less for their education from year to year. As such, we recommend that students be required to contribute more financially to offset the first half of the $375 million in university underfunding.[8]
- We recommend that the Quebec government help students financially by adding one dollar to its current contribution for each dollar increase in tuition fees. This new annual government investment of $187.75 million in Quebec's universities would amount to an increase of 0.35% of its total budget and 1.7% of the total education budget of $11 billion.
- Other measures must be implemented to allow businesses to assume a greater role in funding education, training and research. In this regard, we recommend that mechanisms be set up allowing the private sector to partner with students – former, current and future – to help them pay higher tuition fees. For example, one of these mechanisms could be to allow employers to repay their employees' student loans and make their contribution an eligible expense as part of the 1% of payroll that corporations must invest in employee training. Another option would be to call upon companies to encourage employees with children to save for their higher education. Thus just as a company can contribute to an employee's RRSP, it would be able to do the same to the employee's Registered Education Savings Plan (RESP).

Recommendation 1.1.2.:

- ***That students be required to contribute more financially to offset the first half of the $375 million in university underfunding;***

[4] Fernand MARTIN, *Savoir et croissance, les universités: catalyseurs du Montréal métropolitain – Les retombées économiques*, Université de Montréal, February 2004, p. 9.
[5] Research Infosource Inc., *Canada's Top 50 Research Universities 2003*, November 2003, Web site: http://www.researchinfosource.com/top50.shtml (last consultation, December 7, 2004).
[6] CREPUQ-MEQ, *Rapport du Comité conjoint CREPUQ-MEQ sur le niveau des ressources*, November 2002, p. 19.
[7] Board of Trade of Greater Montreal, *Institutions for higher education in Quebec: a critical issue for the economic engine of Quebec,* February 2004. Available online at: http://www.ccmm.qc.ca/documents/Positions/2003%202004/Memoire_universites.pdf
[8] The Board of Trade believes that there are many creative ways for students to assume a greater share of the costs of their education without rendering access to higher education beyond the reach of the less privileged. For example, tuition fees could vary according to such parameters as the income that graduates earn once they join the workforce or according to the costs inherent to their field of education.

- ***That the Quebec government help students financially by adding one dollar to its current contribution for each dollar increase in tuition fees;***
- ***That mechanisms be set up allowing the private sector to partner with students – former, current and future – to help them pay higher tuition fees.***

1.1.3. Construction of two university superhospital projects

As the Board of Trade has mentioned over the past few years, the construction of the Université de Montréal (CHUM) and McGill University (MUHC) university hospital centres (UHC) are relevant and necessary investments given that biomedical research and biotechnology are among the sectors in which Greater Montreal excels. These projects would also have a positive impact on attracting and retaining world-class research and medical talent in Montreal. Last summer, the Government of Quebec repeated its commitment to proceed with these projects. While executing a project of this magnitude is both complex and fraught with difficulties, the Board of Trade would like to reiterate its importance for the City's economic competitiveness. We therefore hope the government will not only forge ahead with the UHCs but also consider public-private partnerships in order to ensure the construction of quality facilities at the lowest possible cost.

Recommendation 1.1.3.:

That the Government of Quebec ensure the rapid construction of the two university superhospitals in Montreal.

1.2. Improve business competitiveness

For the Board of Trade, Montreal's economic competitiveness, while undeniably fuelled by local talent, is also dependent on the access its businesses have to export markets and on their ability to invest in their own success. As such, the following measures seek to improve either one of these factors with a view to achieving the objective of making the Montreal economy – and by extension that of Quebec – all the more competitive.

1.2.1. Facilitate the flow of Quebec exports across the U.S. border

The Greater Montreal area has over 5,000 exporting companies and accounts for 70% of all Quebec exports. The vitality of the export sector, which represents more than 55% of Quebec's GDP,[9] plays a major role in the economic growth of Quebec. In 2001, Quebec international exports generated over 667,000 jobs.[10] In 2003, Quebec exports amounted to $64 billion, of which over $53 billion or 83% headed south. The Champlain-Lacolle border crossing is the most frequently used point of entry into Quebec and the gateway to a large market comprising New York, Philadelphia and Washington, D.C. In 2002, 371,059 trucks and 1,039,135 cars passed through this crossing to the U.S., an average of more than 1,000 trucks and 2,850 cars per day.

In the aftermath of 9/11, the U.S. government implemented a series of strict security programs and measures aimed at the border in order to prevent terrorism. For Quebec exporters, tighter security and the requirements of the new programs create additional major challenges. We therefore believe it is of paramount importance for the governments of Quebec and Canada to implement complementary or joint initiatives to facilitate trade flow from Canada to the U.S.

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[9] Government of Quebec, Ministère du Développement économique et régional, *Calepin : Le commerce extérieur du Québec*, December 2003.

[10] Government of Quebec, *Impact économique des exportations québécoises – 1990, 1997 and 2001,* October 2003.

The first of these initiatives is certainly to continue, and indeed increase representations before the governments of the neighbouring U.S. states to impress upon them the importance of cross-border trade, and make them aware of the issues facing Quebec exporters.

Under the new control measures, exporters must henceforth demonstrate to the U.S. government that they are "low-risk" companies through security certification programs. This compliance is important because it ensures easy access across the border. C-TPAT (Customs-Trade Partnership Against Terrorism) is the U.S. government program whereby companies take a series of measures to assure U.S. customs officers of the integrity of their security practices as well as those of their trade partners for the entire supply chain. This certification helps speed up processing at the border and constitutes an eligibility criterion for the FAST-EXPRES (Free and Secure Trade) program, a joint Canada-U.S. initiative that offers exporters, carriers and pre-authorized drivers faster clearance of pre-approved eligible goods through the use of dedicated lanes at the Champlain border crossing.

The benefits of these programs are therefore only available to companies that have completed the certification process. However, the complexity of the compliance process requires businesses to invest a lot of time and money to adapt their infrastructures to the U.S. security. Failure to comply carries even more dire consequences: a dramatic increase in waiting time at the border, administrative difficulties exporting and complications with carriers. The delays associated with the movement of goods belonging to companies that are not C-TPAT, combined with new hours of service rules for truckers, could pose almost insurmountable obstacles for Quebec carriers and exporters.

For small and mid-sized Quebec exporters, failure to make the necessary investments to meet the requirements presents a major stumbling block to developing export markets. Insofar as many Canadian exporters are SMEs and the U.S. is typically the first place small and mid-sized companies target in their first foray into international markets, the Board of Trade recommends that the draft budget include the following financing measures:

- We acknowledge the importance of the government's efforts to actively encourage small and mid-sized exporters to participate in the border security programs (C-TPAT, EXPRES-FAST) and would like to see them intensified so that all exporters understand the need to meet these requirements if they wish to do business in the U.S.;

- In conjunction with awareness activities, we would like to see the government quickly contemplate concrete measures to support small and mid-sized companies that undertake to comply with the new customs requirements since our concern is that the major costs involved in obtaining security certification will hamper the development of U.S. bound Quebec exports;

- In addition to initiatives aimed directly at exporting companies, the government should facilitate cross-border trade by improving and further developing the transport infrastructures leading to the U.S. More specifically, the Government of Quebec must make the investments it announced in roads leading to the Champlain border crossing.

Recommendation 1.2.1.:

That complementary or joint initiatives be quickly implemented by the governments of Quebec and Canada to increase the flow of trade between Canada and the U.S.:

- ***Increase efforts to actively encourage small and mid-sized exporters to participate in border security programs (C-TPAT, FAST-EXPRES);***

- ***Set up effective measures for small and mid-sized exporters grappling with the high cost of complying with the new customs standards;***
- ***Make the investments announced in roads leading to border crossings.***

1.2.2. Eliminate the capital tax

The capital tax is aimed at large corporations and financial institutions and is levied on equity capital, debt capital and capital reserves. Capital is a mobile production factor that can be rapidly moved to those locations that offer the best conditions for profitability. Consequently, investment opportunities in Quebec are rendered less attractive to foreign investors, who compare the business tax environments between countries and provinces.

Because it constitutes an additional fixed expense for businesses, capital tax stifles investment and labour productivity. It is also recognized in the business community that this additional expense dissuades innovation and the acquisition of new technology. This tax imposes a disproportionate burden on highly-capitalized companies such as those operating in manufacturing, natural resources, financial and high-tech sectors, which are strongly concentrated in urban centres. Lastly, this tax is levied without any regards to profitability and can therefore destabilize companies during periods of low earnings or losses.

As for financial institutions (deposit taking institutions, insurers, etc.), the impact of the capital tax is also significant since it imposes an onerous tax burden. As stated in the report of the Task Force on the Future of the Canadian Financial Services Sector of 1998, "Capital taxes render regulated financial institutions less competitive and create incentives that are inconsistent with sound prudential management."[11]

The capital tax in Quebec has been set at 0.60% for corporations (currently the highest rate in the country) and 1.2 % for financial institutions since January 1, 2003. No additional reduction is planned for 2005. Although more than 15,000 companies no longer have to bear this burden since January 1, 2005,[12] and although the government has committed to abolishing the capital tax for SMEs during its current mandate, it is critical that the same advantages apply to large companies, especially since they are often the most geographically mobile, prime contractors and consequently, major job creators.

While aware of Quebec's current financial situation, the Board of Trade believes that in order to improve the competitiveness of Quebec – specifically, in relation to the other Canadian provinces that have already experienced the negative impact of the capital tax and have either abolished it completely or announced measures leading to its elimination – the abolition of the capital tax for corporations and financial institutions must remain a priority. Indeed, there is an important link between productivity and corporate investment. Thus, eradicating the capital tax would reduce the cost of these investments and encourage companies to invest more, ultimately boosting productivity and job creation. Such productivity gains are all the more important since the appreciation of the loonie against the greenback is making exports more costly for our southern neighbours. The Board of Trade believes that Quebec should be among those provinces that are taking initiatives to eliminate the capital tax.

Lastly, the increase in local and foreign investments that would result from the elimination of the capital tax would help boost GDP and in the medium term contribute to compensating the government for the

[11] Task Force on the Future of the Canadian Financial Services Sector *Changes, Challenges and Possibilities. Task Force Report,* September 1998, p. 116.
[12] In June 2004, the Government of Quebec announced a new deduction ceiling starting in January 2005, which will increase the number of companies exempt from the capital tax to 74.5%.

loss of revenues currently derived from this tax. For example, the capital tax provided the provincial government with total annual revenues of $1.87 billion in 1999.[13]

CAPITAL TAX
(For companies other than financial institutions)

	2003	**2004**	**2005**
Federal[1]	0.225%	0.2%	0.175%
Alberta	N/A	N/A	N/A
British Columbia	N/A	N/A	N/A
Prince Edward Island	N/A	N/A	N/A
Manitoba[2]	0.3%	0.3%	0.3%
New Brunswick[3]	0.3%	0.3%	0.3%
Nova Scotia[4]	0.25%	0.3%	0.3%
Nunavit	N/A	N/A	N/A
Ontario[5]	0.3%	0.3%	0.3%
Quebec[6]	0.6%	0.6%	0.6 %
Saskatchewan[7]	0.6%	0.6%	0.6 %
Newfoundland	N/A	N/A	N/A
Northwest Territories	N/A	N/A	N/A
Yukon	N/A	N/A	N/A

Source: Samson Bélair Deloitte & Touche

Recommendation 1.2.2:

That the Government of Quebec immediately and completely abolish the capital tax, a tax measure considered to be highly detrimental to business productivity, the competitiveness of financial institutions and job creation.

[13] Ministère des Finances du Québec, *Statistiques fiscales des sociétés en 1999*, 2003.

2. City financing

Several organizations,[14] including the Board of Trade, have noticed in the past few years that Quebec municipalities lack sufficient revenues and underscored that they are overly dependent on property tax revenues. In the last decade, not only have their revenues advanced at a slower pace than those of the upper levels of government (provincial and federal), municipalities have seen their responsibilities increase substantially, and the revenues have not always been adjusted accordingly. For example, between 1995 and 2001, while the Canadian economy grew 31 %, federal and provincial revenues advanced 38% and 30% respectively. During the same period, municipal revenues increased only 14%.[15]

The small revenue growth of municipalities, combined with their inability to diversify their income sources, have placed them in a particularly difficult situation. Following various municipal reforms in Quebec during the 1990s, over $1.1 billion in new responsibilities were transferred to the municipalities[16] (public transit, social housing, recreation, environmental standards, water quality, etc.). The municipalities of Quebec and Canada have therefore directly and substantially helped the upper levels of government achieve a zero deficit – so much so that according to the Organization for Economic Cooperation and Development (OECD) and the president of the Conference Board of Canada,[17] Canadian cities are also feeling the effects of the "fiscal imbalance."

Urban infrastructures are being especially hard hit by this financial context. Faced with a budgetary impasse, the municipalities chose to indefinitely postpone investment in their ageing infrastructures rather than slash services to citizens – what the Conference Board of Canada refers to as the "hidden deficit." For the City of Montreal, the value of investments needed for urban infrastructures (water management, road repair, bringing real estate properties up to standard, public transit) is estimated at $12 billion for the next ten years.[18] This figure does not include new construction but only what is required to upgrade existing infrastructures after 15 years of forced neglect.

For the Board of Trade, all these elements raise major concerns. On the one hand, the health of urban infrastructures, as pointed out in the study published by Statistics Canada,[19] is a major factor that can affect the operating and production costs of businesses and merchants, particularly in terms of merchandise flow and transportation. On the other hand, these same businesses and merchants, through business taxes and property tax on non-residential properties, are among the largest contributors to city financing. In the case of Montreal, property tax on non-residential properties for the 2005 budget equalled 41% of the taxes collected by the City – whereas this category of property represents only 28% of the taxable property value.

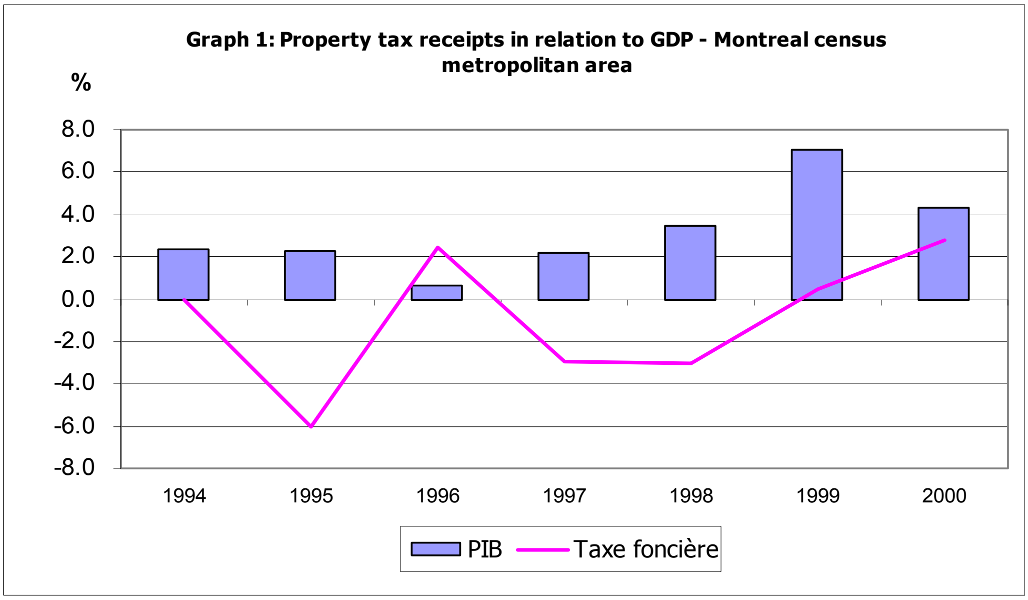
Rethink, increase and diversify

The over-dependence of cities on property tax revenues is the main reason for their financial difficulties. In 2005, 74% of Montreal's revenues were derived from properties: property taxes, taxes aimed at non-residential property owners and compensation in lieu of taxes.
The property tax is poorly adapted to the new and ever-expanding municipal responsibilities: it is a tax base that does not evolve at the same rate as economic growth and is a regressive form of taxation (the proportion of personal income allocated to paying property tax drops as personal income increases).

[14] The TD Bank, the Conference Board of Canada, the Federation of Canadian Municipalities, the Round Table on Environment and the Economy and the Union des municipalités du Québec, to name just a few.
[15] TD Bank Financial Group, *A choice between investing in Canadian cities or disinvesting in Canada's future* (2002).
[16] Conference Board du Canada and the Union des municipalités du Québec: *La situation fiscale des municipalités québécoises*, May 2003.
[17] URBA, publication of the Union des municipalités du Québec, vol. 24, no. 2, April 2004.
[18] Presentation by Frank Zampino, chairman of the Executive Committee of the City of Montreal, to the Board of Trade, October 2004. The City estimates investments needed for water management at $20 billion over 20 years; at $3.8 billion over 10 years for roads; at $3.36 billion over 10 years for transit.
[19] Harchaoui, Tarek M. and Faoui Tarkhani, *Public Infrastructure in Canada,* Statistics Canada, November 2003.

From 1994 to 2000, property tax receipts rose an average of 0.38% while the province's GDP grew 2.89% annually. This situation is all the more pronounced in cities of the Montreal census metropolitan area, where property tax revenues dropped an average of 0.91% annually while regional GDP expanded 3.18%. Graph 1 clearly shows this inequity in Montreal.

A jump in property values – as has just occurred in Montreal – does not necessarily solve the problem. Based on market conditions in Montreal on July 1, 2002, the value of 411,550 residential and non-residential properties on the City's new valuation roll rose 22.7% on average over 2000. Unfortunately,



Source: Conference Board of Canada and the Union des municipalités du Québec.

this is only an increase "on paper." In fact, for the owners of these properties, the increase in their personal wealth remains theoretical: they do not necessarily have more money in their pockets. As such, the City cannot hope to see its revenues advance by the same proportion without radically increasing the burden of its taxpayers.

We therefore believe that the Government of Quebec must work closely with representatives of Quebec's cities to find ways to boost and diversify revenue sources. This reflection, which should have begun a long time ago, must take place quickly and culminate in an initial wave of changes as of the first budget. These changes should provide for new, increased, diversified and predictable revenue sources for the City.

Needless to say, the Board of Trade is not making this recommendation merely to see more public funds flow to municipalities for day-to-day operations. The Board of Trade is concerned about the rising cost of public services provided by Greater Montreal's cities and expects municipal administrations to make continuous efforts to reduce expenses. The reason it would like to see new, increased, diversified and predictable revenue sources for the municipalities is because there are needs, notably in the area of urban infrastructures, and these needs are best addressed by the cities directly concerned.

Recommendation 2:

> ***That the Government of Quebec immediately begin working closely with the representatives of the federal government and of Quebec's cities to find ways to increase and diversify their revenue sources. This reflection process should proceed rapidly and culminate in new, predictable, recurring and diversified revenue sources for the City.***

While the Board of Trade would very much like to see profound, lasting changes in city financing, it also recognizes the need, in the short term, for new, predictable, recurring and diversified revenue sources. To this end, the Board of Trade proposes a series of measures that complement the previous recommendation and that in addition to meeting the need for increased financial resources can be implemented fairly rapidly. Needless to say, these proposals must not be viewed as individual, stand-alone solutions but rather as complementary approaches that can be implemented without increasing the burden of tax payers in the Greater Montreal area.

2.1. Finance major urban infrastructure projects

As stated earlier, municipalities require tremendous financial resources to maintain and renew their urban infrastructures. The City of Montreal alone needs $12 billion for its infrastructures over the next 10 years. For the Board of Trade, the sustainable economic development of Quebec's metropolis hinges on an adequate and rapid response to these needs. First and foremost, efficient infrastructures reduce costs for the businesses and companies that rely on them.[20]

Moreover, infrastructure needs are a major burden on municipal administrations and even a threat to their financial equilibrium. In the medium term, the Board of Trade fears that cities will have no choice but to substantially hike taxes or significantly reduce services to citizens, merchants and entrepreneurs. Lastly, it is important to remember that adequate, efficient infrastructures contribute to a city's quality and environment which, in turn, adds to its competitiveness in terms of attracting investors and workers.

While it insists on the importance of immediately meeting the challenge of renewing the urban infrastructures of Quebec's urban centres, the Board of Trade understands that it is difficult to finance major investments at a time when health care and education expenses are taking up a growing part of the public purse. In this context, the Board of Trade believes the time has come to innovate and implement new ways of financing urban infrastructures, beginning with close collaboration between all the levels of government – federal, provincial and municipal – and the private sector.

2.1.1. Set up innovative "public works, private capital" partnerships to finance urban infrastructures

The Board of Trade is inviting the three levels of government to examine the avenue of "public works, private capital" partnerships to execute value-added infrastructure projects. The Board of Trade drew its inspiration for this recommendation from the model used in Portland, Oregon, where, since the end of the 1950s, numerous housing and neighbourhood revitalization projects, as well as subsidy programs for new or expanding businesses, have seen the light of day.[21] The capital required for these projects is raised by the Portland Development Commission through the sale of bonds. Depending on the nature of the project, the expansion of the tax base (through the higher property values of the properties affected or built as part of the project) is used to repay the principal and interest on the bonds.

Besides making large scale projects financially possible, this approach is all the more interesting because it cannot be successfully implemented without the involvement of its public and private partners and

[20] According to a study published by Statistics Canada (Harchaoui, Tarek M. and Faouzi Tarkhani, *Public capital and its contribution to the productivity performance of the Canadian business sector,* November, 2003), the injection of public capital in transportation and public transit infrastructures, and water distribution and waste water systems saves companies (all sectors combined) $0.17 **per year** for each dollar of public capital invested.
[21] For more information in this regard, visit www.pdc.us.

beneficiaries. Moreover, in order to be approved, the investment must have demonstrable and measurable added value that will make it possible to repay the bondholders over subsequent years.

Under this model, the government's contribution can take various forms: in addition to acting as project developers and implementers, they can also guarantee the bonds issued, making them even safer, and by extension, less costly.

Recommendation 2.1.1.:

That the governments of Quebec and Canada, in conjunction with municipal administrations, jointly and actively participate in setting up "public works, private capital" partnerships to finance value-added urban infrastructures.

2.1.2. The Société du Havre: a high-priority project conducive to the new ways of doing things

This way of doing things could be applied with great success to integrated urban development projects. Indeed, in the case of land use or revitalization projects for which private investments are planned, it is in fact possible to forecast the added property value at the end of the project and to finance the infrastructure work required based on anticipated new tax revenues.

Such is the case for the Montreal Harbourfront development project spearheaded by the Société du Havre, possibly the most ambitious urban development and planning project in Montreal's history. Perhaps because of the size of the territory being planned or the magnitude of the work, the investment required to exploit the immense potential of the Harbourfront is simply colossal. We believe that to ensure its top-quality development, a partnership with the private sector is inevitable.

In this particular case, we believe it important to mention the leadership the Quebec and Canadian governments can provide as catalysts of the project. Just like the Government of Quebec contributed to the construction of the head office of the Caisse de dépôt et placement du Québec, and the expansion of the Palais des Congrès to make the Quartier International a reality, its participation in this major project with Société du Havre would greatly speed up its execution. In this regard, we would like to see the governments of Quebec and Canada join forces and give priority to the following projects: modernize the Bonaventure Autoroute to access the shores of the Saint Lawrence; build a world-class exhibition centre; and create a public transit link between the Harbourfront and downtown as integral parts of the project to relocate the Casino near the Peel basin. As well, the Government of Quebec should immediately launch a feasibility study for the run-of-river hydroelectric generating station project mentioned in the document *Montreal Harbourfront – Vision 2025*, made public in Spring 2004 by the Société du Havre de Montréal.

Recommendation 2.1.2.:

That the governments of Quebec and Canada each contribute to the Montreal Harbourfront development project, notably, by placing a priority on the planned investments in the Harbourfront and in so doing, give the project real impetus.

2.2. Improve the financial situation of cities

2.2.1. Transfer one percentage point (1/7.5) of the QST

One way to diversify city revenues that the Board of Trade finds especially appealing was proposed by the Minister of Municipal Affairs, Sports and Recreation, Jean-Marc Fournier, at the Annual Meeting of the Union municipalités du Québec on May 8, 2003. Mr. Fournier suggested setting up a revenue-sharing scheme between the government and the municipalities based on the Quebec sales tax (QST) revenues collected on the territory of such municipalities. As a guest speaker at the Board of Trade's forum during the last election campaign, the chair of the Conseil du trésor, Monique Jérôme-Forget, also raised the possibility of sharing a percentage point of the QST with the municipalities.

According to this last proposal, 1/7.5 (or 13.3%) of QST revenues collected on a given territory would be transferred to municipalities in that territory. In this way, the amount collected by a municipality would directly correspond roughly to the economic activity generated on its territory[22].

At first glance, one percentage point (1/7.5) of the QST rate and one percent (1%) of the QST revenues may appear the same. Nothing could be further from the truth.

Let's look at the facts. Total QST revenues in Quebec were estimated at $9 billion for 2003-2004. The QST rate is 7.5%. When the Board of Trade proposes transferring one percentage point of the QST, this means 1/7.5 (or 13.3%) of total revenues – quite a bit more than 1% of receipts.

One percentage point **= $1,200 million**
(1/7.5 or 13.3% of revenues)

One percentage of receipts **= $90 million**

Total QST revenues were estimated at $9 billion for 2003-2004.[23] One percentage point (1/7.5) would therefore amount to $1.2 billion. Because QST receipts are unevenly distributed across Quebec, it is rather difficult for the Board of Trade to estimate the exact value of the transfers to the main cities of Greater Montreal. Nevertheless, assuming that the distribution of the QST is more or less the same as the GDP, we estimate that Greater Montreal municipalities (in this case, the Census Metropolitan Area or CMA) would share about 50% of the total or approximately $600 million annually. The City of Montreal, for its part, calculates its share at around $235 million[24].

The Board of Trade would like to see the Quebec government recognize the financial importance of the major cities in the global economic dynamic and, in particular, Montreal's role as the economic engine of Quebec. This long-awaited recognition should also promote greater fiscal autonomy and put an end to situations where Montreal's municipal administration is forced to rely on ad hoc decisions by the upper levels of government to balance its budget. The lingering doubt as to whether the Quebec government will fully respect the City Contract signed with the City of Montreal is a case in point.

On this basis, transferring one percentage point of the QST to Quebec's municipalities – if the transfer were guaranteed for the long term – would be a major step forward. Cities like Montreal could then have access to a revenue source that truly reflects the economic growth on their territory. In the medium term, simply replacing the amount paid in the form of subsidies and transfers by the Quebec government to municipalities by an equivalent share of the QST revenues would allow these municipalities to obtain predictable revenues from Quebec that would likely increase far more rapidly than property tax revenues. Therefore, given that the government has little room to manoeuvre in the next budget, and given that the Board of Trade is against any increase in the tax burden of Greater Montreal residents, we would be pleased to see a portion of the current transfers and subsidies replaced by an equal amount coming from the transfer of one percentage point of QST revenues. This measure, which wouldn't cost anything in the government's 2005-2006 budgets, would ensure substantial, predictable growth in municipal revenues in the medium term corresponding with the economic growth generated in the metropolitan region.

[22] In this regard, the Board of Trade sees the potential inequities of a transfer based on QST collected on a municipality's territory, for example, two neighbouring municipalities could have very different levels of commercial activity while being part of the same economy. For this reason, we believe it would be better to use the census metropolitan area or the metropolitan region as a reference territory.

[23] Government of Quebec, *2004-2005 Budget,* March 2004.

[24] Presentation by Frank Zampino, chairman of the Executive Committee of the City of Montreal, to the Board of Trade, October 2004.

Recommendation 2.2.1.:

That the Government of Quebec share one percentage point (1/7.5) of QST revenues with the cities of Quebec without increasing the tax burden of Greater Montreal residents.

2.2.2. Total reimbursement of the QST

As the Board of Trade stated in its pre-budget submissions of the previous years, the status of municipal administrations, vis-à-vis the Quebec sales tax (QST) is both unusual and surprising. The upper levels of government cannot charge each others sales tax; in fact, they are exempt, thus reducing the cost of the goods and services purchased for their operations and for the delivery of services to citizens, merchants and entrepreneurs. For the Board of Trade, the same logic should apply between the federal, provincial governments and municipalities.

Because they pay QST on every purchase, municipalities currently pay a net tax of 7.5%. Yet since the vast majority of goods and services they purchase are used to provide citizens, merchants and entrepreneurs with services on which QST is not charged, the cities, rather than the consumer, end up assuming the tax burden at the time of purchase. This situation runs against the spirit of the tax.

On January 1, 1997, the Quebec government abolished the 43% refund on QST paid by municipalities that they had been receiving since the tax was introduced in 1992. Since then, 7.5% of the funds consisting of the tax contributions of the Montreal citizens, merchants and entrepreneurs that should be used to make purchases necessary for the delivery of municipal services, end up in provincial coffers – coffers that these very same citizens, merchants and entrepreneurs already help fill through income tax and QST levied on purchases. For its part, the Government of Canada last year recognized the unfairness of charging municipalities the tax on goods and services (GST). Thus after giving them a partial reimbursement of 57.14% for many years, the Government implemented a full refund in February 2004.

In our view, exempting municipalities from QST or refunding them in full would be in keeping with the spirit of this pact while making it more equitable and significantly reducing the real cost of municipal investment. According to the City of Montreal, the municipal administration will pay the Quebec government some $80 million in 2005[25] in QST. There is no doubt that fully refunding this tax would greatly improve the financial means of Quebec municipalities.

Recommendation 2.2.2.:

That, as of the next budget year, the Government of Quebec grant municipalities a full refund of the QST

2.2.3. Compensation in lieu of taxes

Property tax, based on property assessments, has for some time been the method of choice of municipalities to finance the services they deliver to their citizens, merchants and entrepreneurs. In this respect, the Government of Quebec, unlike private owners, has enjoyed a special status whereby it does not have to pay the full amount of property taxes, and as a result, the full cost of municipal services its properties nevertheless enjoy. Even if the Government of Quebec is required to pay the rates and service charges incurred for services consumed directly by public buildings, in most cases, these charges are not enough to cover the entire cost of the municipal services. Compensation intended to address this shortfall is referred to as "compensation in lieu of taxes."

[25] This amount includes QST paid by para-municipal companies, including the Société de transports de Montréal (largest) and the Société d'habitation de Montréal.

As part of the 1980 reform, Quebec municipalities agreed that the Government of Quebec would compensate them for the fact that they are deprived of a portion of the sales tax by paying them, over time, compensation in lieu of taxes on public and para-public buildings. However, this is a commitment that the government has not been able to fully respect. Consequently, for many years, the compensation in lieu of taxes has been paid at 100% for administrative buildings, at 80% for buildings in the health and post-secondary education systems (Cegeps and universities) and at 25% for elementary and high schools. In 1998, according to the report of the *Commission nationale sur les finances et la fiscalité locales*, the Quebec government paid its municipalities some $311 million in compensation in lieu of taxes or the equivalent of 55% of the property taxes it would have paid on the basis of a property assessment.

A new fiscal and financial agreement signed in 2000 between the Quebec Government and the municipalities (better known as the "Fiscal Pact") somewhat resolved the situation and was followed by gradual increases in the compensation rates. Thus, between 2000 and 2003, the real compensation rates paid by the provincial government for buildings in the health and post-secondary education systems increased from 80% to 94.5% of the property value, while increasing some 25% to 35.5% for elementary and high schools.

For 2005, the Minister of Municipal Affairs, Sports and Recreation announced increases in the compensation rates and the various tax bases. Thus, the compensation rates for the three categories of buildings in Montreal for 2005 are 95.6% for buildings in the health and post-secondary education system (Cegeps and universities), 75.7% for elementary schools and 64.9% for high schools. The amounts that will be paid to the City of Montreal by the Quebec government as compensation in lieu of taxes for 2005 are estimated at $44.6 million and $53.4 million, respectively, for the buildings in the health and post-secondary education systems, and $41.1 million for elementary and high schools.[26] For these three categories of buildings alone, granting compensation equal to 100% of the property tax value would result in a revenue increase of at least $17.7 million for the City of Montreal this year.

The Board of Trade is therefore reiterating its recommendation with regards to compensations in lieu of taxes. In the interest of tax equity, the Board of Trade of Metropolitan Montreal supports the conclusion of the *Commission nationale sur les finances et la fiscalité locales* recommending that the Canadian government pay compensations in lieu of taxes equal to 100% of the local taxes on the property values of its own buildings. Such a measure would simplify the compensations in lieu of taxes and increase municipal revenues.

Recommendation 2.2.3.:

> ***That the compensation in lieu of taxes paid by the Government of Quebec to the municipalities equal 100% of the local taxes on the property value of all the buildings it owns, as of the next budget year.***

2.2.4. Distribution of gasoline tax revenues collected by the federal government to the municipalities

Everything seems to indicate that the federal government will respect its commitment and negotiate with the Canadian provinces to transfer a portion of gasoline tax revenues to municipalities. The Board of Trade is particularly in favour of this measure and urges the Government of Canada to respect this commitment as of the next budget.

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[26] City of Montreal, Budget 2005, November 2004, p. 68.

For the Board of Trade, it is important that this transfer actually help the municipalities. The Board of Trade therefore hopes that the Government of Quebec will not take advantage of these new funds to reduce its commitments to its municipalities.

This transfer means the Quebec government will be responsible for redistributing the amounts to the municipalities. We would like to make our expectations very clear with respect to the formula that will be used to calculate everyone’s share. This formula must take into account the specific requirements of the metropolis and other urban centres of Quebec as well as their public transit needs. In this regard, the Board of Trade fully endorses the principles presented on December 4 by the Federation of Canadian Municipalities that should guide the sharing of the gasoline tax.

Recommendation 2.2.4.:

> ***That the Government of Quebec redistribute to the municipalities of Quebec the gasoline excise tax revenues transferred by the Government of Canada without reducing its financial commitments to the municipalities and according to a formula recognizing the specific challenges of the City of Montreal, namely, in the matter of public transit.***

Conclusion

As an economic engine, Metropolitan Montreal is contributing more than ever to Quebec's prosperity. In this global context where economies are based on knowledge and innovation, this role is apt to become even more pronounced.

Faced with this reality, the development of metropolitan Montreal must not be viewed in apposition to that of the other regions of Quebec. We must not think that the prosperity of one takes away resources from the development of the other regions. Quite the contrary; indeed, it is in Quebec's best interest to ensure that its economic engine runs that at full throttle and it should therefore equip it with the right tools to maximize its potential.

It is with this in mind that the Board of Trade has presented the budget expectations of its some 7,000 members in this brief and put forth constructive proposals apt to improve the economic performance of the City and, by extension, that of Quebec and Canada as a whole. In this same constructive spirit, the Board of Trade would also like to impress upon the government that it is available to work together on concrete, fundamental measures that will help grow the Montreal economy.