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

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"Competitive cities and businesses for a prosperous Quebec"

presented to

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by the

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Summary of recommendations

City financing

The Board of Trade recommends:

- that the provincial government, together with the representatives of Quebec's largest cities, undertake a comprehensive examination of how to diversify the revenue sources of municipalities and apply the fiscal agglomeration principle – specifically, the concept of sharing QST revenue with the major municipalities – and that the resulting recommendations translate into action in the 2004 budget;
- that as of the next budget year, the provincial government either exempt the municipalities from the QST or reimburse them in full in this regard;
- that the compensation in lieu of taxes paid by the provincial government to the municipalities equal 100% of the local taxes on the property value of all buildings owned by the government, as of the next budget year.

Business competitiveness

The Board of Trade recommends:

- that since capital tax is considered a tax measure that is extremely detrimental to business productivity, the Quebec government completely and immediately eliminate it;
- the implementation, as part of Quebec's export development strategy or in complement thereto, of the following measures to support exporters:
    - A tax credit for companies taking steps to develop their export business;
    - A mechanism to finance salaries for new positions created specifically to develop international markets;
    - The creation of a government-backed fund, aimed specifically at financing the export projects of low- and medium-technology SMEs;
    - Participation in the financing of sector-based consortiums of companies and government organizations focused on international business.

The Board of Trade of Metropolitan Montreal has more than 7 000 members. Its mission is to be the leading group representing the interests of the Greater Montreal business community. Its objectives are to maintain, at all times, relevance to its membership, credibility towards the public and influence towards government and decision-makers.

Introduction

Concerned about the major competitiveness issues in Greater Montreal, the Board of Trade of Metropolitan Montreal has examined the budget choices that the Quebec government is preparing to make for the new 2003-2004 budget. In the current context of trade globalization and international competition between urban agglomerations, the key role of cities as engines of growth and innovation is now clearly recognized. The fact that Canadian cities account for a large share of the GDP in their respective provinces – Montreal, for example, accounts for 50% of Quebec's GDP – attests to the important role they play in ensuring the prosperity of the provinces and the country.

It is therefore clear that the strength and vitality of Quebec and Canada hinge greatly on the competitiveness of their major urban agglomerations and their resident companies. A consensus prevails in this regard among the organizations that recently studied the issue of cities, notably, the C5 group, which comprises the five largest Canadian urban agglomerations (Calgary, Montreal, Toronto, Vancouver, and Winnipeg), the chambers of commerce of these five cities, the Federation of Canadian Municipalities and the TD Bank.

In the past decade, in an effort to balance the public purse, the higher levels of government have limited municipal investment even as devolving new responsibilities to these same municipalities. In a context of expanding urbanization, where four out of five Canadians now live in an urban setting, municipal administrations are called upon to respond to increasingly pressing needs. For example, all the infrastructure studies show that substantial funds are required to make the necessary improvements. With their limited, flat revenue base, cities simply do not have the means to simultaneously provide services to citizens, see to their economic development and renew their infrastructures.

Quebec's cities are thus being especially hard hit by their dependence on their key source of revenue, property tax. In this regard, Montreal heads the list of North American cities with the highest percentage of total city revenues generated from property taxes, that is, 72.6%. Because property tax is determined by property value and not directly tied to economic activity, it does not allow cities to enjoy the benefits of the economic growth they may experience and encourage. In order to be able to assume their many responsibilities and create a stimulating and competitive environment, urban agglomerations need to diversify their revenue sources and be able to rely on adequate financing. The solutions required therefore call for both immediate adjustments, which will allow cities to meet their needs in the short term, and lasting measures that will support their long-term development plans. In this regard, we support the agglomeration fiscal principle put forward by the new government, which calls for each citizen to pay his fair share.

Concrete and lasting initiatives are essential if we hope to remedy the situation depicted in the recent diagnosis published by the Montreal Metropolitan Community[1]. Despite the period of growth currently enjoyed by the Montreal region – growth characterized by a significant progression in exports in the past decade – its per capita GDP is still the lowest among the North American agglomerations of similar size.

1. Montreal Metropolitan Community, *Vision stratégique : Document déclencheur (préliminaire)*, tome 1 -Diagnostic, October 2002

This poor performance in terms of standards of living underscores the need for further improvement and greater efforts in the areas business competitiveness and exports.

In light of the foregoing, the Board of Trade of Metropolitan Montreal has identified **city financing** and **business competitiveness** as critical issues on which the Government of Quebec must take action in its budget.

In this vein, the Board of Trade of Metropolitan Montreal would like to suggest the implementation of concrete, immediate and easily applicable measures to help the municipalities and bolster business productivity and competitiveness. Through these measures, the Board of Trade of Metropolitan Montreal is offering the Government of Quebec possible solutions that can be deployed right away in order to begin making the investments everyone considers essential to the vitality of the Montreal region and to Quebec as a whole.

It goes without saying that, while the proposed measures are required and fulfill pressing needs, they alone will not ensure sustainable and optimal economic development for Metropolitan Montreal. As well, the Board of Trade would like to point out that beyond this budget year, it is important to aim for greater financial autonomy for the urban agglomerations and for the acquisition of the powers and means required for them to meet their growing responsibilities.

1. Municipal financing

Compared with other jurisdictions, chiefly in the United States and Europe, municipal taxation in Quebec is considered relatively static in that Quebec's cities rely almost exclusively on property taxes for their revenue, a source of income that is not directly tied to economic activity. This excessive dependence on property tax (it should be remembered that 72.6% of Montreal's total revenue is property-based), limits revenues while imposing a heavy burden on citizens. As it becomes abundantly clear that the responsibilities of cities are increasing much faster than their revenue sources, it is apparent that the Quebec government must take concrete action to address the problem. For the Board of Trade, the answer is not to add new taxes but instead to find ways to more equitably share the tax base and allow the municipalities to diversify their revenue sources so that they can directly reap the economic benefits of their investments.

As such, it is essential that the Quebec government, together with the representatives of Quebec's largest cities, immediately begin studying ways to diversify municipal revenue sources and incorporate these solutions into the next budget, in 2004.

In this regard, among the possible solutions, the Board of Trade favours the proposal put forth by the Minister of Municipal Affairs, Sports and Recreation at the annual meeting of the Union des municipalités du Québec on May 8 to set up a QST revenue-sharing scheme between the government and the municipalities.

Recommendation: that the provincial government, together with the representatives of Quebec's largest cities, undertake a comprehensive examination of how to diversify the revenue sources of municipalities and apply the fiscal agglomeration principle – specifically, the concept of sharing QST revenue with the major municipalities – and that the resulting recommendations translate into action in the 2004 budget.

The Board of Trade acknowledges that major changes in the way cities are financed will not materialize as quickly as one would hope. As well, to the extent that the cities that make up the Metropolitan Montreal Community, like other large cities in Quebec, in reality do not have any flexibility in the management of their finances, it is critical to reduce the pressure on municipal administrations by rapidly giving them access to increased, foreseeable and recurring revenue streams while always ensuring equity among taxpayers.

In this context, the ability of the Montreal urban agglomeration to be successful and become a font of wealth creation – an indispensable prerequisite to its redistribution and to enhancing the resulting social cohesion – is closely tied to its ability to rally citizens and companies and inspire creative initiatives in a spirit of cohesion and coherence. Hence the urgent need to give the Montreal agglomeration the means for economically sound and dynamic political governance. To this end, the Board of Trade would like to present to the Government of Quebec measures that, while addressing the need to increase the financial resources of our cities, can be achieved in the very short term.

1.1 Full reimbursement of the QST

With respect to the Quebec sales tax (QST), the status of the municipal administrations is both unusual and surprising. The upper levels of government cannot charge each other 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.

Municipalities, however, do not enjoy such an exemption: they pay the 7% QST on every purchase. Yet the vast majority of the goods and services purchased by the City of Montreal are used to provide citizens with services on which QST is not charged. As such, rather than the consumer assuming the tax burden at the time of purchase, as the QST theory would have it, the City assumes the bill.

Up until six years ago, to ensure that the municipalities did not assume the entire tax burden, the government reimbursed them 43% of the QST paid. This reimbursement was abolished on January 1, 1997, and replaced by what could be referred to as an overpayment to the benefit of the Quebec government. Since then, this 7.5%, consisting of the tax contributions of Montreal citizens and that should be used to make purchases for the provision of municipal services, end ups in Quebec’s coffers, coffers which these very same citizens already help fill through income tax and QST levies on purchases.

Thus, exempting the municipalities from the QST or reimbursing them in full would be in keeping with the spirit of this tax while making it more equitable and significantly reducing the real cost of municipal investments. For example, according to the City of Montreal, the municipal administration paid out $70 million in QST to the Quebec government in 2001 and does not expect that amount to differ materially in 2002. There is no doubt that a full reimbursement of the QST would considerably improve the financial means of the municipalities in the Montreal region.

Recommendation: That the provincial government, as of the next budget year, exempt municipalities from the QST or fully reimburse them in this regard.

1.2 Compensations in lieu of taxes

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

In 1998, according to the report of the *Commission nationale sur les finances et la fiscalité locales*, the Quebec government paid Quebec municipalities a compensation in lieu of taxes in the order of $311 million, i.e., the equivalent of 55% of the property taxes it would pay on the basis of property evaluations.

In the case of the provincial government buildings, the tax system is complex and each category of building is subject to a specific tax treatment. For example, in 2001, the real compensation rates paid by the Quebec government for buildings in the health and post-secondary education systems increased from 80% to 92.2% of their property value between 2000 and 2002, while increasing from 25% to 33.7% for primary and secondary schools.

The amounts that will be paid to the City of Montreal by the Quebec government as compensation in lieu of taxes are estimated for 2003 at $45.6 million dollars for the buildings used by the health and social services network, at $47.8 million for the buildings used by the higher learning sector, that is, cégéps and universities, and at $21.8 million for the buildings used by the primary and secondary education sector[2]. In 2003, the compensation rates for these three categories of buildings are estimated at, respectively, 94.5% for the first two and 35.5% for the third. For these three categories of building alone, granting compensations equal to 100% of the property tax value would boost the City of Montreal's revenues by $45 million per year.

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 Quebec government pay compensations in lieu of taxes equivalent to 100% of the local taxes on the property value of its buildings. Such a measure would simplify the compensation in lieu of taxes plan and increase municipal revenues.

Recommendation: That the compensation in lieu of taxes paid by the provincial government 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. Corporate taxation

2.1 Capital tax

Aimed at large corporations and financial institutions, capital tax is levied on equity capital, debt capital and capital reserves. It therefore applies on capital expenditures made by companies, such as plant construction and equipment and material purchases. Not only do corporations pay this tax at the time of the initial expenditure, they must continue to pay it for the entire life of the goods. Capital tax therefore constitutes an additional fixed cost, increasing the real cost of investments and hence reducing the capital available for other investments.

Capital tax in Quebec is set at 0.64% for corporations (currently the highest rate in the country) and 1.28% for financial institutions. In 1999, this tax generated $1.87 billion in revenue for the provincial government[3].

2. City of Montreal, *Plan budgétaire de la Ville de Montréal*, Budget 2003.
3. Ministère des Finances du Québec*, Statistiques fiscales des sociétés en 1999*, 2003.

Because it constitutes an additional fixed expense for businesses, capital tax stifles investment and productivity gains. It is also recognized in the business community that this additional expense dissuades innovation and the acquisition of new technologies. As well, because it increases production costs, Quebec companies find themselves at a disadvantage both on the international and domestic fronts vis-à-vis foreign companies unfettered by the need to add the cost of capital tax to the price of their goods and services.

Capital tax imposes a disproportionate burden on highly capitalized companies such as those operating in the manufacturing, natural resources, financial and high tech sectors. Companies that invest heavily in new projects must pay the capital tax before the investment even begins to pay dividends, which could take years. Lastly, tax on capital is levied without any regard to profitability and can therefore destabilize companies during periods of low earnings or losses.

Unlike machines and plants that require long-term investments, and are difficult to move, capital is a mobile production factor that is typically rapidly moved to those locations that offer the best conditions for profitability. Capital tax therefore has a direct impact on investments, driving it to other jurisdictions where a higher rate of return can be obtained. Consequently, investment opportunities in Quebec are rendered less attractive for foreign investors, who compare the business tax environment between different countries or provinces.

Other provincial administrations have already recognized the negative impact of capital tax and have either completely abolished or announced measures to eliminate it. Alberta and British Columbia no longer levy a corporate capital tax and Ontario is in the process of reducing it. The previous Quebec government had also announced a gradual reduction, but the 0.30% target rate for 2007 is the same as the Ontario rate today. As such, insofar as others are acting, the Quebec government's reduction plan is contributing very little in the short term to increasing Quebec's competitiveness on the national and international scale. In fact, at the beginning of the year, the federal and Ontario governments announced further decreases to their capital tax rate, to be phased in over the next few years, thus placing more pressure on Quebec to promptly act on this matter.

Of course, the Board of Trade is encouraged by the fact that the Liberal Party of Quebec has acknowledged in its action plan for SMEs the negative effects of the capital tax and by your government's commitment to abolish this tax for SMEs during the current mandate. However, we believe that all companies should benefit as soon as possible from the removal of this tax measure. Waiting for a second mandate to eliminate the capital tax for large companies, as your action plan for SMEs suggests, would create an inequitable situation for these job-creating companies that afford Quebec visibility on the international scene.

The Board of Trade is of the opinion that the elimination of the capital tax would encourage companies to invest and ultimately lead to productivity gains. The resulting increase in local and foreign investments should boost GDP, helping, in the medium term, to offset the loss in revenue currently generated by this tax.

Recommendation: Since capital tax is considered a detrimental tax measure that stifles business productivity, the Board of Trade recommends that the Quebec government immediately abolish this tax.

2.2 Measures to support exports

Greater Montreal has over 5,000 exporting companies and is home to 70% of all Quebec exporters. The vitality of the export sector plays a major role in Quebec's economic growth. However, a negative trend has emerged in the past few months. Data published in spring 2003 by Export Development Canada (EDC) reported a 4.1% decrease in the export of Quebec goods and services in 2002. However, with a projected growth of 4%. the outlook is more encouraging for 2003. Still, this figure remains below the Canadian average of 5%. In this regard, the Board of Trade believes that the need to bolster export development is so pressing that an appeal to joint and complementary action on the part of both levels of government is in order.

Given their importance, it is essential to find creative ways to support exporting companies and hence contribute to the growth of the Quebec economy. This support is all the more necessary given that typically, major investments and efforts are required to develop new markets before yielding results. In this regard, the economic slowdown south of the border has certainly driven home the importance of diversifying our export markets.

In this context, the Board of Trade sincerely hopes that your government will confirm the adoption of the *Stratégie québécoise de développement des exportations* announced by the outgoing government in its March 11 budget. The goal to lead "*a greater number of companies to acquire a true export strategy and to increase the number of regular exporters*" clearly remains one of the effective ways to boost the competitiveness of businesses in Greater Montreal and Quebec.

Aware that like many government programs, the Strategy in its current form will have to be reviewed by your government, the Board of Trade is using this pre-budget document to reiterate the measures it considers the most important for Quebec exporters.

2.2.1 Export tax credit

The first measure proposed by the Board of Trade to rapidly stimulate the development of Quebec exports is to offer a tax credit to companies taking preliminary steps to develop their export business. These steps would include, among others:

- preparing an export business plan;
- training personnel in international trade;
- participating in a trade mission;
- participating in a trade show.

The purpose of such a measure is to encourage companies to develop their exports in a systematic, organized manner. The Board of Trade considers that facilitating access to such steps greatly enhances the chances of success.

2.2.2 Financing new jobs dedicated to exports

The exporting process is a long one, and in order to be successful, foreign market development should be approached as a separate task. Unfortunately, it is difficult for companies to free up an employee or create a position expressly for this task because typically, the financial rewards of his work and initiatives will only materialize after a time.

In this context, the Board of Trade believes it is relevant to implement a mechanism to finance salaries for new positions created specifically to develop international markets. With a view to encouraging the immediate use of this measure, rather than offering partial financing over several years (as is the case, for example, with the refundable tax credit for a portion of the salary of an employee working for a company in E-Commerce Place), the government assistance could cover the entire salary but be limited to the first year of work. As well, this assistance could be made available only for a newly created position, thus contributing to the creation of promising jobs, especially for young people.

2.2.3 Government-backed fund

The Board of Trade recommends the creation of a government-backed fund to specifically finance foreign market development projects for low- and medium-technology Quebec SMEs with an export business plan.

The advantage of such a fund is that it fulfills a real need for a private source of financing for low- and medium-technology companies seeking to develop foreign markets. By guaranteeing a portion (20% for example) of the potential losses of a fund set up by a financial institution, the government acts as a facilitator, making available to SMEs as much as five times the financing typically accessible to SMEs. In fact, the first benefit of such a guarantee is that it significantly limits the risk incurred by the financial institution, which should make financing more accessible and cheaper for small and medium borrowers.

2.2.4 Financing the start-up of sector-based consortiums

Quebec SMEs generally run into formidable and savvy competition on the international markets. Not only does the Board of Trade believe that often, one of the only ways for Quebec companies to be competitive is to pool their resources and expertise, it would go one step further. The Quebec public sector, at all levels, frequently has exportable expertise that oftentimes complements the know-how found in the private sector but that no one thought to market outside our borders. As such, in addition to encouraging export companies to pool their talents, the Quebec government should ensure that these groups include, when relevant, participants from the public sector.

As such, in order to launch sector-based initiatives (such as trade missions on different markets or aimed at multi-lateral development banks) and promote the competitiveness of Quebec's offering abroad, the Board of Trade suggests that the Quebec government examine the possibility of financially contributing to the formation of sector-based consortiums of companies and government organizations dedicated to international trade.

Recommendation: That the government implements, as part of Quebec's export development strategy or in complement thereto, the following export support measures in the next budget:

- **A tax credit for companies taking preliminary steps to develop their exports;**
- **A mechanism to finance salaries for new positions created specifically to develop international markets;**
- **The creation of a government-backed fund to specifically finance the export projects of low- and medium-technology companies;**
- **Participate in the financing of sector-based consortiums of companies and government organizations dedicated to international trade.**

Conclusion

As an economic engine and the main site for the creation of wealth in Quebec, Greater Montreal must have political, economic and tax powers and tools befitting its size and heightened economic responsibilities. The Board of Trade believes that Quebec and Montreal companies must operate within a fair legislative and fiscal framework that favours innovation, productivity and competitiveness. The recommendations formulated by the Board of Trade as the Government of Quebec prepares its next budget point in this direction. They are pragmatic solutions that can be swiftly translated into action. The Board of Trade expects the Quebec government's new commitments to translate into concrete initiatives optimizing the sustainable economic development of the Montreal agglomeration, and by extension the entire province of Quebec.