Policy Forum: Quebec’s Debt—Taming the Beast

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ABSTRACT

The burden of Quebec’s debt has changed significantly since 1960. While the province incurred very little debt in the years before the Quiet Revolution, its borrowing increased steadily from 1961 until the mid-1990s. By the time the trend was reversed, the Quebec government had recorded a deficit for 40 consecutive years. Having achieved one of the heaviest debt burdens, measured as a share of gross domestic product, among the Canadian provinces, and having seen two rapid downgrades of its credit rating by Moody’s in the mid-1990s, fearing a further downgrade the Quebec government took steps to clean up its public finances.

After outlining the evolution of Quebec’s debt since the early 1960s, this article briefly describes two statutes enacted by the government to provide greater transparency with respect to the province’s finances, enabling better management of its budget and debt. These statutes are the Balanced Budget Act, passed in 1996, and the Act To Reduce the Debt and Establish the Generations Fund, passed in 2006. The article discusses the impact of the Great Recession on the province’s budgetary balance and indebtedness, and shows how Quebec’s financial situation has changed in terms of its fiscal balance, debt, debt interest, and credit rating. It is now possible to affirm that the two statutes adopted by the government have clearly helped to improve Quebec’s fiscal position.

KEYWORDS: DEBT ■ DEFICIT ■ FISCAL PLANNING ■ INTEREST ■ CREDIT ■ QUEBEC

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QUEBEC’S CHANGING DEBT BURDEN, FROM THE QUIET REVOLUTION TO THE PRESENT

In the early 1960s, Quebec had a very low debt level. In the February 1959 provincial budget, at the end of the Duplessis era, the minister of finance stated that the government did not “wish to take advantage of the general movement to borrow and needlessly impact the future [unofficial translation].”¹ Little did he know that he would be the last finance minister in Quebec to table a balanced budget for the next four decades.

Political choices made since 1959 have significantly changed the debt burden in Quebec. The first budget tabled by Jean Lesage’s government in 1961 marked the start of the Quiet Revolution. The budget speech clearly and deliberately set out how the government intended to use debt to modernize Quebec and catch up with other jurisdictions. It stated that “to bridge so many gaps, the government will have to borrow. It is not fair to make the present generation alone bear the cost of sustainable improvements that will serve future generations equally well [unofficial translation].”²

Over the decades, fiscal deficits have resulted in mounting debt. Figure 1 shows actual and projected changes in Quebec’s net debt as a percentage of gross domestic product (GDP) from 1970 to 2022. These changes can be described as falling into five phases:

1. the 1960s and 1970s: a slow but steady increase;
2. the 1980s: a rapid increase in the first half of the decade, followed by a leveling off and a modest downward trend in the second half;
3. the 1990s: a rapid increase in the first half of the decade, followed by a downward trend, with a return to balanced budgets by the end of the decade;
4. the 2000s: a continuation of the downward trend in the first half of the decade, followed by an upward trend aggravated by the 2008 financial crisis and the resulting Great Recession; and
5. the 2010s: a slight increase in the wake of the Great Recession at the beginning of the decade, with a downward trend starting from the peak in 2012 and gathering momentum thereafter.

This article examines the burden of Quebec’s debt and explains the background to the changes that have occurred over the past decades. In the mid-1990s, the Quebec government took steps to put its financial house in order. It is now clear that two statutes that were enacted, one forcing balanced budgets and the other imposing debt repayment, have clearly helped to improve Quebec’s situation.

¹ Québec, Ministère des Finances, 1959-1960 Budget, Discours sur le budget (French only), February 20, 1959, at 4.
² Québec, Ministère des Finances, 1961-1962 Budget, Discours sur le budget (French only), April 14, 1961, at 84.
Quebec ran deficits for 40 consecutive years, from 1958 to 1998, and its accumulated debt rose from a total value of $2.5 billion in the early 1970s to more than $100 billion in 1998. Grappling with one of the highest debt levels among Canadian provinces, two credit-rating downgrades by Moody’s in 1993 and 1995, and fears of a further drop, the Quebec government held a socioeconomic summit during which it managed to place public finances at the top of the agenda and bring about a Quebec consensus on the need to restore fiscal balance.

The inaugural speech of Quebec Premier Lucien Bouchard, upon his arrival in the National Assembly in 1996, reflected the commitment to make returning to balanced budgets a “national” priority. He stated that eliminating the deficit had only one goal: to preserve the quality of life of Quebec men and women, protect the


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4 Inaugural speech by the premier of Quebec, Lucien Bouchard, to the National Assembly of Quebec, March 25, 1996.
institutions that Quebec had built since the Lesage years, and save future generations from debt and despair.

The Balanced Budget Act\(^5\) ("the BBA"), enacted in 1996 and adopted unanimously by the National Assembly, aims to curb recurring deficits, thereby protecting the government’s ability to act. Under the BBA, the government is prohibited from incurring a budget deficit;\(^6\) as a result, the BBA constrains the management of Quebec’s public finances. It governs the government’s financial operations by requiring it to balance revenues and expenditures and have a zero budget balance, except in special circumstances. In the event of a deficit, the BBA provides for a relatively restrictive mechanism to return to fiscal balance.

First, the BBA states that when a deficit appears, if the amount is less than $1 billion, the government must achieve an equivalent offsetting surplus in the next fiscal year.\(^7\) Second, the BBA states that if the deficit is greater than $1 billion, it must be warranted by one of several specified conditions and be repaid over a maximum of five years in accordance with a set schedule—namely, repayment of at least $1 billion in the first year and 75 percent of the total amount in the first four years.\(^8\) The conditions warranting a deficit of more than $1 billion are as follows:\(^9\)

- a disaster having a major impact on revenues or expenditures;
- a significant deterioration in economic conditions; or
- a change in federal programs of transfer payments to the provinces that would substantially reduce transfer payments to the Quebec government.

The BBA also provides for the creation of a stabilization reserve\(^10\) to which amounts equal to the budget surplus for each fiscal year are allocated. This reserve is basically theoretical, but it serves to maintain a balanced budget: the balance in the reserve is reduced by the amount necessary to achieve a budgetary balance when a budget deficit appears for a given year. Naturally, the balance of the stabilization reserve cannot be negative under any circumstances.\(^11\)

The Quebec minister of finance must report to the National Assembly annually on any variance recorded and on the operations of the stabilization reserve.\(^12\) This reporting occurs in the budget speech.

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\(^5\) CQLR c. E-12.00001.
\(^6\) BBA section 6.
\(^7\) BBA section 8.
\(^8\) BBA section 11.
\(^9\) BBA section 10.
\(^10\) BBA section 5.1.
\(^11\) BBA section 5.1.
\(^12\) BBA section 15.
In choosing to implement balanced budget legislation, Quebec drew inspiration from what was being done elsewhere, including in some Canadian provinces. By 1996, five provinces—British Columbia, Alberta, Saskatchewan, Manitoba, and New Brunswick—had already enacted such legislation. It goes without saying that the constraints of these statutes vary from province to province. For example, in the case of British Columbia, the statute stipulates an annual requirement to balance the budget, barring which Cabinet salary reductions apply under certain conditions. Quebec opted instead for the prospective repayment of any budget deficits.

As in the case of other Canadian provinces, compliance with the BBA proved impossible during the Great Recession. The Quebec government temporarily suspended the requirement to achieve balanced budgets for fiscal years 2009-10 and 2010-11, and subsequently provided for a gradual return to balanced budgets in 2014-15.

Has the BBA improved Quebec’s fiscal situation? The tracking of changes in the budgetary balance shown in figure 2 suggests that since the introduction of the BBA (the grey area), the Quebec government has been genuinely concerned about balancing its budget. Overall, from 1996 onward, the annual budgetary balances in Quebec’s public accounts have remained within a range of ±1 percent of GDP, scattered around the point of equilibrium. Since 2015-16, however, Quebec has registered surpluses. Budgetary balances within the meaning of the BBA represent balances in the public accounts net of payments to the Generations Fund (discussed in the next section). Taking into account the amounts paid to the Generations Fund, Quebec expects a balanced budget in fiscal years 2019-20 to 2023-24.

**G E N E R A T I O N S F U N D**

The Act To Reduce the Debt and Establish the Generations Fund (“the ADGF”) was passed in 2006 and came into force in 2007. When it was enacted, the debt burden was becoming worrisome to the government, particularly in relation to economic conditions. As at March 31, 2006, Quebec was the most indebted province...
in Canada. The total debt-to-GDP ratio stood at 42.7 percent, compared with the Canadian average of 25 percent. Interest on the debt was Quebec’s third-largest spending item after health and education. It represented 12.7 cents for each dollar of budgetary revenue in 2005-06.

The key objective of the ADGF is to reduce debt in relative terms, in order to curb the intergenerational transfer of the debt burden. To achieve this goal, the government created the Generations Fund (“the Fund”). Ultimately, the Fund is to be used exclusively for debt repayment and to serve as an instrument of transparency in public finances by disclosing the amounts that the government is setting aside for debt repayment.

To demonstrate the seriousness of the government’s approach, the legislation was designed to ensure that the debt would be repaid, not on the basis of budgetary availability, but in accordance with a known and predictable plan. It is for this reason that the ADGF sets out a precise debt target—namely, by 2025-26, the amount

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18 Québec, Ministère des Finances, *The Generations Fund: To Foster Inter-Generational Equity, Sustainable Social Programs and Prosperity* (Québec: Ministère des Finances, March 2006), at 2. The debt concept used was total debt. This debt concept was subsequently replaced by other concepts—gross debt and debt representing accumulated deficits.

of debt representing the province’s accumulated deficits is not to exceed 17 percent of Quebec’s GDP and gross debt is not to exceed 45 percent of GDP.  

At the time the legislation was drafted, it was difficult for the government to increase taxes to support the Fund. Accordingly, the ADGF provided for alternative sources of revenue that would be dedicated to the Fund, mainly from Hydro-Québec. In addition to three sources of payments from Hydro-Québec, there are also mining revenues; a fixed amount of the specific tax on alcoholic beverages; unclaimed property; gifts, bequests, and other contributions received by the minister of finance; and, of course, the investment income generated by the Fund itself. The provisions of the ADGF also specify three other revenue sources, although they do not generate any payments at this time since an order in council is required to specify the value of the amounts to be allocated to the Fund. These other sources are (1) a part of Hydro-Québec’s earnings on the sale of electricity outside Quebec as a result of increased generating capacity; (2) charges on water withdrawal; and (3) sums derived from the sale of government assets, rights, or securities.

As with the BBA, under the ADGF, the Quebec minister of finance must report to the National Assembly annually, in the budget speech, on the evolution of both the debt representing the accumulated deficits and the gross debt, on the sums credited to the Fund, and on any sums used to repay the gross debt.

Why did the government create the Fund, into which monies are paid and which will eventually be used to pay off part of the debt, rather than paying off a portion of the debt directly each year with dedicated revenues? One reason is the desire to benefit from a leverage effect—that is, a higher return in the Fund than the amount of interest paid on government borrowings. In this regard, the annual yield of the Fund since its inception has exceeded the Quebec government’s borrowing costs in 11 out of 12 years.

Table 1 shows the amount of dedicated revenues and investment income paid into the Fund annually since 2006-07, as well as debt repayments and projections made by the Ministère des Finances up to 2023-24. In addition, it shows dedicated lump-sum revenues received over the years, such as $300 million from the Territorial Information Fund in the 2013-14 fiscal year.

With respect to debt repayments, the Fund made possible an initial loan repayment of $1 billion in fiscal 2013-14. A second repayment of $8 billion took place in 2018-19, and a third repayment of $2 billion is expected in 2019-20. In spite of

20 ADGF section 1.
21 ADGF section 3.
23 ADGF section 3.
24 ADGF section 11.
26 Québec, Ministère des Finances, Update on Québec’s Economic and Financial Situation: Fall 2018, December 3, 2018.
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<th>Specific tax on alcoholic beverages</th>
<th>Unclaimed property</th>
<th>Investment income</th>
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Note: Numbers may not add because of rounding.

a Revenues of $500 million in 2006-07 were from the sale of Hydro-Québec’s interest in Transelect Chile.

b The payment of $200 million in 2007-08 was made out of the funds allocated to the budgetary reserve in 2006-07.

c The $132 million payment in 2008-09 was made out of the stabilization reserve and resulted from the sale of Société immobilière du Québec assets.

d The $300 million payment in 2013-14 was from the Territorial Information Fund.

e The $131 million payment in 2015-16 was from the Commission des normes du travail’s cumulative surplus.

loan repayments, the book value of the Fund is expected to reach nearly $21 billion in 2023-24.

**CURRENT STATE OF QUEBEC’S FINANCES**

The current state of Quebec’s public finances is presented in terms of fiscal balance, debt levels, interest on debt, and credit ratings.

**Fiscal Balance**

Almost 25 years after the enactment of the BBA, its contribution to Quebec’s return to balanced budgets should be acknowledged. The statute still seems to impose a genuine constraint on the government, presuming a negative collective judgment for a government that does not exert the necessary effort to comply with it.

The Quebec government estimates its budgetary surplus for the year ending March 31, 2019 at $4.4 billion after the payment to the Fund, representing 1 percent of the province’s GDP. Figure 3 shows that this compares enviable with the performance of the other Canadian provinces.

The stabilization reserve, which can be used to allow budget deficits in future years, amounted to $11.6 billion as at March 31, 2019.

**Debt Levels**

While Quebec’s debt-to-GDP ratio showed a relative upward trend over the past three decades, an improvement appeared following the enactment of, first, the BBA and then the ADGF. Figure 4 compares Quebec’s debt levels with Ontario’s between 1981-82 and 2023-24 (projected). It shows that, after the return to general fiscal balance in the late 1990s, Quebec’s net debt-to-GDP ratio followed a downward trend similar to Ontario’s, but it did not narrow the gap between the two provinces (45.9 percent compared to 30.6 percent or 15.3 points in 1997-98, compared to 16.2 points in 2006-07). The gap was still favourable to Ontario by 13.7 points in 2012-13 but was reduced to nil (−0.2 points) in 2018-19. The budget forecasts indicate that in 2023-24 the debt-ratio gap will favour Quebec by 3.8 points.

The net debt-to-GDP ratio gap between Quebec and all other Canadian provinces was an average of 21.3 points in 2006-07 and declined to 9.7 points in 2018-19.30

Finally, in terms of meeting the ADGF targets, the gross debt-to-GDP ratio after the Great Recession stood at 54.3 percent in 2013-14, compared to 46.1 percent as at March 31, 2019. As at March 31, 2020, the ratio will reach 45.3 percent, roughly meeting the ADGF target, but six years earlier than the statutory requirement. The other target, the debt burden representing accumulated deficits as a percentage of GDP (17 percent), will be met by 2025-26, as set out in the ADGF.31

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27 See supra note 16.
28 Québec, Ministère des Finances, *Public Accounts*.
29 Québec, Ministère des Finances, 2019-2020 Budget, Budget Plan, March 21, 2019, at section I.
Interest on Debt

As a result of higher debt levels, greater effort was required from Quebec to pay the interest on debt measured as a percentage of consolidated revenues.

Although part of the decline in the debt-service burden obviously resulted from lower interest rates, at the time the BBA came into force in 1996-97, interest on debt accounted for 15.7 percent of consolidated revenues in Quebec compared with 14.8 percent in Ontario. In 2017-18, the ratio fell in both provinces, to 8.5 percent in Quebec and 7.9 percent in Ontario.30

The March 2019 budget forecast indicates that interest on debt measured as a percentage of consolidated revenues will be 7.4 percent in Quebec in 2023-24 and 8.9 percent in Ontario.

30 Québec, Ministère des Finances, Public Accounts.
Credit Ratings

In the first half of the 1990s, while Moody’s changed Ontario’s credit rating from Aa2 to Aa3 in 1995, it downgraded Quebec’s rating twice, from Aa3 to A1 in 1993 and to A2 in 1995. As noted earlier in this article, in 1996, before the enactment of the BBA, there were fears of a new downgrade.

Since the introduction of the BBA and subsequently the ADGF, Quebec’s credit rating has improved. In 2012, by lowering Ontario’s credit rating from Aa1 to Aa2, Moody’s placed Quebec’s debt on an equal footing with Ontario’s debt. Currently, Quebec’s rating (Aa2) is higher than Ontario’s (Aa3). Only three provinces now have a better rating than Quebec—British Columbia, Saskatchewan, and Alberta.

The same conclusion can be drawn using Standard & Poor’s credit rating; as of 2017, and for the first time in 50 years, Quebec (at AA−) has a better credit rating than Ontario (at A+).

OUTLOOK

In the short term, the outlook for Quebec’s public finances continues to be favourable: the five-year budget plan projects a balanced budget for every year up to and including 2023-24; Quebec’s net debt-to-GDP ratio is declining; and the debt-ratio gap relative to all provinces is also narrowing.

GDP = gross domestic product.

Source: Québec, Ministère des Finances, Public Accounts.
Although the Quebec economy is running at full speed and public finances appear sound, the government still faces the major challenge of the transition in the province’s demographic makeup. According to the most recent demographic outlook of the Institut de la statistique du Québec, the population aged 20-64, which grew by 1.1 million from 1981 to 2018, is expected to decline by 155,269, or 3.1 percent, from 2018 to 2030. In Ontario, over the same period, this age group is poised to grow by 0.7 percent under the demographic projection scenario.\(^{31}\)

Clearly, demographics will have an impact on economic growth. Because Quebec draws most of its workforce from the population aged 20-64, it may be more difficult for the province to increase production, wealth, and the standard of living in the coming decades. The slower economic growth anticipated for Quebec will occur at the same time as increased pressure on health-care costs associated with the aging population, sparking significant growth in public spending. As a result, matching of government revenues and expenditures may be increasingly difficult to achieve.

An analysis produced in 2018 by the Université de Sherbrooke Chair in Taxation and Public Finance\(^{32}\) projected, on the basis of a series of assumptions,\(^{33}\) the government’s ability to maintain both fiscal balance and debt levels. The analysis shows that, particularly in view of the Fund’s presence, the trend over the next decade is toward balanced budgets and debt levels under control. However, from the end of the next decade, fiscal deficits are projected to increase. Thus, despite assumptions based on higher employment rates, productivity growth, and technological developments in health care, it is expected that Quebec’s public finances will be under strain over the long term.

In light of that analysis, while the improvement in public finances since the mid-1990s places Quebec on a more solid footing to face the challenge of the demographic shift, public finances and tools developed over the past decades will have to be readjusted for effective debt management.

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33. For example, employment rates by age group, worker productivity, and several demographically influenced expenditures such as health-care spending.