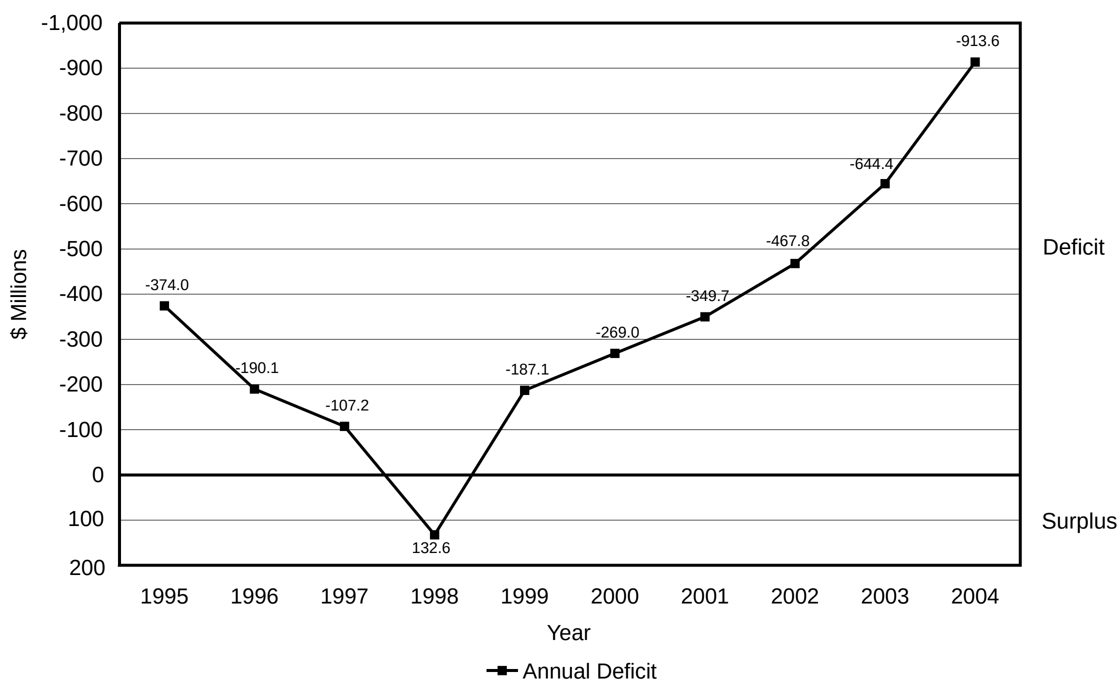
4.3 Sustainability

Sustainability is the degree to which a government can maintain existing programs and meet existing creditor requirements without increasing the debt burden on the economy. A government's annual surplus or deficit, its net debt and a province's gross domestic product (GDP) are important indicators of the state of a government's finances. Each of these indicators provides useful insight into the sustainability of a government's revenue raising and spending practices.

The annual surplus or deficit shows the extent to which a government spends less or more than it raises in revenues in one fiscal year. For the year ended 31 March 2004, the annual deficit reflected in the Province's Consolidated Summary Financial Statements was $913.6 million. Figure 1 provides details as to the annual deficit each year since 1995.

Figure 1

Consolidated Summary Financial Statements
Annual Deficit (Surplus)
Years Ended 31 March
($ Millions)



As Figure 1 shows, Government's annual deficit has been growing each year since 1998 and the $913.6 million deficit for 2003-04 is the largest annual deficit ever recorded by the Province. In 1998, there was a reported surplus of $132.6 million which resulted from a one time payment of $348 million related to the Labrador ferry service transfer.

Key Indicators of the State of Government's Finances

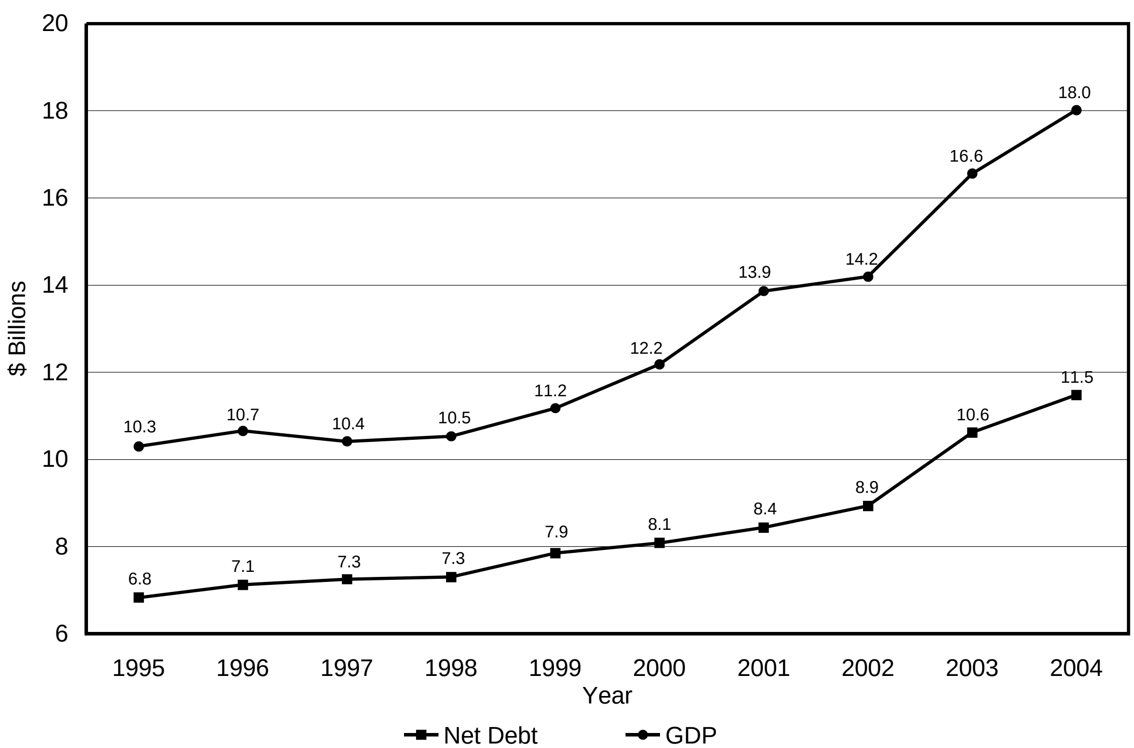
Users of a province's financial statements should look at the long-term trends such as net debt to GDP and net debt as a percentage of GDP.

The net debt is the total of all liabilities reduced by financial assets (i.e. cash and equivalents). As at 31 March 2004, the net debt reflected in the Province's Consolidated Summary Financial Statements was $11.5 billion.

The Province's GDP is a measure of the total value of all the goods and services produced in Newfoundland and Labrador in one year and indicates the size of the provincial economy. For purposes of this report we used GDP information from the Provincial Department of Finance. Government must manage its revenue raising and spending practices in the context of the economy of the Province. Figure 2 provides details as to the net debt in relation to the GDP since 1995.

Figure 2

Consolidated Summary Financial Statements
Net Debt in Relation to GDP
Years Ended 31 March
($ Billions)



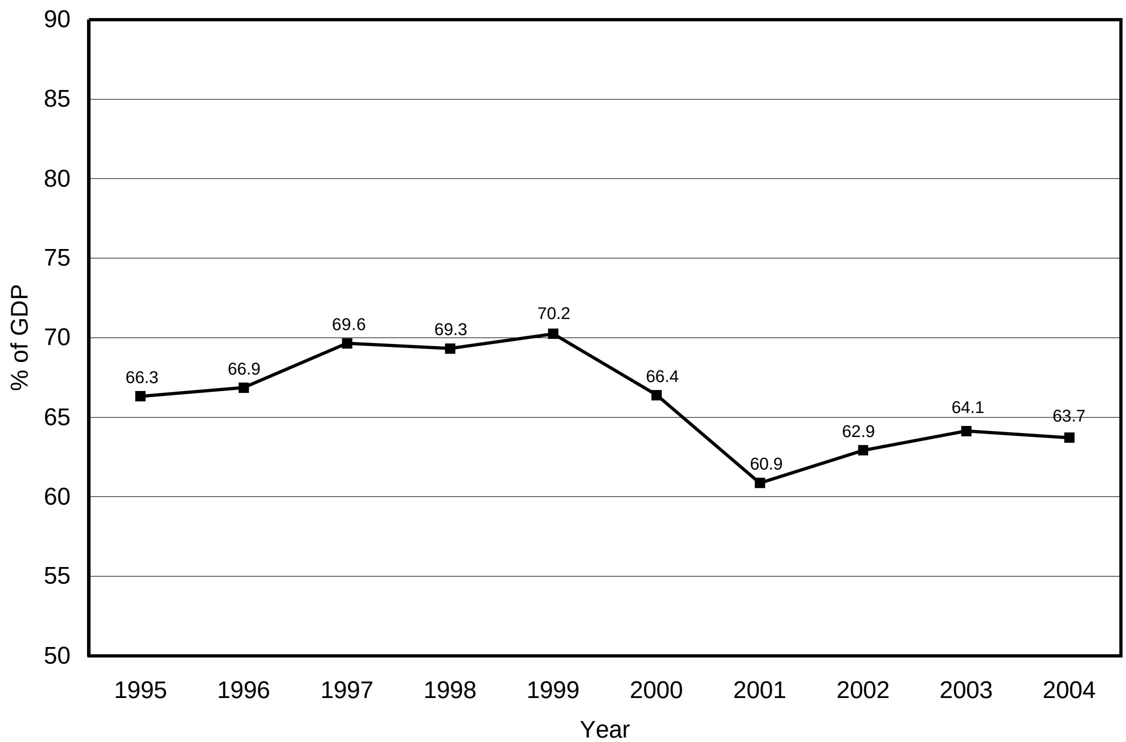
As Figure 2 shows, the GDP of Newfoundland and Labrador has increased substantially from 1995 to 2004. The 2004 GDP of $18.0 billion is an increase of $7.7 billion (75%) from the 1995 GDP of $10.3 billion.

Figure 2 also shows a significant increase in net debt in 2003 and 2004. This increase in net debt is largely attributed to the recording of a liability for group health and life insurance retirement benefits. The liability for 2004 is $1.058 billion (2003 - $985 million).

The financial demands placed on the economy by Government's spending and revenue raising practices can be assessed for sustainability by comparing Government's net debt to the Province's GDP. Figure 3 provides a measure of how much debt Government can afford to carry. The thinking behind this measure is that the larger the GDP the more debt Government can afford to carry.

Figure 3

Consolidated Summary Financial Statements
Net Debt as a Percentage of GDP
Years Ended 31 March



While the net debt as a percentage of GDP decreased from a high of 70.2% in 1999 to a low of 60.9% in 2001, at 31 March 2004 the net debt as a percentage of GDP was 63.7%, the highest net debt as a percentage of GDP of any province in Canada.

Government will need to carefully manage its future revenues and expenditures.

4.4 Flexibility

Flexibility is the degree to which a government can increase its financial resources to respond to rising commitments by either expanding its revenues or increasing its debt. The research study proposes that users of a province's financial statements look at the long-term trends of such indicators as:

- interest costs as a percentage of total revenue; and
- own source revenues to GDP.

Together with a government’s net debt and a province’s GDP, these indicators provide insight into a government's flexibility in responding to rising commitments. For example, when a government has a large net debt and high interest costs, it has fewer resources to allocate to programs and services.

Government incurs interest costs on its borrowings, unfunded pension liability, and the net liability for group health and life insurance retirement benefits. At 31 March 2004, Government's long-term debt net of sinking funds was $6.8 billion and its unfunded retirement benefits liabilities were $4.8 billion. In 2004, Government’s interest costs totalled $1.1 billion. The money to pay interest costs is raised by levying taxes or by charging directly for services.

Interest costs as a percentage of total revenue, sometimes called the “interest bite”, is an important indicator of the state of a government’s finances. This indicator shows the extent to which a government must use revenue to pay interest costs rather than to pay for programs and services. Figure 4 provides information on interest costs as a percentage of total revenue.