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## Key Indicators of the State of Government's Finances

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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.

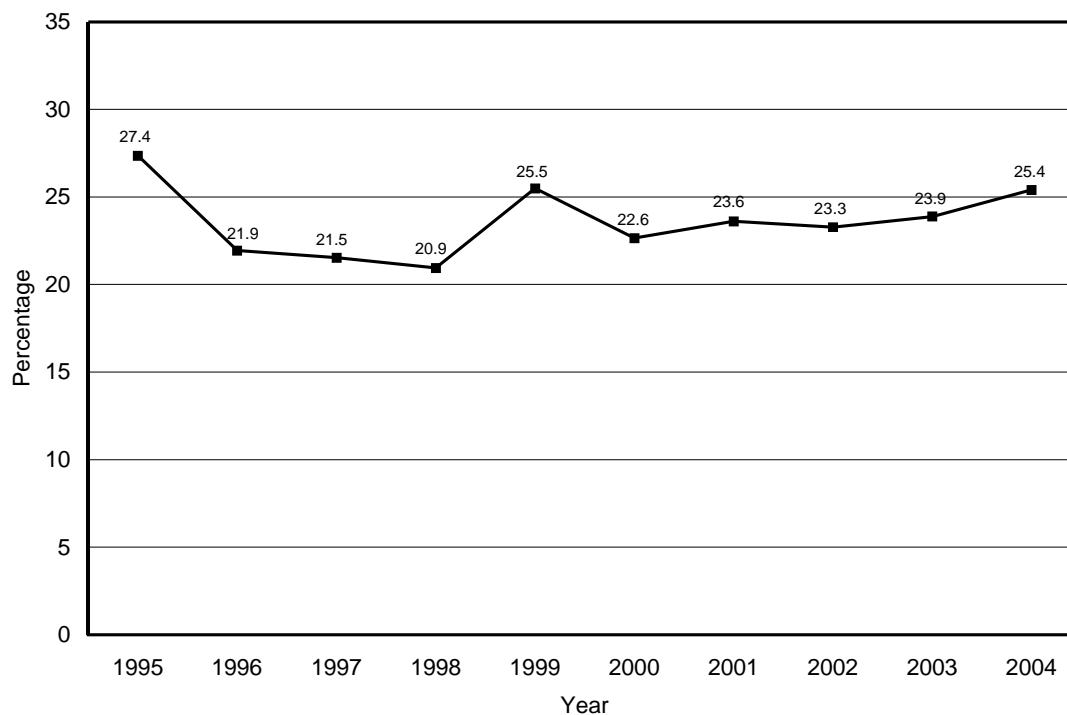
Government incurs interest costs on its borrowings, unfunded pension liability, and the net liability for group health and life insurance retirement benefits. At 31 March 2004, Government's long-term debt net of sinking funds was \$6.8 billion and its unfunded retirement benefits liabilities were \$4.8 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.

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**Figure 4**

**Consolidated Summary Financial Statements  
Total Interest Costs as a Percentage  
of Total Revenue  
Years Ended 31 March**



As Figure 4 indicates, during the ten year period from 1995 to 2004, Government's interest costs as a percentage of total revenue has fluctuated from a high of 27.4% in 1995 to a low of 20.9% in 1998. For the year ended 31 March 2004, the interest costs as a percentage of total revenue was 25.4%, the highest percentage of any province in Canada.

Reductions in the interest bite allows Government to use more of its revenues to pay for programs and services, and use less of its revenues to pay for the interest costs of debt. Increases in the interest bite restricts the amount of revenues available for programs and services as more revenues are used to pay for interest costs.

The Government of Newfoundland and Labrador raises revenue from two general sources. The first revenue source is from within the Province. This source is called "own source revenue". The second source of revenue is transfers from the Federal Government.

Figure 5 provides information on these revenues since 1995.

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Figure 5

### Consolidated Summary Financial Statements Revenue by Source Years Ended 31 March (\$ Billions)

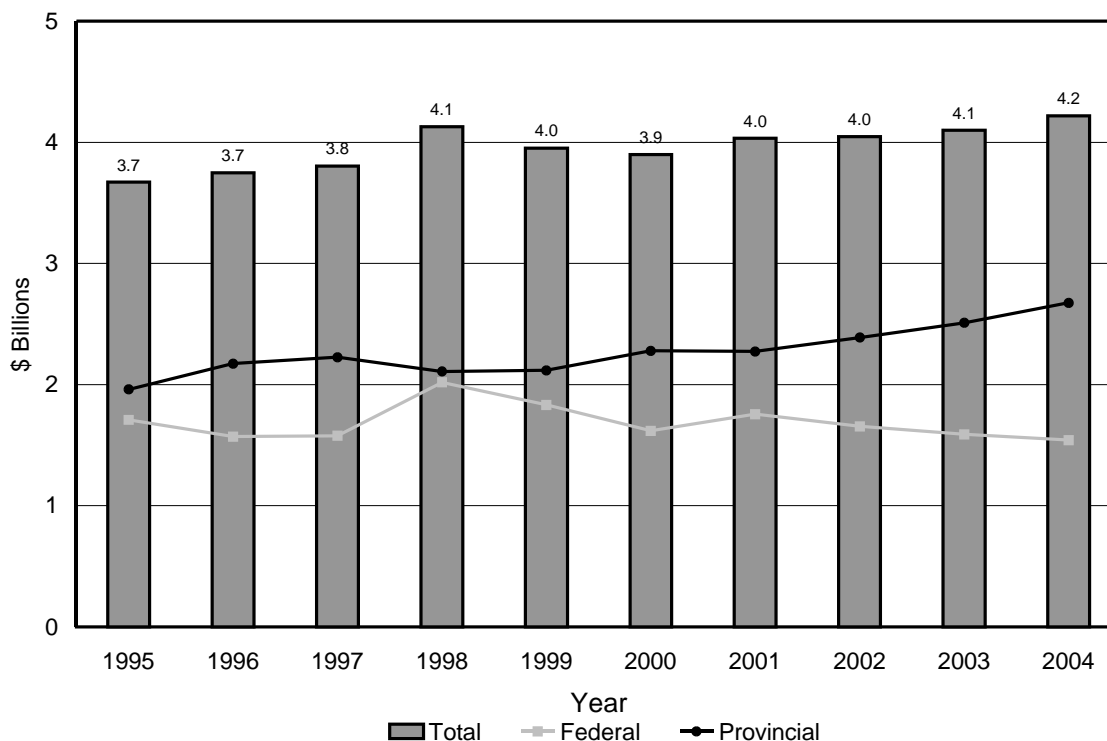


Figure 5 shows that a substantial portion of our total revenue comes from the Federal government. In 2004, 36.6% of our total revenue was received from the Federal government while in 1998, the revenues from the Federal government totalled 48.9% of the Province's total revenue.

Figure 5 also shows that since 2000, while Provincial revenues have been increasing, Federal revenues have been decreasing. Federal revenues have declined in large part because of decreases in the Province's entitlement relating to Federal government equalization payments. The largest variance between Federal and Provincial revenues occurred in 2004 - a spread of \$1.1 billion. The smallest variance was in 1998 - a spread of \$90.2 million which resulted from a one time payment of \$348 million related to the Labrador ferry service transfer.

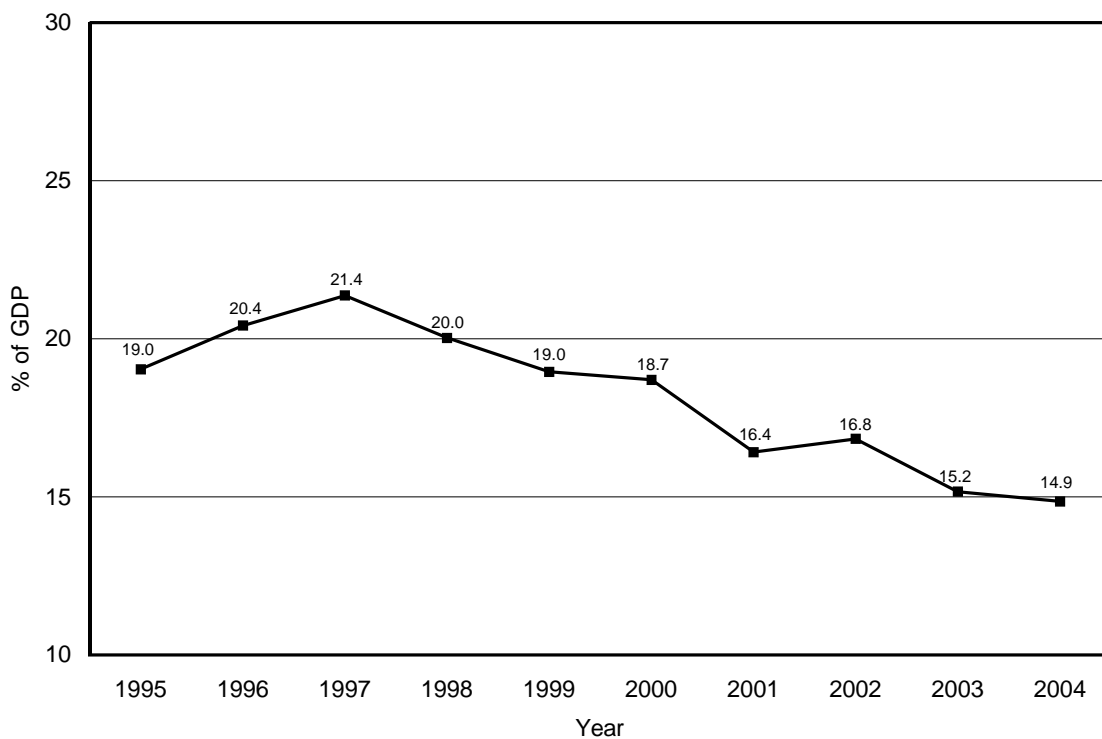
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Another important indicator of the state of a government's finances is shown by comparing the change in a government's own source (Provincial) revenue to the size of the economy as indicated by the GDP.

Figure 6 provides information on this indicator since 1995.

**Figure 6**

### Consolidated Summary Financial Statements Own Source Revenue as a Percentage of GDP Years Ended 31 March



The revenue raised by the Government of Newfoundland and Labrador from sources within the Province, as a percentage of GDP, has declined from 21.4% in 1997 to 14.9% in 2004. Although Provincial revenues have been increasing since 1998, the increase in revenues have not kept pace with the growth in the GDP and as a result, the percentage of Provincial revenues to GDP has been on a general decline.