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.

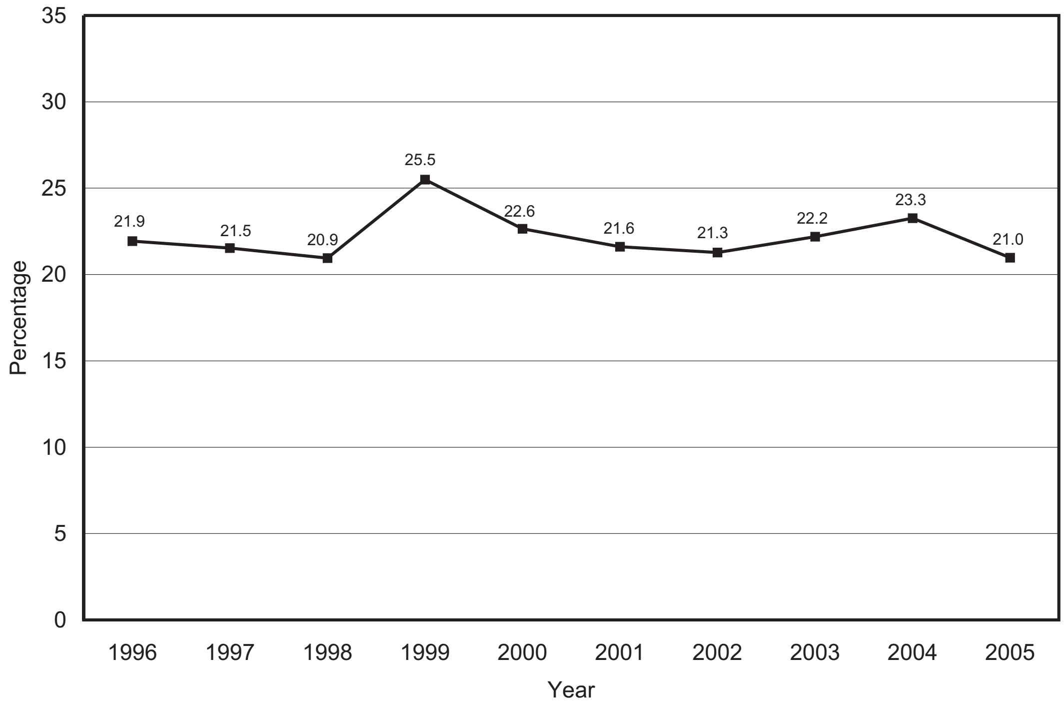
Together with a government's net debt and a province's GDP, these indicators provide insight into a government's flexibility in responding to rising commitments. For example, when a government has a large net debt and high interest costs, it has fewer resources to allocate to programs and services.

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 2005, Government's long-term debt net of sinking funds was $6.8 billion, its unfunded pension liability was $3.9 billion and its unfunded group health and life insurance retirement benefits liability was $1.2 billion. In 2005, Government's interest costs totalled $940.3 million. 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.

Figure 4

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



As Figure 4 indicates, interest costs as a percentage of total revenue continues to be a substantial burden for Government. Our Province continues to have the highest interest cost as a percentage of total revenue 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 1996.

Figure 5

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

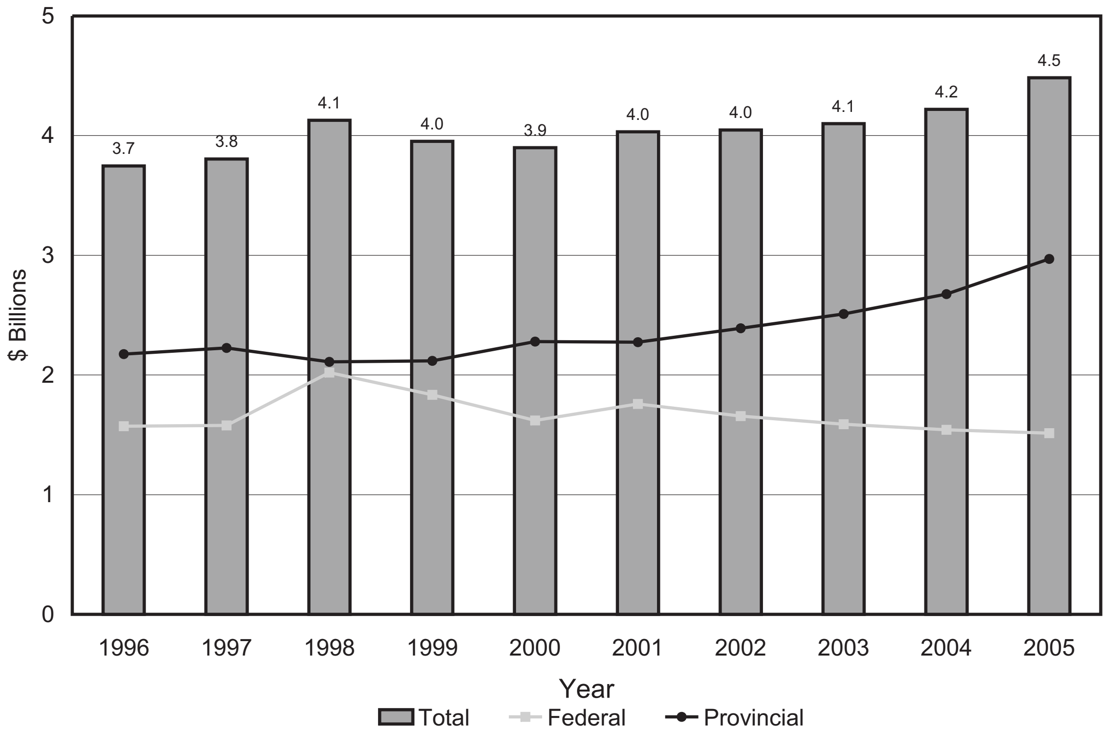


Figure 5 shows that a substantial portion of our total revenue comes from the Federal government. In 2005, 34% of our total revenue was received from the Federal government.

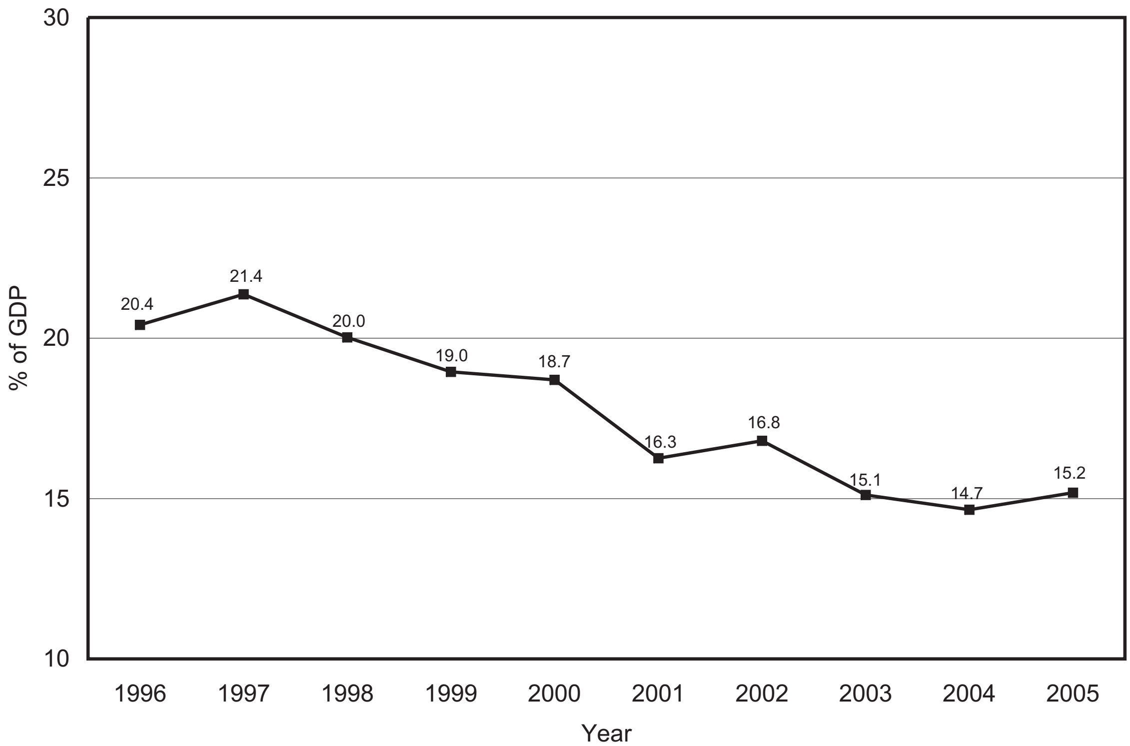
Figure 5 also shows that since 2000, while Provincial revenues have been increasing, Federal revenues have been decreasing. Federal revenues have declined in large part because of decreases in the Province's entitlement relating to Federal government equalization payments. The largest variance between Federal and Provincial revenues occurred in 2005 - a spread of $1.5 billion. This indicates that the Provincial economy is improving.

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 1996.

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 14.7% in 2004. For 2005 it has increased to 15.2%. 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.