

**4.5 Vulnerability** Vulnerability is the degree to which a government becomes dependent on, and therefore vulnerable to, sources of funding outside its control or influence. This indicator measures the extent to which a government can manage its financial affairs without having to rely on others.

The research study proposed that users of a province's financial statements look at the long term trends of such indicators as:

- Federal Government revenues compared to own source revenues;
- foreign currency debt to total government debt; and
- oil revenues as a percentage of provincial revenues.

Details of each of these three indicators are outlined as follows:

A significant portion of Government's revenue in this Province consists of transfers from the Federal Government. These revenue transfers are intended to help pay for the costs of such programs as health, education, and social services.

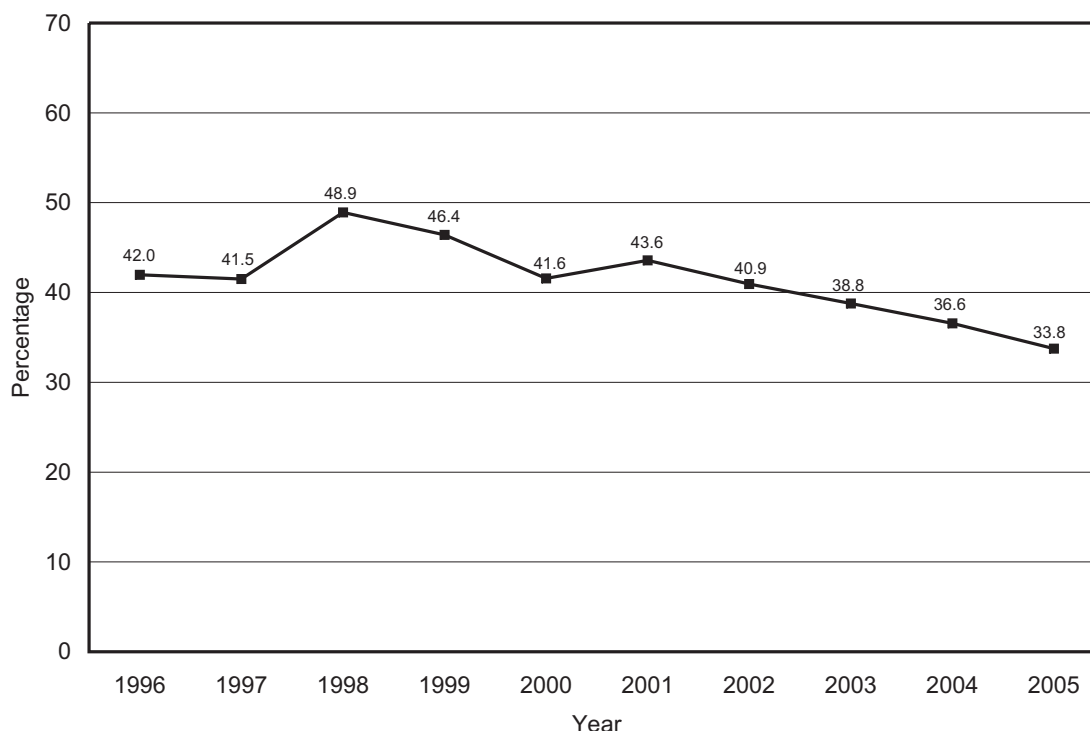
The Federal Government calculates the amount of equalization transfers by comparing the ability of a province to raise revenues with a standard set by the Federal Government. As a result of this calculation, the annual amount of equalization transfers due to Newfoundland and Labrador is significantly affected by the performance of other provincial economies.

Figure 7 indicates the percentage of Federal revenues compared to the Province's total revenues.

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

Figure 7

### Consolidated Summary Financial Statements Federal Revenue as a Percentage of Total Revenues Years Ended 31 March



As Figure 7 shows, Federal revenue as a percentage of total revenues has declined over the last four years. Federal revenues have declined in large part because of decreases in the Province's entitlement relating to Federal government equalization payments. The decreases in entitlement are directly related to the decrease in the Province's population.

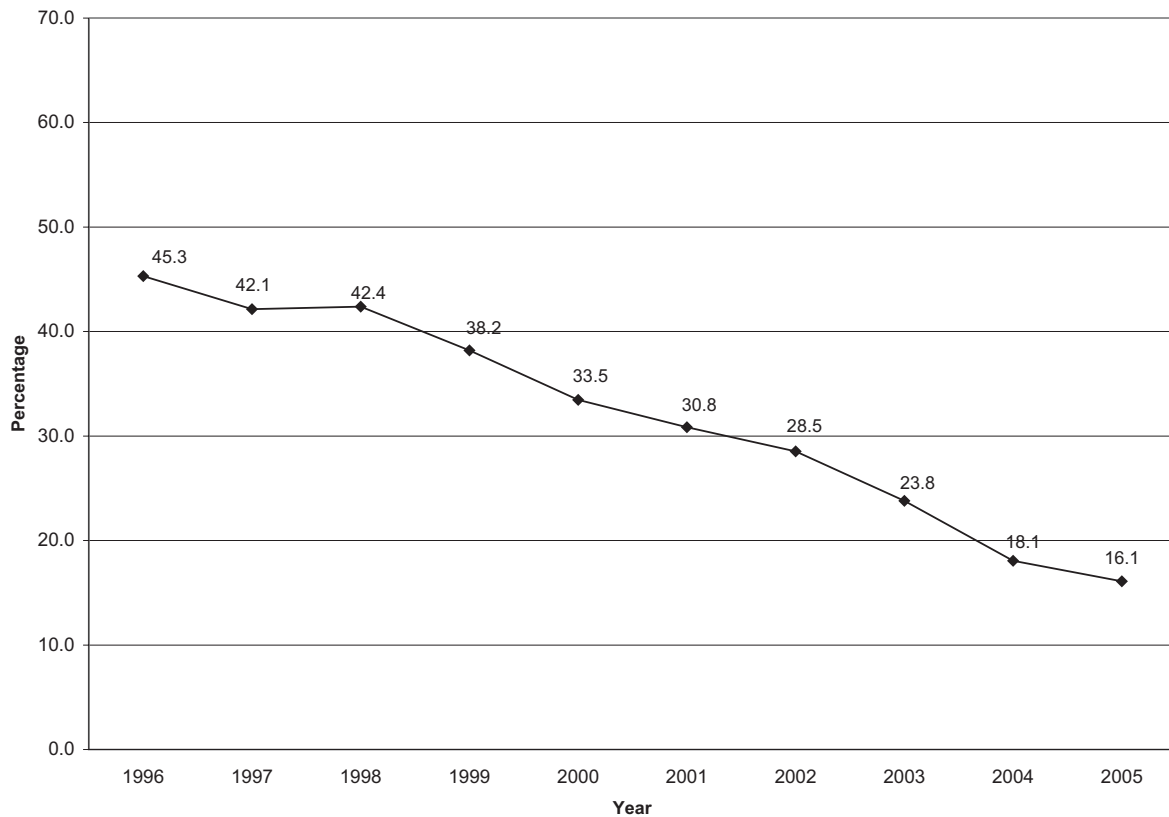
As Figure 7 indicates, over the past ten years, Federal revenues ranged from a high of 48.9% in 1998, which resulted from a one time payment of \$348 million related to the Labrador ferry service transfer, to a low of 33.8% in 2005. The lower the percentage of Federal revenues as a percentage of total revenues, the less potential impact, i.e. vulnerability the Province has to change in these revenues.

Figure 8 compares the Province's foreign currency debt to the Province's total debt, and indicates the degree of vulnerability which the Province has to currency swings.

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

Figure 8

**Consolidated Summary Financial Statements**  
**Foreign Currency Debt as a Percentage**  
**of Total Debt (Net of Sinking Funds)**  
**Years Ended 31 March**



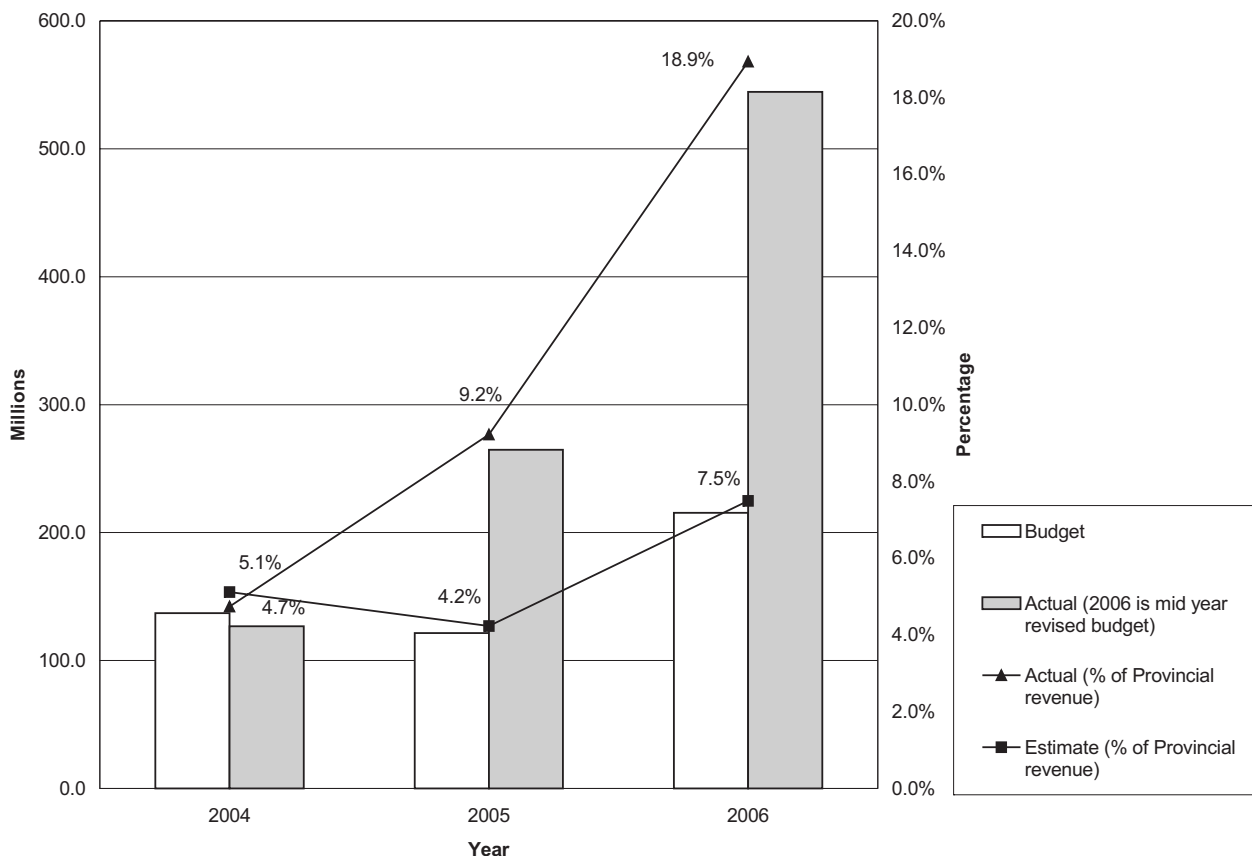
As Figure 8 indicates, over the last ten years, foreign currency debt as a percentage of total debt has been steadily decreasing from a high of 45.3% in 1996 to a low of 16.1% in 2005. As at 31 March 2005 the Province had \$1.1 billion in net foreign debt (net of sinking funds of \$290 million) and as a result is still vulnerable to currency swings. For example, an increase/decrease of one cent in the foreign exchange rates at 31 March 2005 would result in an increase/decrease in foreign borrowings of \$11.5 million.

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

There is an increasing reliance on oil revenues as evidenced by the increasing oil revenues as a percentage of provincial revenues. Oil prices are highly volatile and, therefore, changes in these prices can result in significant differences between budget forecasts and actual. As a result, Government's financial position can be significantly influenced by changes in world oil prices. Figure 9 outlines the oil revenues as a percentage of provincial revenues and shows the significant differences between the budget forecasts and actual revenues attributable to changes in oil prices.

**Figure 9**

### Oil Revenues: Budget, Actual and Percentage of Provincial Revenues Year Ended 31 March



As Figure 9 shows, oil revenues are expected to account for nearly 20% of Provincial revenues in 2006, an increase of 400% from the 5% recorded in 2004.