Newfoundland Labrador





Securing the Future

A 10-Year Sustainability Plan for Newfoundland and Labrador

SECURING THE FUTURE
A 10-YEAR SUSTAINABILITY PLAN FOR NEWFOUNDLAND AND LABRADOR

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Newfoundland Labrador

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A PLAN TO ENSURE A SUSTAINABLE FUTURE FOR NEWFOUNDLAND AND LABRADOR

OVERVIEW

The province of Newfoundland and Labrador has enjoyed a period of sustained economic growth over the past nine years.

While the fundamental drivers of economic growth in the Newfoundland and Labrador economy are expected to continue, revenue to the public treasury is largely dependent on the oil and gas sector; a non-renewable resource characterized by variability and volatility in terms of price and production.

The revenue generated from the oil and gas sector has enabled the Provincial Government to invest in programs and services and necessary infrastructure. While government expenditures have mirrored the growth in revenues, these investments were necessitated by the deficiencies in social and physical infrastructure resulting from years of minimal investment in the years preceding our government taking office.

Our government has managed this resource revenue responsibly by balancing investment with debt reduction – an investment which will contribute to future financial stability and secure our future investments in social programming. Our sound financial management has been recognized by the bond rating agencies which determine the province's credit rating.[1] It is our government's goal to return to surplus in three years and to reduce net debt per capita to the all-province average within 10 years, while providing priority services, especially in health and education.

Through this plan our government will focus on the following key areas:

1) Eliminate deficits, return to a surplus budget in 2015-16 and maintain a strong fiscal position.
2) Health Care Operational Review
3) Post-Secondary Education Review
4) Pension and Post Retirement Liabilities Reform
5) Debt Reduction

1 DBRS Rating Report, August 10, 2012, pp. 2-3; Standard and Poor's Rating Report, November 29, 2012, p. 3 and p. 9

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6) Public Service Salaries and Benefits
7) Spend Analysis/Procurement Reform
8) Priority Setting/Strategic Infrastructure Practices
9) Equity Investments, Economic Diversification and Innovation
10) Competitive Tax Environment
11) Sustainable Expenditures
12) Consult with Municipalities and Local Government

WHERE WE HAVE BEEN

In 2004, when our administration took office, we inherited a structural deficit and a province that was almost $12 billion in debt. In the last 10 years we have invested wisely to rebuild the province, to reinvest in social programs and pay down debt. It is a balanced approach that is working and paying large dividends for the people of Newfoundland and Labrador. We have delivered improved services to the people of the province. We have become more efficient and we have learned that increased efficiencies allow for more money to be invested in crucial services.

INVESTMENTS IN HEALTH CARE AND EDUCATION

We have invested significantly in bringing health care services closer to the people in rural communities. From fiscal 2000 to 2012 our health care budget grew by 142%, from $1.2 billion to $2.9 billion in 2012, currently accounting for 38.7% of provincial spending.

We have also invested significantly in education and in our students. Since 2000 spending in education has increased by 71%, from $700 million to $1.2 billion. Also, Memorial University's budget grew from $128 million to $364 million in 2012-13, while tuition remains the lowest in the country.

Figure 1: Canadian Post-Secondary Tuition Fees (2012-13)

	College	University – Undergraduate (1)	University - Graduate
CDN Avg.	$2,824	$5,581	$5,695
NL	1,452	2,649	2,456
PE	3,500	5,470	4,100
NS	2,865	5,934	7,613
NB	3,000	5,917	5,449
QC	0	2,774	2,969
ON	2,533	7,180	8,041
MB	1,775	3,729	4,292
SK	3,780	6,017	3,656
AB	3,700	5,883	4,746
BC	2,809	5,015	7,593

(1) Undergraduate: represents the average undergraduate tuition including the medical program which has a higher fee
Source: Statistics Canada, The Daily, September 12, 2012

INVESTMENTS IN INFRASTRUCTURE

In 2003-04, approximately $154 million was invested in infrastructure. This investment in infrastructure had increased to $744 million in 2012-13, an increase of 383%. In 2003-04, our government inherited a significant infrastructure deficit. There was a significant deterioration in physical infrastructure including schools, health care facilities, roads, municipal infrastructure, and ferries. Our government developed a plan and allocated resources and began to address these infrastructure needs. Such investment was needed to build infrastructure and to allow for economic development and future growth.

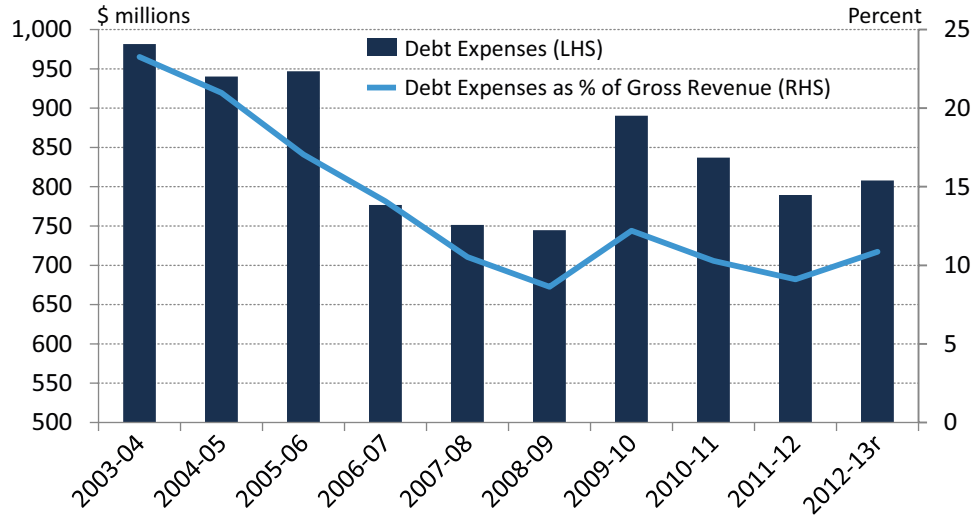
In particular, our government commenced a program to replace older facilities. In 2003-04, Newfoundland and Labrador spent a total of $78 million on construction or acquisition of new buildings, roads and equipment compared to $509 million for 2012-13. Spending on maintenance on schools, health care facilities and other government buildings, increased from $11 million in 2003-04 to $117 million in 2012-13. Investments in municipal infrastructure increased from $37 million in 2003-04 to $102 million in 2012-13. Since 2003-04, cumulative investments in infrastructure have exceeded $5.1 billion. Since 2003-04 government has spent $968 million on municipal infrastructure and approximately $195 million in municipal operating grants.

DEBT REDUCTION

By reducing net debt we have saved money to spend on services. Our government has reduced net debt by 28%, from a high of $11.9 billion in 2004-05 to $8.6 billion in 2012-13. In 2003-04, 23 cents of every dollar was used to pay debt servicing expenses, compared to 10.9 cents in 2012-13. Despite this progress, the annual cost of servicing

the debt is approximately $800 million and therefore, we must continue to reduce net debt. This is money that can be used for health, education and other social spending. For this reason, we made a commitment in Budget 2012 to reduce the province's net debt per capita to the all-province average over a 10-year period.

Figure 2: Debt Expenses and Debt Expenses as a % of Gross Revenue



Source: NL Department of Finance

INVESTMENT IN LABRADOR

Since 2004-05, we have spent over $4 billion in Labrador through the Northern Strategic Plan and other Labrador-related investments, including an unprecedented investment of approximately $384 million to build the Trans Labrador Highway. Since 2004, we have made significant investments in Labrador in infrastructure, health care, education and many other key areas that have benefited people, organizations and businesses. This region is helping to shape our province's future and through continued strategic investments, our government is laying a solid foundation for further success.

SPENDING ON SOCIAL PROGRAMS

Our government is also very proud of our support for, and spending on, social programs. The following are examples of progressive social investments by our government:

- An annual investment of $149 million in 2013-14 in the Poverty Reduction Strategy (PRS). Some examples of PRS initiatives include expansion of the Newfoundland and Labrador Prescription Drug Program to include low-income residents, creation of the Supportive Living Community Partnership Program to help community-based organizations address homelessness and introduction of the Job Start Benefit Program to assist people leaving Income Support for work;

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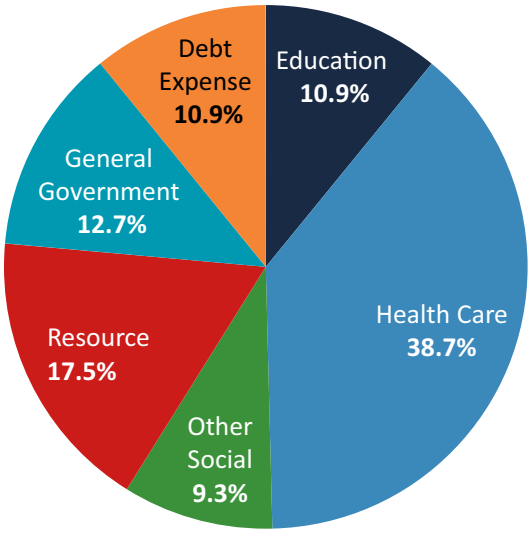
- Another $466 million in 2013-14 to support the delivery of post-secondary education throughout the province, including a continued tuition freeze for all students at Memorial University and the College of the North Atlantic, ensuring that Newfoundland and Labrador continues to have the lowest tuition rates in the country; and
- Over $1 billion in 2013-14 to support children and families. This includes $840.6 million to support education in the province, and an overall investment of $172.5 million through the Department of Child, Youth and Family Services.

As Figure 3 demonstrates, as of 2012-13 revised, 58.9% of our revenues are invested in the social sector.

Figure 3: Where the Expenses Go (2012-13 Revised)



Social Sector accounts for **58.9%**

Source: NL Department of Finance

TAX REDUCTIONS

Since 2007, our government has decreased taxes by over $500 million. This has created a competitive tax regime and allowed for more money to go into the pockets of Newfoundlanders and Labradorians and to help reduce costs for every household in our province:

Figure 4: Tax Reductions ($ millions)

Personal Income Tax	$403.0
Low Income Seniors Benefit	21.0
Retail Sales Tax on Insurance	75.0
HST-Residential Energy Rebate	38.0
Corporate Income Tax	6.0
Payroll Tax	9.0
Total	**$552.0**

Source: NL Department of Finance

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Other notable enhancements include the Home Heating Rebate Program ($15 million annually) and the non-refundable tax credits for child care and volunteer firefighters.

WHERE WE ARE

Newfoundland and Labrador weathered the 2009 economic recession better than most jurisdictions. The strength in the economy, our financial stability and our strategic investments in infrastructure enabled us to stand strong against the economic turmoil that gripped the globe. It was the right course of action at that time. However, governments must not remain static but must be responsive to the times and adjust to changing circumstances. Our government must maintain fiscal prudence,[2] as our per capita expenses are approximately 50% higher than the average of all other provinces.[3] The Auditor General suggests that this level of spending is not sustainable, even taking into account the cost of providing services to a relatively small population over a large geographical area.

However, current fiscal problems are not restricted to our province or other provinces in Canada. While the global economic situation is slowly improving, there are still challenges yet to overcome. Europe has taken action to contain its debt crisis and economic growth in China in 2013 appears to be gaining steam with significant infrastructure spending and a recovery in exports. U.S. economic indicators are showing promise for 2013. However, unemployment in some countries is still high, as can be seen from 2012 unemployment rates in the U.S. (8.1%), Greece (24.4%) and Spain (25.1%).

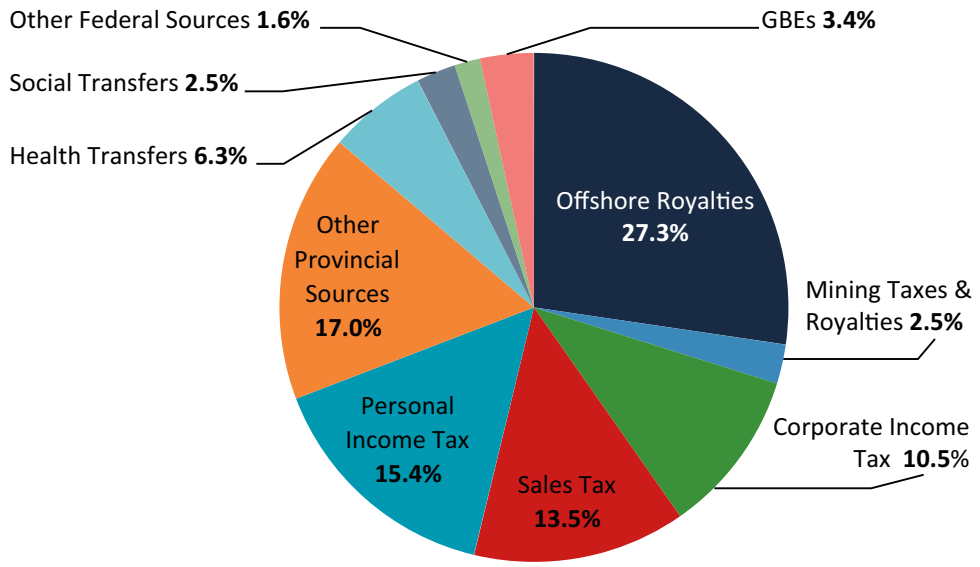
"HAVE" PROVINCE

In 2003-04, provincial revenues totalled $3.9 billion. Of this amount, approximately 36% came from the Federal Government in the form of equalization, Atlantic Accord offset payments and other transfers for health and social programs. By 2012-13, total revenue has climbed to $7.0 billion, an 80% increase in just nine years and we no longer receive any equalization payments. Our province currently receives only 10.4% of our revenues from the Federal Government.

2 Moody's Credit Analysis, October 18, 2012, p. 3

3 Report of the Auditor General on the Audit of the Financial Statements of the Province of Newfoundland and Labrador For the Year Ended March 31, 2012, p. 64

Figure 5: Where the Revenue Comes From (2012-13 Revised)



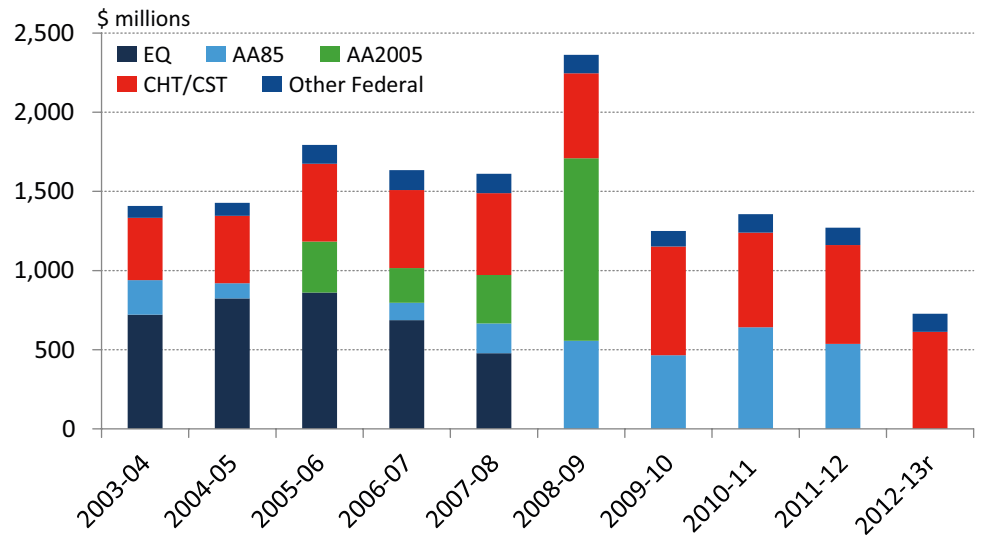
Source: NL Department of Finance Budget 2013 (Statement I and Exhibit I)

Offshore royalties are a significant component of our provincial revenues, with 27.3% of our revenues coming from such royalties in 2012-13.

It is also significant to note that in 2012-13, only 15.4% of government revenues came from personal income tax, and 18.5% of the taxpayers in our province paid 69% of personal income taxes. This means that many low- and middle-income earners in our province have benefited from lower taxes, thereby increasing their disposable income.

More significantly, revenue received from the Federal Government has decreased to $727 million. Equalization transfers from the Federal Government were a mainstay of the provincial treasury since the program was implemented in 1957. A defining moment in the history of Newfoundland and Labrador, and a clear sign of our economic transition on the national scene, was in 2008-09 when we ceased to qualify for equalization and became a “have” province.

Figure 6: Federal Fiscal Revenue by Source



Source: NL Department of Finance

However, being a "have" province does not mean we are rich. It simply means we can pay our own way and make independent choices about our collective priorities. In 2013, Newfoundland and Labrador is one of only four Canadian provinces which do not receive equalization payments (the other three provinces are British Columbia, Alberta and Saskatchewan). Our province is very proud of paying our own way and standing tall on the national stage but there is more work to do. We must recognize the responsibility it places on us to manage our economic and fiscal future.

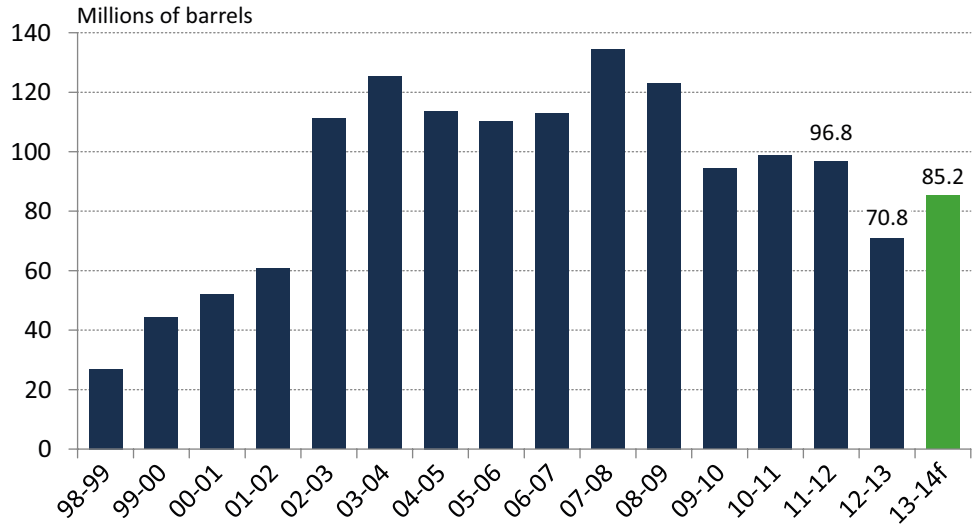
While our government had reduced new spending growth over the last number of years (2.2% in fiscal 2012 and 1.5% projected in Budget 2013), our revenues currently do not match our expenditures. The following are factors that have contributed to the projected deficits:

- Since 2007, our government has decreased taxes by over $500 million annually.
- Equalization ended in 2008-09. In 2004-05, 22.1% of our province's revenue came from equalization, today we receive nothing.
- Atlantic Accord payments ended in 2011-12, when the province received its last payment of $536 million.
- A 28.9% increase in public service wages since 2006-07 added approximately $500 million to our expenditures annually.
- Oil production decreased from 96.8 million barrels per year in 2011 to 70.8 million barrels in 2012, a decrease of 26.9%.

Very significantly, our non-renewable resources, once extracted, are gone forever. While there has been expansion in existing oil fields and the promise of future growth from exploration activity, oil production is in decline. Over the long term, revenues from these sources will diminish and the province will need to rely on other sources of

revenue such as renewable resources and a diversified economic base. The Provincial Government plans to reduce the province's economic dependence on the oil and gas sector and diversify the economy as outlined in the Energy Plan. This is one of the reasons why the Muskrat Falls hydro development project is so important.

Figure 7: Total Newfoundland and Labrador Offshore Oil Production



Note: Fiscal Years
Source: Canada-Newfoundland and Labrador Offshore Petroleum Board; Dept. of Finance

PROGRAM EXPENSES

Prior to 2003, there was insufficient investment to meet public demands for enhanced programs and services and infrastructure improvements. As a result, the 82% growth in provincial revenues since 2003-04 was used to fund an increase in program expenses of 75%, growing from $3.8 billion in 2003-04 to $6.6 billion in 2012-13. This growth rate is high relative to an increase in CPI of 20.4% over that same period. Growth in public expenditure has far exceeded the general level of inflation that has occurred in Newfoundland and Labrador during this period. This was deliberate and necessary to lay the foundation for future growth and the development of our province.

While growth in program expenses has returned to more moderate levels in recent years, ultimately spending levels must be aligned with long-term revenue expectations. In particular, the province must ensure that investments are strategic, balanced and sustainable.

PROJECTED DEFICITS FOR 2013-2015

Today we are facing fiscal challenges with projected deficits, as are many other provinces. As can be seen from Figure 8, for the 2012-13 fiscal year all provinces were projecting a deficit, with the exception of Saskatchewan.

Figure 8: Federal / Provincial Fiscal Positions

Province	2012/13 Budget Balance ($ millions)		
	Budget	Latest Update	
	2012	Level	Change
NL	-258	-726	-468
PE	-75	-80	-5
NS	-211	-249	-38
NB	-183	-357	-174
QC	-1,500	-3,305	-1,805
ON	-14,820	-11,859	2,961
MB	-460	-567	-107
SK	95	56	-39
AB	-886	-3,000	-2,114
BC	-968	-1,469	-501
All Provinces	-19,266	-21,555	-2,289
Federal	-21,100	-26,000	-4,900

Source: Wait Until Next Year, CIBC Presentation, January 2013, p. 27.

Budget 2012 projected a $258.4 million deficit for Newfoundland and Labrador. This projected deficit was revised at mid-year to $725.8 million.

The deficit projections prior to this budget based on mid-year assumptions for 2013-14 and 2014-15 were $1.6 billion and $1.5 billion respectively. In Budget 2013, our government updated the earlier projections (the 2013-2015 numbers are based on a price of $105US for Brent):

2012-13	Deficit will be $430.9 million
2013-14	Deficit projected to be $563.8 million
2014-15	Deficit projected to be $650.5 million
2015-16	Surplus projected to be $230.4 million

In summary, our government has invested wisely to rebuild our province. The current economy is booming as a result of these investments. However, the reality is that our revenues currently do not equal our expenditures. As good economic stewards, we have to take steps to bring our expenditures back in line with our revenues so that we have an expenditure base that is sustainable in the future.

CURRENT ECONOMIC SITUATION

Building on the strength of the economy in recent years, the province is expected to experience growth again in 2013, with increased exports, investment and consumption more than offsetting a reduction in government spending. The following are projections for 2013:

- Employment growth of 2.8%. Average employment in the province was 230,500 in 2012, representing an increase of 18,700 or 8.8% since 2003. More people are working than at any other time in the province's history;
- The unemployment rate is expected to decrease by 1 percentage point. Since 2003, the unemployment rate has declined by 3.9 percentage points and 18,700 person years of employment have been created;
- Personal income growth of 7.3%. From 2003 to 2012, personal income increased by 61.3%;
- Disposable income growth of 7.1%. From 2003 to 2012, disposable income increased by 63.7%;
- Retail sales growth of 4.2%. From 2003 to 2012, retail sales increased by 43.0%;
- Capital investment growth of 17.4% to $11.8 billion in 2013. From 2003 to 2012, investment increased by 170.4%;
- Mineral shipments to increase by about 23% to $4.7 billion. From 2003 to 2012, mineral shipments increased by 393.6%; and
- An increase in total overnight tourist visits by about 1.4%.

However, having a strong economy and balancing a budget are separate things. While our provincial economy is strong, our government's revenues are not high enough to sustain our increased expenditure levels. In other words, we are not living within our means. We have to reduce spending to bring it in line with the money we take in. This is not unlike the situation faced by the Alberta government.

While economic prosperity is expected to continue over the forecast period, we must be cognizant that this growth will continue to be subject to volatility from the resource sector and global economic uncertainties. Economic growth does not shield the province from the fiscal challenges that are projected over the medium to long term.

WHERE WE ARE GOING

10-YEAR SUSTAINABILITY PLAN

Fundamental to achieving long-term fiscal sustainability, our government has committed to reducing net debt per capita to the all-province average within 10 years. This 10-year plan will have distinct themes:

Year 1 (Budget 2013)	Deficit Reduction Process
Year 2 (Budget 2014)	Reviews of Memorial University and College of the North Atlantic, Regional Health Authorities (RHAs) and Unfunded Pension Liabilities
Year 3 (Budget 2015)	Return to Surplus
Years 4 to 10	Continued Focus on Innovation, Economic Diversification and Debt Reduction

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In order to achieve the targeted net debt per capita, fiscal discipline is required to moderate expense growth and infrastructure spending with an overall goal of generating surpluses sufficient to support strategic capital investment in health care facilities, schools and roads while simultaneously reducing net debt. Debt expenses as a percentage of revenue have improved significantly since 2003-04. However, this may not last because, as the economy begins to grow, interest rates are expected to rise, costing much more in interest costs and limiting capacity to invest in programs and infrastructure.

Although per capita debt levels have also decreased, they still remain the third highest in the country. The all-province net debt per capita target measures our performance against other jurisdictions and is considered an objective and reasonable fiscal goal for the province. The lower the debt, the less we pay in interest.

Bond rating agencies, the Auditor General and leading economists all stress the importance of having a plan, and our plan responds.

Our government has committed to a decision-making framework over a 10-year time horizon which focuses on achieving a debt target that is reasonable and sustainable. Inevitably, a long-term view involves looking forward based on a current set of assumptions. As circumstances change, the plan will be amended as necessary.

In order to provide the capacity to invest in new, priority programs and services, government will have to promote efficiency and innovation to create capacity from the existing expenditure base. This will involve a continuing evaluation of existing programs and services to ensure alignment with government's priorities to ensure that they are being delivered in the most efficient and effective manner, and that we seek out innovative approaches to deliver core programs. This process was launched in Budget 2012 and was the foundation of the efficient program delivery exercise that has reduced base expenses in Budget 2013 by $410 million.

The 10-year plan will incorporate a near-term focus for the next three years. This near-term focus will establish a fiscal framework that eliminates the deficit and returns to a balanced budget. The balance of the Sustainability Plan will focus on maintaining the fiscal discipline that is required to ensure the principles and actions that underlie the plan are not eroded and that the fiscal balance will be protected over the long term. The plan promotes fiscal policies that promote economic and fiscal stability for future generations and promotes the efficient and effective delivery of programs and services.

FISCAL CHALLENGES

The strength in the Newfoundland and Labrador economy facilitates our ability to deal with the economic and fiscal realities to which the province will be exposed.

Despite expansion in the oil and gas sector associated with Hibernia South and White Rose, as well as the expected commencement of production at Hebron in 2017, current estimated oil reserves are not expected to fully replace production from existing fields that are in natural decline. Increased exploration to take advantage of the highly prospective geology of the Newfoundland and Labrador offshore area remains a priority.

REVENUE FORECASTING

Oil revenues account for approximately one-third of the province's revenue. Every $1 change in the price of a barrel of oil has a $26 million impact on revenue. Similarly, a one cent change in the exchange rate impacts revenue by $27 million.

There are a number of factors which contribute to the determination of the oil price used in the budget process. These factors include geopolitical factors, the fundamental principles of supply and demand and the impact of global economic conditions. There is significant volatility, uncertainty and risk in making short-term predictions.[4]

Given the province's reliance on oil revenues, the price used for budget planning must be conservative and incorporate the views of a number of forecasters as they relate to the factors noted above. In its near-term budget for the next three years, the province has assumed a price of $105US per barrel. This price is based on data analysis of various oil forecasters and extensive consultations with PIRA, various financial institutions, and economists. Dr. Wade Locke, a leading economist at Memorial University, was retained by government as a Senior Economic Advisor and provided advice on revenue forecasting methodology.

Figure 9: Oil Price Forecasts[5]

Year	Sproule	GLJ	EIA	Average	Locke	Budget 2013
2013/14	$106.41	$104.38	$107.19	$107.98	$107.40	$105.00
2014/15	$101.14	$102.50	$101.12	$104.55	$102.90	$105.00
2015/16	$99.63	$102.50	$102.91	$105.08	$103.30	$105.00
2016/17	$104.91	$101.88	$105.96	$107.01	$105.80	$107.01
2017/18	$107.05	$100.00	$109.90	$108.57	$107.30	$108.57
2018/19	$108.66	$100.34	$114.05	$109.97	-	$109.97
2019/20	$110.28	$101.86	$118.36	$112.49	-	$112.49
2020/21	$111.94	$103.90	$122.92	$115.39	-	$115.39
2021/22	$113.62	$105.98	$127.76	$118.90	-	$118.90
2022/23	$115.32	$108.09	$132.86	$122.53	-	$122.53

Source: NL Department of Finance

OIL PRODUCTION

The Provincial Government's source for production data from the producing oil fields is the Canada-Newfoundland and Labrador Offshore Petroleum Board (CNLOPB). One of the more challenging aspects of projecting revenue is the inability to obtain timely

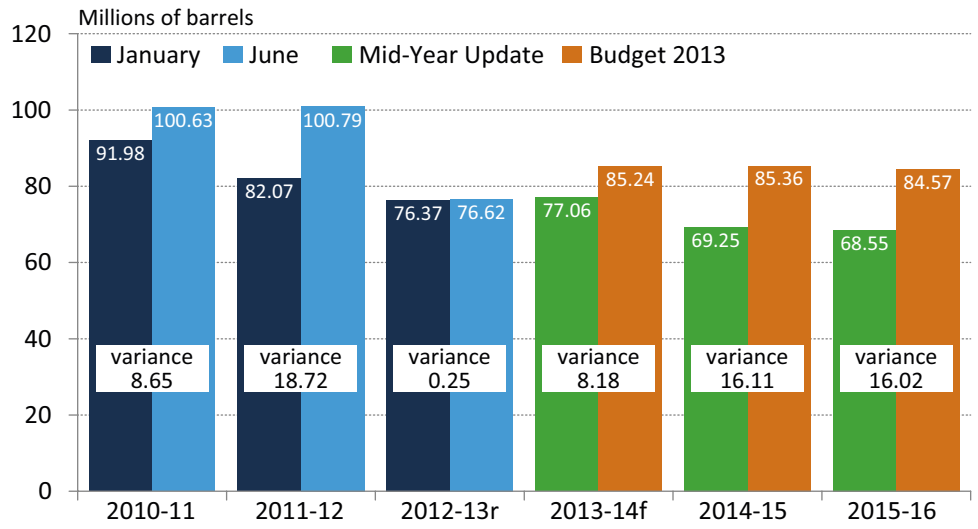
4 Reports prepared by PIRA, an international energy consulting company dated February 28, 2012 and October 26, 2012 and prepared for the province during the Muskrat Falls debate.

5 Average includes PIRA and Consensus

and precise production data. The Provincial Government is dependent on the CNLOPB to provide the production information as they are the only independent source for this information. The Auditor General noted on page 37 of his 2012 Report:

> "World oil prices are highly volatile and production levels related to non-renewable resources can vary significantly. Therefore, changes in these factors can result in significant changes in revenue from year to year and differences between budget forecasts and actual results. As a result, Government's financial position can be significantly impacted by factors which are outside of its control."

Figure 10: CNLOPB Offshore Production Forecasts



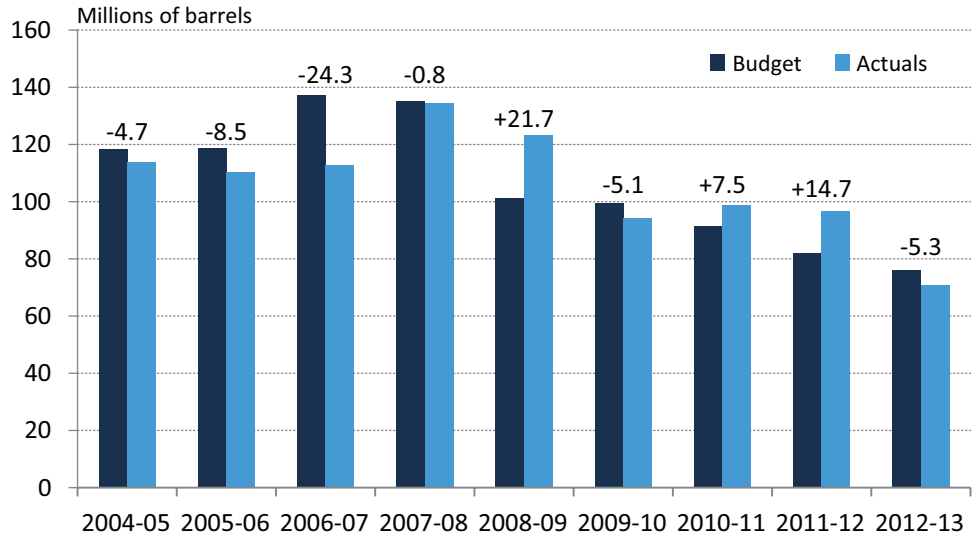
Source: CNLOPB

In January and June of each year, the CNLOPB provides the province with production data. As noted in Figure 10, there is a significant amount of variability in these forecasts, even within a six-month period. As the figure shows for the 2011-12 fiscal year, production changed from January to June in that year by 18.72 million barrels of oil. Note also for the forecast period, 2013-14 to 2015-16, production forecasts used for the 2012-13 mid-year update varied by approximately 40 million barrels when compared to the revised data provided during Budget 2013 for that period. This production change represents close to $1 billion in revenue for the province.

While this variability is beyond the control of the province, we are committed to working with the CNLOPB to strengthen the forecasting process and to align the timing of updates with the province's forecasting process.

The variability demonstrated in Figure 10 has resulted in significant variances in the production volumes used for the annual budget compared with actual production volumes, as outlined in Figure 11.

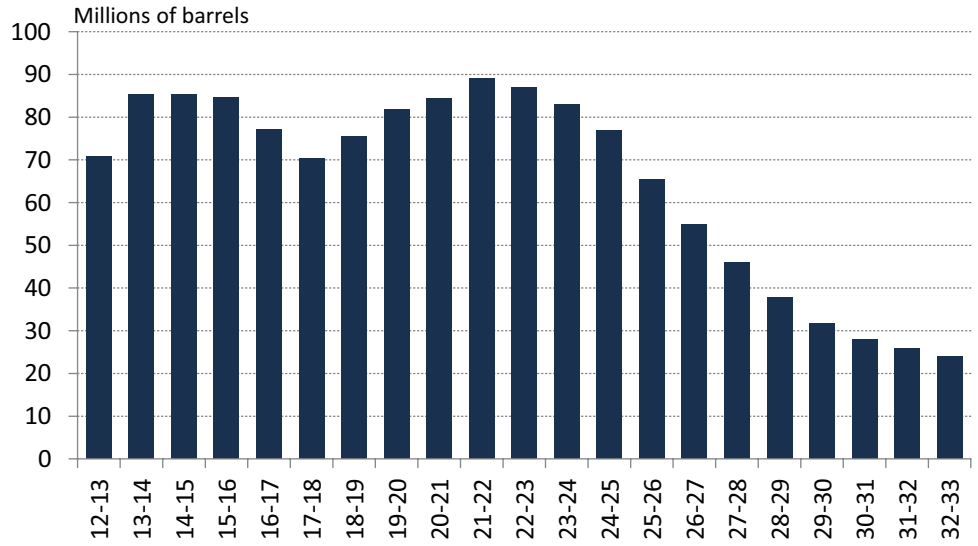
Figure 11: Total Offshore Oil Production (Budget Forecast vs. Actual)



Note: Difference from Budget Forecast vs. Actuals reported above columns
Source: NL Department of Finance

While there is variability in production forecasts, it is evident that oil production is declining as outlined below. The projected decline in production over the next 20 years supports the requirement for a plan to manage expenditures and to diversify the economy from a non-renewable to a renewable resource-based economy, while still focusing and investing in industries such as tourism and the fishery.

Figure 12: Offshore Oil Production



Source: CNLOPB and NL Department of Finance

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Earlier this year, based on mid-year data, deficits in excess of $1.6 billion and $1.5 billion were forecasted for each of the next two years. The information below illustrates the changes that have contributed to the improved financial position of the province since mid-year. For example, the improvement in 2013-14 is the result of the combined impact of revenue improvements (66%) and cost reductions (34%).

Figure 13: Revenue/Expense Changes since Mid-Year ($ Millions)

	2012-13	2013-14	2014-15
Mid-Year Deficit	(725.8)	(1623.3)	(1523.7)
Change in Revenues			
Offshore Royalties	97.4	265.5	283.1
Mining Tax	(14.5)	148.4	33.5
Personal Income Tax	35.9	21.0	0.8
Sales Tax	113.1	152.6	113.8
Corporate Income Tax	45.7	41.1	(11.7)
Other	-	67.2	37.0
Revenues Increase	277.6	695.8	456.5
Change in Expenses			
Program Expenses	(7.3)	(301.4)	(316.0)
Debt Servicing Expense	(10.0)	(62.3)	(100.7)
Expenses Decrease	(17.3)	(363.7)	(416.7)
Revised Deficit	(430.9)	(563.8)	(650.5)

Source: NL Department of Finance

The 2013-14 projected deficit of $1.6 billion has been reduced to $563.8 million as a result of the following:

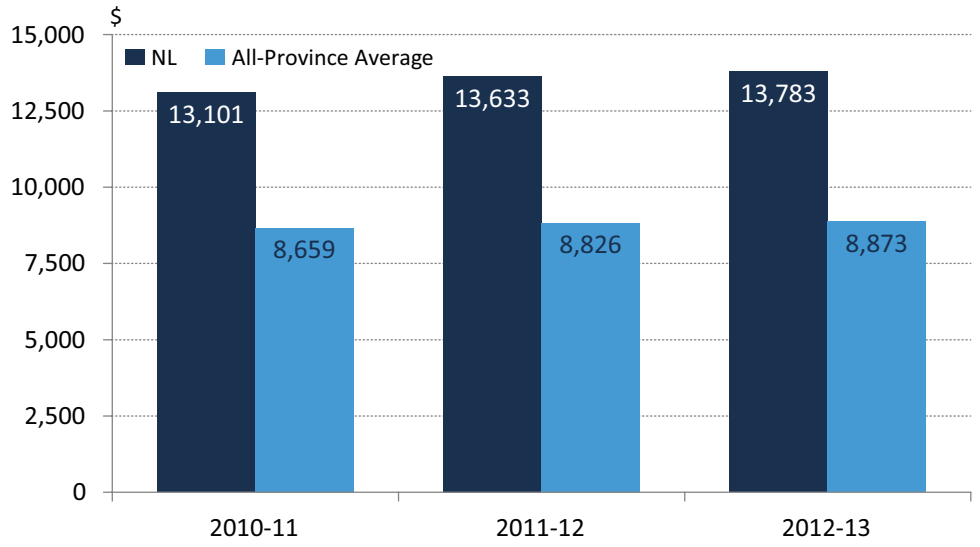
- Oil royalties are projected to increase by $265.5 million primarily due to an expected increase in production of approximately eight million barrels;
- HST revenues are projected to increase by $152.6 million as a result of a change in the methodology used by the Federal Government to allocate HST revenues to the province;
- Mining tax is projected to increase by $148.4 million;
- Revenue from Personal Income Tax, Corporate Income Tax and other revenue is projected to increase by $129.3 million; and
- The decrease in the projected deficit is also a result of reduction in net expenditures of $301.4 million. This includes $410 million resulting from the core mandate review, offset by increased expenses associated with new or expanded programs, and costs associated with workforce adjustments.

The fact that such variability could materialize in a matter of months illustrates the need for a Sustainability Plan that strengthens the fiscal position of the province to address this variability when it occurs. This variability also demonstrates that there is uncertainty inherent in the longer term assumptions that underlay any plan. Despite this variability, the plan provides a road map for decision making and a recognition that the plan must be responsive to changes in circumstances.

HEALTH CARE EXPENSES

While government is projecting a return to surplus in 2015-16, it remains necessary to focus on reducing expenses to a sustainable level over the long term. On a per capita spending basis, Newfoundland and Labrador's gross program expenses are above the Canadian average by $4,910.

Figure 14: Per Capita Gross Program Expenses 2010-11 to 2012-13



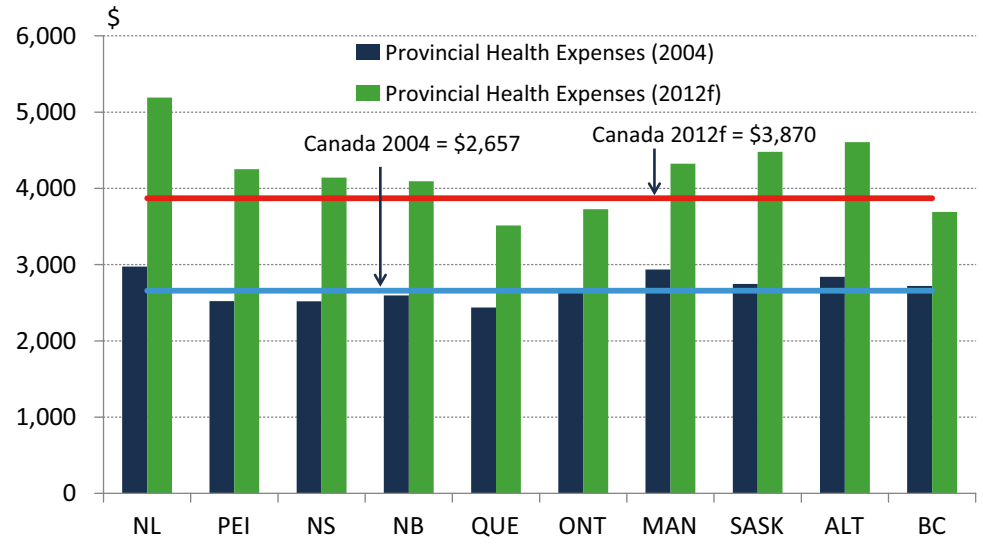
Source: Finance Canada

One of the expense categories that is contributing to the program expense gap is health care expenses. There are significant sustainability challenges facing the province's health care system. Spending on health care increased from $1.2 billion in fiscal 2000 to $2.9 billion in 2012-13. Of the total $2.9 billion public sector health care budget, 69% supports the Regional Health Authorities.

Health services in the province are currently delivered through 15 hospitals and rehabilitation centres, the Provincial Cancer Care Centre, 22 community health centres, 114 community clinics and 20 long-term care facilities. Also, there are 33 emergency departments which are open 24/7 in Newfoundland and Labrador, 82% of residents have access to an emergency department within a 30-minute drive and 98% of residents have access to a community clinic within a 30-minute drive. There are significant costs associated with this level of access to health care. Provincial per capita

expenses are $5,190 per person compared with the all-Canadian average of $3,870. Despite ranking high in comparison to other provinces, there are still significant challenges with the delivery of health care services.

Figure 15: Per Capita Provincial Government Sector Health Expenditure 2004 vs. 2012f



Source: CIHI 2012 Table B.4.2

Notwithstanding the necessity to moderate expenditure growth, there will be pressures on programs and services, most notably from the change in provincial demographics and an aging population. Considering the aging population and the potential for growth in health care expenses if historical trends continue, the ability to moderate health care expenses presents a significant sustainability challenge for government. Despite these challenges, government is committed to maintaining quality health care services.

PENSIONS AND POST RETIREMENT LIABILITIES

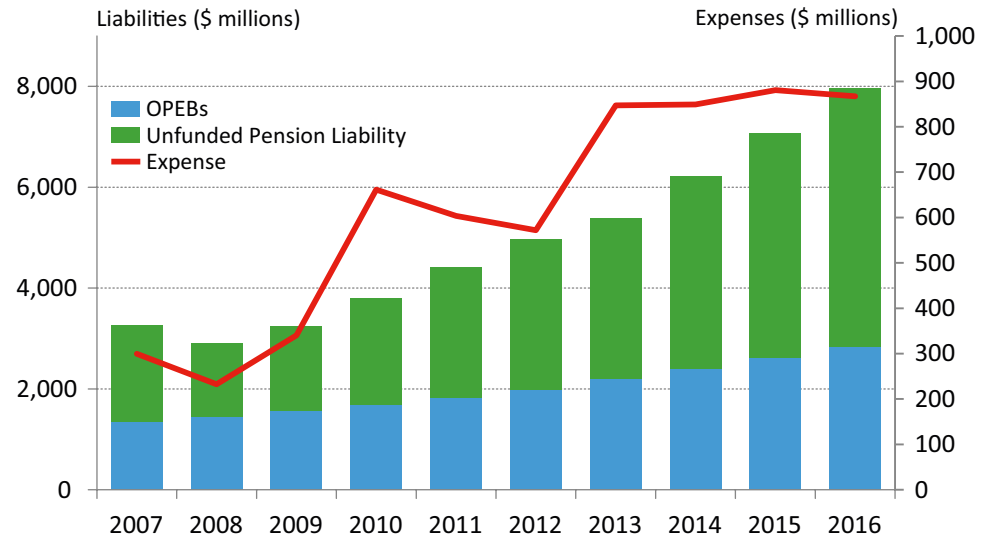
Government sponsors five defined benefit pension plans for core government and its agencies, Public Service Pension Plan (PSPP), Teachers' Pension Plan (TPP), Uniformed Services Pension Plan (USPP), Members of the House of Assembly (MHA), and Provincial Court Judges (PCJ). As of March 31, 2012, liabilities for these plans totalled $9.4 billion, offset by assets of $6.4 billion, resulting in an unfunded liability of $3.0 billion which is a significant component of net debt.

Government also sponsors a group insurance plan with a commitment to fund the plan 50-50% from the date of retirement to death. The current unfunded liability associated with this post retirement benefit is approximately $2.0 billion, for a total of $5 billion for pensions and group insurance benefits. This is 64% of the provincial net debt of $7.8 billion at March 31, 2012. Based on revised actuarial assumptions, this

unfunded pension liability grows to $3.3 billion in 2012-13. Improved life expectancy assumptions are expected to have a significant impact on the liability when the next valuation is completed.

As noted by the Auditor General, the unfunded pension liability continues to increase, despite the $3.3 billion in special payments contributed to the pension plan since 2006, and the total pension obligation is currently greater than it was on March 31, 2005.[6] The growth in the unfunded pension and post retirement liabilities is not sustainable and a long-term solution must be found. This focus is necessary to secure and protect the pensions of the members of the public service.

Figure 16: Growth in Total Retirement Liabilities and Expenses (As at March 31)



Source: NL Department of Finance

In addition to the increasing unfunded liabilities, government's annual pension expense and post retirement expense will continue to increase unless measures are taken to address the issue. Annual pension and post retirement expense approximates $900 million annually.

In his 2011 report, the Auditor General noted that the unfunded pension liability is a significant portion of the province's net debt and if no corrective action is taken, the Teacher's Pension Plan (TPP) will be 21% funded by 2029 and the PSPP will be 48% funded in 2029.[7]

6 Report of the Auditor General on the Audit of the Financial Statements of the Province of Newfoundland and Labrador For the Year Ended March 31, 2012, p. 51

7 Report of the Auditor General on the Audit of the Financial Statements of the Province of Newfoundland and Labrador For the Year Ended March 31, 2011, p. 483

CORE MANDATE REVIEW

The core mandate review that was initiated by government in Budget 2012 resulted in a reduction in base expenses of $410 million. The extensive review and analysis completed over the past year by departments and agencies identified further opportunities for efficiencies and expense reduction that will form part of the ongoing process to achieve a sustainable level of expenses.

FOCUS AREAS FOR SUSTAINABILITY PLAN

The key focus areas for our government to ensure a solid fiscal foundation for the province are outlined below. Achieving the goal of a balanced budget is the first step. A continued culture of sound fiscal management is required to maintain the progress over the long-term.

1) **Eliminate deficits, return to a surplus budget in 2015-16 and maintain a strong fiscal position.**

2) **Health Care Operational Review**

   As noted, the health care sector presents a significant sustainability challenge for government, but with challenge comes opportunity – an opportunity to deliver services in a more cost effective and efficient manner. Building on the recent and ongoing operational improvement initiatives taking place at the Regional Health Authorities (RHAs), government has allocated up to $5 million in Budget 2013 to complete an operational review of the RHAs to identify further efficiencies in the health care system and to ensure sustainable, accessible health care into the future.

3) **Post-Secondary Education Review**

   The Provincial Government will engage with Memorial University and College of the North Atlantic to conduct a review to ensure that programs are being delivered as efficiently and cost-effectively as possible. This review will respect Memorial University's autonomy as a university.

4) **Pension and Post Retirement Liabilities Reform**

   We have initiated a review of pensions and have been working with benefit consultants to review options for reform. The review of pensions and post retirement benefits commenced in 2012-13 and will continue over the next year. This ongoing review and reform will involve the engagement of key stakeholders in the process, including the various unions, whom we will listen to and work with in protecting pensions and benefits.

   Other jurisdictions have also been reviewing and reforming their government benefit plans, some of whom have been doing so by sharing risks with members.

5) Debt Reduction

We will commit to continue to pay down direct debt as it becomes due and will aim to continue to reduce the cost of debt servicing. In 2012, we committed to pay one-third of any surplus towards the unfunded pension liability and as a result a payment of $294 million was made in 2012. We will continue to use surpluses to reduce net debt.

6) Public Service Salaries and Benefits

Salaries and benefits account for up to 55% of program expenses government-wide with certain departmental salaries and benefits comprising as much as 70% of expenses. Since 2003-04, the core public service has grown by approximately 20%. This factor, combined with the increase in wages, has resulted in significant growth in salaries and benefits. The number of public service employees per 1,000 of population is higher in Newfoundland and Labrador than all provinces except Saskatchewan and exceeding all Atlantic provinces.

Part of our plan for streamlining the size of the public service focuses on attrition management, an early retirement incentive, a hiring freeze and a comprehensive review of all positions in government. Disciplined hiring practices will be required and enforced to ensure the public service is maintained at a level that is sustainable and in line with the efficient delivery of services.

Government will also undertake a review of compensation benefits including overtime, paid leave and sick leave.

7) Spend Analysis/Procurement Reform

In 2012-13, our government initiated a spend analysis across government departments and entities. Similar analysis has been completed in other jurisdictions with success. This analysis is expected to identify cost savings opportunities. This review will incorporate continuing efforts around the management of discretionary spending and the development of strategic procurement practices across government departments and entities.

8) Priority Setting/Strategic Infrastructure Practices

Government will continue to make strategic infrastructure investments. We will continue to allocate $5 million per year to support planning for future infrastructure requirements. These funds ensure appropriate data is obtained at the beginning of the infrastructure decision making process to support the business case for the project and to appropriately plan and design infrastructure that will meet the long-term needs of government.

9) Equity Investments, Economic Diversification and Innovation

Government will continue to fund its equity investment in the Lower Churchill Project. This investment supports our long-term plan to diversify the economy and the revenue base. Muskrat Falls is a solid investment that will generate significant dividends for the province over the long term and will help fill the gap when oil revenues reach their natural declines.

Our strategic equity investments in Hebron, the White Rose satellite fields and Hibernia South support the goals of the Energy Plan and provide increased revenues for the province. Also, we will continue to invest in economic development, tourism, fishery and aquaculture and rural Newfoundland and Labrador.

10) Competitive Tax Environment

In Budget 2013 we chose not to raise personal income tax. Maintaining current levels of personal income taxes and business taxes supports a competitive tax environment.

11) Sustainable Expenditures

The implementation of the initiatives outlined above support our government's long-term goal of achieving the all-province net debt per capita and returning and maintaining expenses to a sustainable level. The savings achieved in Budget 2013 demonstrate significant progress toward this long-term goal.

12) Consult with Municipalities and Local Government

We will continue our dialogue with municipalities and local governments in relation to their delivery of services and fiscal planning.

CONCLUSION

The plan outlined above will be challenging and will change as necessary to adapt to the changing economic environment both locally and globally. Government will monitor and balance the impact on the economy of any reduction efforts.

Any plan must be accountable to its public. In light of that principle of transparency and accountability, we are committed to reporting on progress against the plan.

Newfoundland Labrador

www.gov.nl.ca/budget2013