



Australian Government
Commonwealth Grants Commission

File Ref: 2006/0034

Senator the Hon Richard Colbeck
Parliamentary Secretary to
the Minister for Finance and Administration
Parliament House
CANBERRA ACT 2600

Dear Parliamentary Secretary

As required by the Terms of Reference which you sent to the Commission on 1 May 2006, we are writing to provide you with a Preliminary Report on the financial capacity of Norfolk Island. Consistent with the Terms of Reference, the Commission will provide a Final Report by 30 September 2006.

The attached report provides the most comprehensive available assessment on what revenue might be raised by levying comparable State and local taxes and what might be spent in comparable circumstances to provide State and local government services. It has been compiled by the staff of the Commission drawing on the best available data. Staff have identified some remaining gaps in the analysis and some estimates might change once staff have had the opportunity to better incorporate the results of the ABS economic survey of the Island, which only became available on 22 June 2006.

We consider that the document, together with a more comprehensive draft document setting out the Commission staff's analysis of current financial arrangements, which will be available mid-July, will form a good basis for our consultations on the Island, scheduled for 17 and 18 August 2006. Those consultations will allow the staff estimates to be tested against Island views and will also provide an opportunity to close any outstanding data gaps.

We have been mindful in preparing this report not to present tentative Commission conclusions on the question of the appropriate level of Australian Government support under different administrative arrangements. While staff estimates could be used to derive such estimates, the Commission prefers not to attach its imprimatur to any estimates before it has had an opportunity to more carefully consider the results of the ABS survey and to consult on the Island.

The Commission also notes that its work is part of a set of inquiries that the Australian Government has initiated to provide it with information on the economic and financial impact of new administrative arrangements on the Island. For its part, the Commission has asked staff to use observed historical information when they compile estimates, and will use similar data when it

reaches its conclusions in its final report. The Commission is not able to base its conclusions on projections of what economic and financial conditions might be on the Island after new administrative arrangements are introduced. Other studies initiated by the Australian Government should enable the conclusions in our final report to be modified to reflect new administrative arrangements.

Wherever possible the staff of the Commission have used the same analytical approach as is used in our work on State Finances. On the expenses side, this is based on looking at how expenses in a particular jurisdiction might vary from national average spending due to known differences in the use of a service (due largely to known differences in population composition), and to known differences in the cost of service delivery (due largely to location influences). Our approach provides an estimate of what a comparable jurisdiction might spend to provide the same level of service and takes into account the special circumstances of the Island. These estimates may differ from the costs that other jurisdictions might charge to deliver comparable services to the Island and Commission staff have not attempted to determine what the estimates might be on this basis.

Consistent with the Terms of Reference, Commission staff have developed estimates of what revenue might be raised if comparable State and local taxes were levied on the Island assuming current levels of wages, prices and economic activity. The current revenue raising arrangements on the Island differ considerably from the average State and local revenue arrangements in other jurisdictions. Final estimates of the Island's revenue raising capacity will depend on the precise revenue arrangements adopted on the Island, allowing for the possibility that some Island specific revenue measures are preserved, and on the economic impact of both those arrangements and of other administrative changes. Both those impacts fall outside the scope of the Commission's analysis.

Yours sincerely

Alan Morris
Chairperson

Ross Williams
Member

Glenn Appleyard
Member

30 June 2006

REVIEW OF THE FINANCIAL CAPACITY OF NORFOLK ISLAND 2006

PRELIMINARY REPORT

1. On 20 February 2006, the Minister for Local Government, Territories and Roads announced that advice from the Commonwealth Grants Commission (the Commission) would be sought on State and local government funding arrangements for Norfolk Island. On 1 May 2006, the Hon Senator Richard Colbeck, the Parliamentary Secretary to the Minister for Finance and Administration, sent the Commission terms of reference. This is reproduced below in Box 1.

Box 1 Terms of reference for the Norfolk Island Inquiry 2006

Pursuant to Section 16C of the Commonwealth Grants Commission Act 1973, I ask the Commission to advise on the financial capacity of Norfolk Island (henceforth, the Island) to provide State and local government services comparable to the services available in comparable communities in the States and Territories (henceforth, the States), having regard to the circumstances of the Island and assuming that the Island makes the Australian average revenue raising effort from its State and local government equivalent revenue bases and that the Island operates at the average level of efficiency.

In particular, advice is sought on:

- (i) what it might cost to provide State and local government services, including depreciation, on the Island at the average range and levels provided in the States, recognising the size and circumstances of the island, assuming that the Island government operates at the same level of efficiency as State and local governments;
- (ii) the capacity of the Island to raise revenue from a comparable range of taxes and charges levied by State and local governments and at the average levels of these taxes and charges;
- (iii) the amount of financial assistance needed from the Australian Government to allow the Island to meet the cost of providing the services mentioned above (including the actual cost of servicing its existing loan agreements) having regard to the Island's capacity to raise revenue also mentioned above; and
- (iv) how much local government funding the Australian Government might provide to Norfolk Island on a basis consistent with local government funding arrangements applying in the rest of Australia.

The Commission is to provide a preliminary report by end June 2006 and a final by the end of September 2006.

PRELIMINARY REPORT

2. The Commission is conducting the inquiry in two stages.
3. This preliminary report concludes the first stage. It provides staff estimates of what it would cost to provide comparable State and local government services and the revenue raising capacity of the Island. It also provides staff estimates of the required level of Australian Government financial support. A supporting information document, which explains how Commission staff have arrived at these estimates, will also be available.
4. The Commission cannot endorse these estimates until it has had an opportunity to more carefully consider the results of the ABS survey released on 22 June 2006 and to consult with stakeholders on the Island. The estimates also depend on how the services provided by the Norfolk Island Government are allocated to State and local sectors. We want to discuss this allocation with stakeholders on the Island.
5. In the second stage of the inquiry, the Commission will hold a conference on the Island on 17 and 18 August 2006 to discuss the preliminary report and supporting information with representatives of the Norfolk Island Government, its Administration, service providers, other interested parties and relevant Australian government agencies. The Commission will submit a final report to the Government by the end of September 2006.
6. As a result, the figures included in this report are preliminary and subject to revision.
7. In addition, any conclusions we may reach, even in our final report in September, about the amount of financial assistance to which Norfolk Island might be entitled will require further revision when decisions on governance arrangements and the extension of Commonwealth legislation and taxing regimes are made. They will also need to be updated so that the amounts paid will be relevant to the year in which they are paid.

RESULTS

State expenses and revenues

8. Table 1 provides a response to:
 - clause (i) of the terms of reference on what it might have cost in 2004-05 to provide State services on the Island, comparable to those available in comparable communities on the mainland; and
 - clause (ii) on the capacity of the Island in 2004-05 to raise revenues from a comparable range and level of taxes and charges levied by State governments.

Table 1 Comparative expenses and revenue raising capacity — State services

		2004-05
	\$pc ^(a)	\$'000
Cost of providing services at Australian levels ^(b)	5 912	11 900
Less revenue raising capacity	2 981	6 000
Financial assistance required	2 881	5 800

(a) Ordinarily resident population on Norfolk Island was estimated at 2 013 in 2004-05.

(b) Including depreciation and debt charges.

Source: CGC staff estimates.

Local government expenses and revenues

9. Table 2 provides a response to:

- clause (i) of the terms of reference on what it might have cost in 2004-05 to provide local government services on the Island, comparable to those available in comparable communities on the mainland; and
- clause (ii) on the capacity of the Island in 2004-05 to raise revenues from a comparable range and level of taxes and charges levied by local governments.

Table 2 Comparative expenses and revenue raising capacity — local government services

		2004-05
	\$pc ^(a)	\$'000
Cost of providing services at Australian levels ^(b)	2 732	5 500
Less revenue raising capacity	1 143	2 300
Financial assistance required	1 590	3 200

(a) Ordinarily resident population on Norfolk Island was estimated at 2 013 in 2004-05.

(b) Including depreciation.

Source: CGC staff estimates.

10. The total amount that the Australian Government would need to provide to allow Norfolk Island to meet its current loan agreements is \$800 000 per annum, for a period of 15 years. This amount relates to a local government type service and so has no impact on the costs of providing State government type services.

Financial assistance for local government under two funding models

11. In response to clause (iv), Tables 2 and 3 summarise how much local government funding the Australian Government might have provided to Norfolk Island on two bases. Table 2 (above) shows the financial assistance to which Norfolk Island would have been entitled in 2004-05 if

it were funded under an Indian Ocean Territories model. Table 3 shows the financial assistance if it were funded as a State government under an ACT model.

Table 3 Local government financial assistance for Norfolk Island under an ACT funding model

		2004-05
	\$pc ^(a)	\$'000
General purpose assistance	53	107
Local roads funding	24	47
Total	77	154

(a) Ordinarily resident population on Norfolk Island was estimated at 2013 in 2004-05.

Source: Department of Transport and Regional Services (2003-04), *Local Government National Report*.
CGC staff calculations.

Summary

12. In response to clause (iii), Commission staff have estimated that in 2004-05 Norfolk Island would have required about \$5.8 million from the Australian Government in State equivalent financial assistance to provide services at the average range and levels provided in the States (at average levels of efficiency), having regard to the Island's capacity to raise revenue at Australian average levels.
13. In response to clause (iii), Commission staff have estimated that, for a period of 15 years commencing in 2004-05, Norfolk Island would require \$0.8 million per annum to service their existing loan arrangements.
14. In response to clause (iv), Commission staff have estimated that in 2004-05 Norfolk Island would have required:
 - \$3.2 million if the Indian Ocean Territory funding model was used; or
 - about \$0.15 million if the ACT funding model was used.
15. Given the apparent downturn of the economy in 2005-06, it is likely that Norfolk Island's revenue raising capacity may have reduced, increasing the amount of financial assistance likely to be required in that year. This would be partly offset by the fall in the Norfolk Island population which would reduce the cost of providing services.
16. The final report will provide Commission calculations in relation to revenue capacity and expenditure need and the basis on which those are determined.