

## **Norfolk Island Economic Sustainability: Ten Policies to Increase the Welfare of All Islanders**

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The political debate over the transfer of powers to the Commonwealth unfortunately does not address sustainability on Norfolk Island. In fact, the likely outcome will lead to a less sustainable economy, like the Indian Ocean Territories. Since 1979 the Island economy has come close to providing the surpluses necessary for asset replacement and investment. Many locals recognise that there are changes required to make the Island more efficient. Therefore, a program of microeconomic reform driven by the Norfolk Island Government will do much more to improve the welfare of Islanders than the current reforms being proposed by the Commonwealth.

Almost all of the discussion about NIG finances and the Norfolk Island economy has come out of particular vested interests, or been based on a partial analysis of the impacts on a particular group of people, an organisation or a budget. Rather than working from the detail up to a plan for the Island, a more general analysis should first be undertaken and these general conclusions reflected in the consistent details of such a plan.

On sustainability, there are many possible outcomes for sustainable development of the Island. Choices made now, and in the future, will impact on the population, tourist numbers, productivity and the income of the Island. There's no question of choosing a single static model that will hold into perpetuity. Future choices (made by Government and individuals) should be able to build on frameworks put in place today. There are no "magic bullets" for the Island, and no single decision or person will set Norfolk on a path to economic sustainability. What's required are many changes driven by Government, supporting individuals and businesses to work in their own interests as well as the wider interests of the Island. The Government can help to unleash the creative power of the people, but it cannot immediately overcome the structural disadvantages of the economy.

In terms of how the economy has been functioning to date, I'd also make the following comments. The short-term nature of decisions regarding consumption versus investment may allow the economy to "muddle through" during times of favourable economic circumstances. However, the lack of adequate investment in the right areas of the public and private sectors is now being felt in the economy. Also, the self-interested tendency to push an ever-greater financial burden onto tourists has resulted in Norfolk Island making itself uncompetitive. Tourists are free to choose where they travel, and what they do with their time and money. Islanders have already tried to push too much of the financial burden onto tourists. Acumen Alliance estimates that tourists (who make up around 20% of the population) contribute around 50% of Government income directly, and around another 20% indirectly. The lack of business innovation in the economy is certainly not due to excessive income and company taxes. In this regard the many measures to protect businesses and individuals from the positive forces of competition must be abolished. Furthermore, hidden costs and cross subsidies should also be removed.

The following specific policies would improve the social and economic welfare of Norfolk Islanders:

- 1. Decrease the average cost of air tickets**

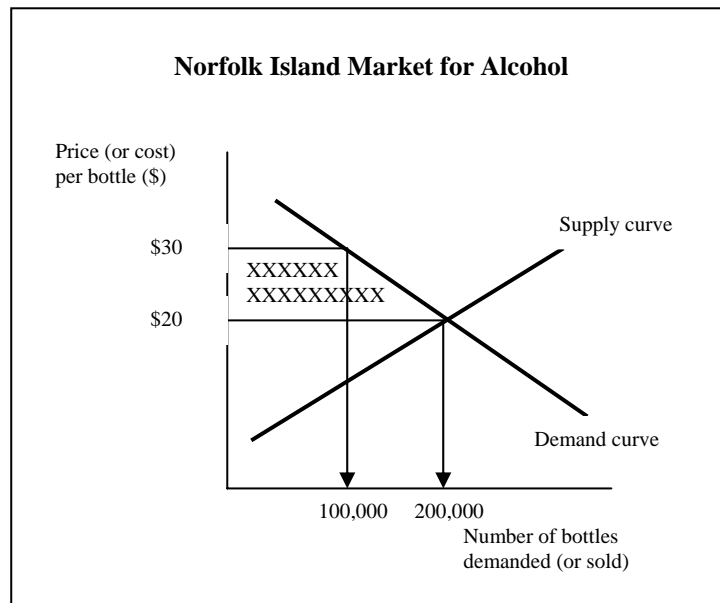
Airfares are a highly visible component of travel expenses, and would probably make up around half of the total cost of the typical tourist trip to Norfolk Island. While domestic Australian travellers (as well as those in Europe, America and many other parts of the world) have significantly benefited from lower fares, travel to Norfolk Island is still comparatively expensive. This is not so much the case on Air New Zealand from Auckland, but in particular on flights from Sydney and Brisbane. In large part this is because of the higher expense of leased aircraft, as well as the high level of commission charged for distribution and handling. All efforts must be made to reduce the cost of air tickets at every stage of the distribution chain. Jetstar or Virgin Blue would make a much more economic alternative to the current airline run by NIG, because they have lower costs of operation and much more experience. Furthermore, the Melbourne market should be reconsidered to increase the base of potential tourists from a more southerly climate. Ticket price disparities between locals and tourists should also be abolished. It costs the same amount to put a local in a seat as it does to put a tourist in a seat. The current disparity adds to the imposts born by travellers to Norfolk Island.

2. **Telecommunications costs must be brought down**

Both the costs born by Norfolk Telecom and the bills paid by its customers must be reduced. One important aspect of telephone/fax/data/internet costs is that they are a direct cost of doing business. Inflated costs hurt business and they hurt employment. The evidence of telecommunications reform in the OECD points to genuine competition being the only force strong enough to bring these costs down. There are obvious difficulties in introducing competition in such a small community. One option is to hold the infrastructure in a fully Government owned vehicle and then allow service providers to compete for customers by differentiating on product and price. Short of that, measures are needed to support genuine competition in voice and data services. The cross subsidy provided by businesses and tourists to locals (in the form of extortionate IDD pricing and free local calls) must be ended so that a correct price signal is sent to all consumers. And crucially the proposed GSM mobile network must be owned by an entity completely separate from Norfolk Telecom. Otherwise most of the benefits of having a new network will be lost.

3. **Bring competition to alcohol provision**

The current situation where GBEs prop up the core recurring expenses of Government is unhealthy. Furthermore, the situation of having a monopoly in alcohol importation hurts the Norfolk Island economy. Consider the market for alcohol in the diagram below with typical demand and supply curves, where the quantity demanded falls as the price increases and the supply curve reflects an increasing marginal cost as the Bond ships more and more bottles to the Island.



For example, instead of selling a typical bottle at the competitive price of \$20, the Bond is directed to sell a typical bottle for \$30. The response from consumers (made up of locals and tourists) is that they only buy 100,000 bottles instead of 200,000. There's also a loss of welfare (or utility) to the community of the parallelogram shaded with the Xs, this is due to consumers deciding to buy fewer bottles and having to pay a higher price for them. In qualitative terms making the liquor market competitive would encourage private businesses to source product at a lower cost, and would introduce new lines that are currently not on the Island (i.e. a lower cost for consumers and businesses, as well as more choice).

4. **Introduce more competition to freight between Norfolk, Australia & NZ**  
Whether this is done by facilitating new entrants or regularly tendering out the work, benchmarking the cost of services compared with efficient operations on other routes or developing new means of transport, freight is a vital link between Norfolk and the outside world. Excessive charges for freight are a direct burden on locals and are also inevitably passed on to tourists – thus discouraging the main industry on the Island even more. Further, there should be more use made of airfreight to compete with sea freight, particularly on the flights out of Norfolk. Freight prices should be lower for outward freight in both cases as there is almost always lower capacity utilisation on the outbound direction.
  
5. **Scrap a range of hidden and inefficient “taxes” in favour of a GST**  
A GST with the same requirements as in Australia could be managed for the Island through established ATO structures and expertise. In all collections of government revenue there is some cost of collection, ranging from the cost of salaries to check compliance and administer the system, to bad debtors, complexity and confusion in the general community. Some taxes may even cost more to collect than they generate when you look at all of the financial and qualitative costs involved. Some of the imposts on the economy that may be replaced by a GST are: customs duty, the Financial Institutions Levy, the departure fee and excessive retail prices charged by the Bond and Norfolk Telecom. In particular, visitors leave the Island with a bad taste in their mouth after paying the departure fee. Many visitors are not aware they will have to pay for the right to get off the Island and it's one of their last impressions of Norfolk before heading home to tell their family and friends about their holiday. Some of the benefits of introducing the GST to Norfolk are that: it could be administered by the ATO (where the system is already fully operational and works well) rather than another mini-bureaucracy here on the Island, revenues will grow and contract with the economy, it protects privacy, and is less regressive than many of the taxes and charges currently being collected by NIG. Introducing a GST would also allow the Revenue Fund to align revenues and expenses more closely, and thus reduce the need for NIG to rely on monopoly GBEs to prop up the budget.

6. **Liberalise the movement of resources between Norfolk, Australia & NZ**

Barriers to the movement of people and capital often reduce economic prosperity. One of the justifications for immigration permits appears to be to protect the jobs and businesses of Residents, which is curious considering that many locals already hold down several jobs (and in some cases there is currently a lack of TEPs to fill available roles). In other cases GEPs have restrictive conditions put on their permits in order to protect the business interests of Residents. Also, the process for outside investment in tourist accommodation acts as a disincentive to improve the range and appeal of the accommodation currently on offer. And the 30-day limit for visitors also acts as a disincentive to stay longer on the Island. All of these restrictions are an increased cost of regulation. They are a cost for businesses and a cost for families and individuals in terms of the time, money and effort required to comply. These resources (i.e. the time, money and effort) would be more productively put into use to increase the lifestyle of all Islanders. These restrictions also stop consenting parties from reaching mutually beneficial outcomes. And the enforcement of these restrictions uses up the precious time of those employed in NIG as well as precious public funds. Consolidating customs, immigration and quarantine functions with Australia would make it easier for tourists to visit from Australia and would also significantly increase the chances of securing a low-cost airline to fly between Norfolk-Sydney-Brisbane-Melbourne. Deregulating the markets for land and businesses on the Island would increase the liquidity of these assets, potentially bringing greater exposure and asset values to the Island. Deregulating immigration would also avoid the current inflexibilities and costs that act as a disincentive for productive short to medium term employment.
7. **Distortions between the treatment of locals and tourists should be eliminated**

Examples of how these distortions hurt the economy are as follows. Liquor prices have three tiers: cheaper spirits for tourists, retail prices for locals and premium wholesale prices for businesses (surely one of the few places in the world where bulk wholesale prices are more than retail prices!). Locals pay more for spirits than tourists, partially a cross subsidy so that the Bond can compete with spirit prices in other locations. In this instance the Bond is using price discrimination to force locals to pay more than tourists because locals have few other options to buy spirits. In terms of wholesale liquor, there is an absurd situation where some establishments send their staff to purchase liquor privately rather than ordering through their business, which would have to pay a higher price. In terms of the pricing signal for telephone calls, free local calls are encouraged while IDD calls are heavily “taxed”. This conditions consumers to believe that local calls don’t cost anything to provide, which is not true. The exorbitant rates on IDD calls are an unfair burden for business, tourists and locals with friends and family who are overseas.

8. **Reduce the size and complexity of Norfolk Island Government**

Regardless of comments made in previous reports regarding Norfolk Island, it's a credit to all those involved that such a small community can manage most of the functions of the three tiers of Government in Australia in such a remote location. However, one of the disadvantages of attempting to do so is that far too many Islanders are tied up in the work of Government rather than in productive areas that would directly increase the size of the economy. This is largely due to the lack of economies of scale in such a small community. There are many areas that could be carved out of NIG: Post and Philatelic, Customs, Immigration, Airport, Lighterage, Broadcasting, IT, Healthcare and Worker's Compensation funds, Liquor Bond, Parks, Electricity... Moving these areas to private sector ownership or management would unleash the profit motive to improve these organisations. Alternatively, closing some of them down would reduce costs to NIG and free up the time of Government and the Administration to add value to the Norfolk Island community. Further there are many conflicts of interest within Government and the Administration, requiring improvements in governance. A new political model must be found to allow the Executive Government to pass the reforms that are required. This may involve a new electoral system, fewer MLAs or the formation of political parties.

9. **Selective privatisation**

Selective privatisation could lead to greater tourist numbers and lower costs of production. For example, the Government could offer a 49% interest in the airport or tender a long-term lease to manage the airport where NIG shares in any earnings upside. Macquarie Airports and the Australian Infrastructure Fund and many other organisations have much superior management expertise in running airports compared to NIG. Outside owners or managers would: assist with marketing Norfolk as a destination, progress development opportunities in the vicinity of the airport, take some of the capital expenditure off the NIG balance sheet, and maximise the value of the asset. One of the main areas that specialist airport operators have pursued is introducing greater (duty free) shopping right into the walkways that passengers transit to and from their planes. This should be pursued at the earliest convenience, since some visitors to the Island are unaware of the Bond at all (as well as other retail outlets), and while waiting two hours before your departure is an ideal time to be selling goods to passengers.

10. **The financial management of the public and private sectors must improve** Informed decisions can only be made when accurate and useful information is available. Current accountability and transparency is low across the economy, because of a lack of measurement and disclosure of data. The adoption of accrual budgeting is essential for Government and the community to understand the importance of longer-term financial planning and asset replacement. Managing a cash budget from year to year will inevitably lead to disaster for either a community or a family. It's also essential to finalise an asset register that estimates the useful lives, replacement costs and timing of public infrastructure so that the NIG budget can be managed to incorporate the lumpiness of asset replacement. Implementation of a GST, preferably with quarterly reporting, would improve measurement of the economy and inform the community of movements in consumption over time. Also, Norfolk Island Annual Reports compare unfavourably to those in Australia. They are fragmented (having been brought together from small sections and written by numerous authors), they lack any financial notes to the accounts, they are filled with details that are simply repeated from year to year, they are backward looking, and they don't meet Generally Accepted Accounting Practices.

The essence of the above case is to argue for increased economic efficiency on Norfolk Island. And to take advantage of low regulation, so that the population can be freed to grow and develop their economy. Unfortunately for all those businesses and individuals who rely on tourism, people can't be forced to choose Norfolk as a destination. There are some things that can be done to shift the demand curve slightly in Norfolk's favour, in spite of operating in an intensely competitive market where the Island has relatively weak competitive advantages. However, it is possible to significantly shift the supply curve by reducing the cost of tourism. This will lead to more tourists and increased social and economic outcomes for all Islanders. Furthermore, the above policies will help to grow the income of the Island over time and put in place the incentives for people to work and innovate in their businesses. This will lead to lower costs and a more attractive offering of retail goods for locals and tourists alike.

