



Australian Government

Commonwealth Grants Commission

**REVIEW OF THE COSTS OF SERVICING THE
INDIAN OCEAN TERRITORIES (IOTS) 2007**

COMMISSION DISCUSSION PAPER CGC 2007/19

APRIL 2007

CONTENTS

INTRODUCTION	1
The purpose of this paper	1
BACKGROUND TO THE INQUIRY	2
PROPOSED APPROACH TO THE INQUIRY	4
Comparable communities	5
Required expenses of the Territories	6
The revenue raising capacity of the Territories	6
The level of funding required from the Australian Government	6
Local government funding processes	6
INFORMATION COLLECTION AND WORK PLAN FOR THE INQUIRY	7
HOW YOU CAN HELP US	8
SUBMISSIONS AND COMMISSION CONTACTS	9
ATTACHMENT A: STATE AND LOCAL GOVERNMENT ACTIVITIES	11

INTRODUCTION

- 1 On 10 April 2007, the Commonwealth Grants Commission (the Commission) received terms of reference from the Parliamentary Secretary to the Minister for Finance and Administration (seeking advice) on State and local government funding arrangements for the Indian Ocean Territories (the Territories). The terms of reference are shown in Box 1.

Box 1 Terms of reference for the Indian Ocean Territories Inquiry 2007

Pursuant to section 16D of the Commonwealth Grants Commission Act 1973, I ask the Commission to advise, by 31 October 2007 if possible, on an appropriate level of funding for the Indian Ocean Territories in 2005-06. This funding should allow the provision of State and local government services at levels comparable to communities in the rest of Australia that have similar service requirements, assuming that services are provided at comparable levels of efficiency and that comparable efforts are made to raise State and local revenues from the Territories' revenue bases.

In particular, advice is sought on the following, recognising that Western Australian laws have been extended to the Territories:

- (i) what level of annual expenditure would be required to provide the range and level of State government type services, including depreciation, in each Territory (or in both where that is the current method of provision) consistent with those in comparable communities in Western Australia, recognising the size and circumstances of the Territories and assuming that services are provided at a level of efficiency comparable to the average achieved by remote Western Australia;
- (ii) the capacity of the Australian Government to raise State government type taxes and charges in each Territory at Western Australian levels, taking into account any special circumstances of the Territories;
- (iii) the level of expenditure implied by the findings of (i) and (ii);
- (iv) how this amount could be updated annually; and
- (v) whether the present methods for determining local government funding provide an outcome for the Territories comparable to that in comparable local authorities in Western Australia. If not, how much local government funding should the Australian Government provide to each Territory on a basis consistent with the arrangements for comparable local authorities in Western Australia and taking account any special circumstances of the Territories?

The purpose of this paper

- 2 The paper provides:
- the background to the inquiry;
 - a proposed approach to the inquiry;
 - information collection and a work plan for the inquiry;
 - an explanation of how the parties to the inquiry — the Australian Government Department of Transport and Regional Services, Western Australian agencies and the Christmas and Cocos (Keeling) Islands' administration, shires and communities might assist; and
 - background information on the Commission.

BACKGROUND TO THE INQUIRY

- 3 The Australian Government provides funding to the Territories for services and infrastructure, so that they have the capacity to provide services at the same level as comparable mainland communities. Funding is provided through the normal budget cycle.
- 4 Prior to each year's Federal Budget, the Department of Transport and Regional Services (DOTARS) advises the Treasury on the appropriate level of funding for that year. In providing advice, DOTARS considers
- the 1999 Commission report¹ into the appropriate level of funding for the Indian Ocean Territories for 2000-01,
 - new legislative requirements;
 - the previous year's expenditure; and
 - forecasts for the coming year.

The Treasury uses that advice to prepare a funding estimate for the Federal Budget.

- 5 The 1999 Commission report recommended that infrastructure and services in the Territories be re-examined periodically to ensure that the level of funding provided remains appropriate. The Terms of Reference ask the Commission to conduct a new inquiry, similar to that undertaken in 1999. The results of this inquiry will be used by DOTARS to recommend future levels of funding.
- 6 In the 1999 inquiry, the Commission noted that:
- The Australian Government was responsible for the delivery of Commonwealth and State type services to the Territories and for the payment of local government grants to the Shires. It also collected all taxes and charges on the Territories, except those raised by the Shires.
 - The Australian Government had applied a policy of implementing a legal regime and administration aimed to align arrangements for the Territories with those of isolated mainland communities.
 - The Territories were administered through the DOTARS.
 - State-type services were, as far as possible, provided by Western Australian agencies (in some cases, the Shire Councils) under arrangements with the Australian Government. Similarly, State-type taxes and charges were collected by Western Australia.
 - Local government services were provided by the Shire Councils which have the same range of powers, functions and responsibilities as local governments in Western Australia.
 - Any services not covered by these arrangements were provided by the Administration.

¹ Commonwealth Grants Commission (1999) *Report on Indian Ocean Territories 1999*, Australian Government Publishing Service, Canberra. This report also provided advices on how the level of funding might be adjusted annually. The report is available on the Commission's website at www.cgc.gov.au.

- All government expenses in the Territories, other than those resulting from revenue raised by the Shire Councils and some user charges for State-type services, were funded by the Australian Government. The level of expenditure each year was determined as part of the Australian Government's budget process.
- 7 The Commission concluded that the level of Australian Government and State-type services, revenue raising efforts and local government funding in the territories were generally of a standard found in comparable communities in the rest of Australia. There were, however, a few areas where State-type services and revenues were below that level. Other findings of the 1999 inquiry relevant to this inquiry are listed in Box 2.
 - 8 The Terms of Reference for the 2007 inquiry do not ask the Commission to report on the level of Commonwealth services or the level of infrastructure in the Territories. They ask the Commission to report on the level of State and local government services and revenue raising capacities.
 - 9 The results of the 1999 inquiry were used by the Australian Government to inform funding of the Territories over the past seven years, including how much funding to provide and how that funding should be spent. The findings on areas in which the IOT are disadvantaged compared with mainland communities, the management of existing infrastructure, and the ability of the Territories to contribute revenue to the Government have been used to provide guidance to the government in making a wide range of decisions regarding the Territories.

Box 2 Selected main findings, Indian Ocean Territories Inquiry 1999

Levels of services

- 1 The level of Commonwealth-type services on the IOTs was at the standard found in comparable mainland communities.
- 2 There are a few areas on both Territories where State-type services were below the standard provided in comparable communities on the mainland. Additional expenditure by DOTRS and Parks Australia was necessary in those areas if the Government's objective of aligning services with those in comparable communities is to be achieved.
- 3 On the Cocos (Keeling) Islands, the services that needed additional expenditure were: vocational education and training; health (carer and patient support, and specialist services); welfare services (including a social worker); environment protection; assistance for industry; grants for cultural and recreation services, and non-government welfare activities.
- 4 On Christmas Island, additional expenditure was needed for: vocational education and training; health (carer and patient support, and specialist services); welfare services; assistance for industry; grants for cultural and recreation services, and non-government welfare activities.
- 5 More needed to be spent on depreciation and the repairs and maintenance of assets on the Cocos (Keeling) Islands. On Christmas Island, the depreciation expense had been overestimated but more needed to be spent on repairs and maintenance.
- 6 The funding the IOT Shires received aligned with that received by comparable local authorities on the mainland.

Revenue raising efforts

- 7 Except for those taxes not levied on the IOTs (wholesale sales tax, excise duties and customs duties), Commonwealth taxes were raised at the same level as those that apply on the mainland.
- 8 Compared with remote communities in Western Australia, the residents of the IOTs were paying appropriate levels of State-type tax — all State-type taxes were levied on the IOTs, and Western Australian rates of tax were applied.
- 9 The rates of electricity and sewerage charges on the IOTs were the same as those in remote Western Australian communities.
- 10 Other user charges for housing rents (for both welfare housing and employees), airport charges and some health services were at levels that would be expected in small remote communities on the mainland.
- 11 The housing rents charged by the Shire of Cocos (Keeling) Islands for their tenants that would not qualify for welfare housing were lower than those on the mainland.

PROPOSED APPROACH TO THE INQUIRY

- 10 We are asked to provide estimates of the costs of providing State-type services at the same level as provided in comparable communities in Western Australia, taking account of any special circumstances of the Territories and assuming those services are provided at the same efficiency as in comparable communities and the revenue that could be collected under tax rates applicable in Western Australia. As in the 1999 Inquiry, the cost of providing services is to include depreciation expenses relating to infrastructure used in providing services. We are also asked to

advise whether the funding assessed for the Shires is comparable with that for similar communities in Western Australia,

- 11 We think the main analytical tasks that must be done in responding to the reference are to:
- decide on a range of comparable communities in Western Australia on which to base our assessments of the appropriate level of services;
 - establish the average cost of delivering State-type services in those comparable communities;
 - determine whether those cost levels need to be adjusted for the effects of any special circumstances of the Territories;
 - determine the capacity to raise taxation and other revenue in the Territories using Western Australia tax rates and charges — taking account of the special circumstances in the Territories.
 - compare the methods used by the Western Australian Local Government Grants Commission (WALGGC) to derive the grant funding for the Shire in each Territory with those used to establish the funding for comparable local authorities in Western Australia, with particular emphasis on the methods used to allow for the special circumstances of the Territories.

Comparable communities

- 12 No communities in Australia are strictly comparable to the Indian Ocean Territories. However, in the 1999 Inquiry, the Commission developed a list of remote Australian communities with characteristics, particularly demographic characteristics, similar to those of the Territories. Those comparable communities were drawn from all States. The community chosen for comparison depended on the service being examined because:
- the population characteristics and service delivery needs of the two Territories differ; and
 - the population group using a service in any particular comparable community was a better match for those on the Territories for some services but not others.
- 13 The terms of reference say the benchmarks for the current inquiry should be Western Australian communities that have service requirements comparable to the Territories. We propose using the Western Australian communities identified in the 1999 Inquiry as the starting point. These are listed in Attachment A.
- 14 In the 1999 Inquiry, Western Australian communities where the requirements for one or more services were considered comparable to the Territories included:
- Broome, Darkan, Derby, Exmouth, Fitzroy Crossing, Halls Creek, Kununurra, Laverton; Leonora, Mt Magnet, Mullewa, Onslow, Pannawonica, Wyndham and Yanchep.
- 15 The Commission seeks views on whether those communities are still appropriate or whether some should be deleted or others considered.

Required expenses of the Territories

- 16 The terms of reference ask us to estimate what it might cost to provide each Territory with State services, such as schools education, hospital and police services, at the levels provided in comparable Western Australian communities — the Territory’s required expenses. Services usually provided by the Australian Government such as health insurance, social security benefits and immigration services are not within the scope of this inquiry. A list of relevant services is provided in Attachment A.
- 17 We will estimate what it cost to deliver the range and level of State government services in the selected Western Australian communities — by cataloguing what and how services are provided and what they cost.
- 18 We will also need to know whether any special circumstances exist in each Territory, including demographic and geographical circumstances that require higher or lower costs or levels of service. Delivering these services through contractual arrangements might also lead to additional service delivery costs and these would need to be investigated and included in our estimates where relevant.
- 19 Ideally we would look at service delivery costs across a range of comparable communities to determine costs based on average levels of efficiency.

The revenue raising capacity of the Territories

- 20 The terms of reference ask us to estimate the revenue that could be raised in the Territories from State taxes, such as payroll tax, land tax and mining royalties if the tax rates applied in Western Australia were applied. Taxes imposed by the Australian Government, such as income tax and the goods and services tax are not within the scope of this inquiry.
- 21 Since Western Australia tax laws have been extended to the Territories, this task becomes one of determining whether there are any special circumstances of the Territories that would affect the ability to raise revenue from the state taxes and charges. The special circumstances could include the applicability of various taxes and charges. They may also include practical considerations such as whether the revenue base is material enough to warrant collection of the tax or charge, particularly if the cost of collection would be far higher than the amount raised.

The level of funding required from the Australian Government

- 22 We would estimate the net cost for each Territory by subtracting its State-type tax revenue from what it needs to spend to deliver services at Western Australian levels. We will do this separately for each Territory.

Local government funding processes

- 23 We have also been asked for advice on whether the present methods for determining local government funding provide a financial outcome for the Territories similar to that in comparable local authorities in Western Australia.

- 24 The Australian Government funds the Shire in each Territory on the basis of an assessment of their requirement for general purpose assistance and roads funding undertaken by the WALGGC. Responding to this aspect of the reference will require a comparison of the methods the WALGGC uses for each Shire and for remote local authorities in Western Australia. Since the WALGGC's methods treat each Shire as if it were a local authority in Western Australia, we will focus our interest on how the special circumstances of the Territories are accounted for in the WALGGC methodology.

INFORMATION COLLECTION AND WORK PLAN FOR THE INQUIRY

- 25 The Commission places a high level of importance on consulting whenever they inquire into the level of service and revenue raising capacities of jurisdictions. For this inquiry, Australian and local government officials as well as Territory residents will have opportunities to raise issues with the Commission. They can make submissions and attend the conferences in the Territories.
- 26 The first step in conducting the Inquiry will be to collect information. We will need information from:
- Western Australian agencies on the standard and level of services provided in comparable communities in Western Australia;
 - the DOTARS (including its on-island administration offices) on expenses incurred in administering and providing State and local government services in each Territory, along with State and local government revenues collected in each Territory; and economic, demographic and other characteristics of each Territory;
 - the shires and communities on local government finances and the economic, demographic and other characteristics of each Territory;
 - agencies providing State-type services in each Territory on the standard and level of services provided and resources used in providing those services; and
 - the WALGGC on the methods it uses to assess the local funding requirements of each Territory and remote local authorities in Western Australia.
- 27 The subsequent steps will be to:
- build an understanding of the economic, demographic and other characteristics of each Territory that would affect the State-type services each requires.
 - compile a picture of the range and level of State services that would apply in each Territory under Western Australian policies and estimate what would need to be spent if they were provided at this level; and
 - compile a picture of the State-type revenues that would be collected in the Territories under Western Australian tax policies.

- 28 We will then be in a position to formulate draft responses to each clause of the terms of reference that will then be tested through consultation with the communities on the Territories and other interested parties.
- 29 Supporting our analysis, we will use information from the Commission's State finances and other work and from Local Government Grants Commissions. However, the Commission's experience suggests that not all data we will require will be readily available. As in 1999, we will most likely need to use judgment to ensure that the differences between the Territories and Western Australia are recognised adequately.
- 30 Consultation with the Administrations, local government authorities, service providers and communities in the Territories, and with policy makers and service providers in Canberra and Perth will be essential to successfully complete this work. We will do this through an initial round of meetings in Perth, a visit to the Territories and by analysing written submissions.
- 31 The proposed timetable for the inquiry is as follows:

Task	Timing
Issues paper released	Mid April 2007
Data requests released	Late April 2007
Data returned	18 May 2007
Submissions received	28 May 2007
Discussions in Perth with Territory representatives, DOTARS, WALGGC, WA agencies	28 and 29 May 2007
Commission visit to Territories	early August 2007
Further submissions	7 September 2007
Final report	31 October 2007

HOW YOU CAN HELP US

- 32 We developed a good understanding of the unique circumstances of the Territories in 1999, but many things will have changed. So we will again need the assistance of parties interested in the outcome of this inquiry. In particular, we will need financial information on comparable communities and information on how each service is provided and the unique problems facing the Territories in delivering services and in raising revenue.
- 33 The Commission would welcome comments from interested parties on the following.
- Is the approach the Commission intends to take to the inquiry reasonable? What else should we have regard to?
 - What special circumstances affect the need for government services and the cost of providing them (and how have these changed since 1999)?

- Any comments you may have on the list of comparable communities in Western Australia. For example, are there other comparable communities that the Commission should consider?
- What are the special circumstances of the Territories that affect what taxes and charges can be imposed and the revenue collected from them?

34 A list of State and local government services and revenue sources is provided in Attachment A.

SUBMISSIONS AND COMMISSION CONTACTS

35 Submissions should be received by **28 May 2007**. They should address the issues outlined in this paper and any other issues pertinent to the inquiry.

36 The Commission intends to make the inquiry as open and transparent as possible. So, all submissions will be posted on its web site, unless the provider explicitly requests otherwise.

37 Wherever possible, submissions should be provided by email to:

secretary@cgc.gov.au

38 Alternatively, submissions can be sent to:

The Secretary
Commonwealth Grants Commission
5 Torrens Street
BRADDON ACT 2612

39 Please direct any questions on the review to:

Stephen Tregea-Collett, phone (02) 6229 8838
Email: stephen.tregea-collett@cgc.gov.au

Box 3 — About the Commission

The Commonwealth Grants Commission was established in 1933 to give the Australian Government independent advice on financial aspects of Commonwealth relations with the States (and more recently, the Territories). Its reports are presented to the Commonwealth Parliament through the Minister for Finance and Administration.

The Commission's main role is to advise the Australian Government on the appropriate distribution of the Goods and Services Tax revenue and Health Care Grants among the States. The distribution is designed to provide all States with the same fiscal capacity to provide services. It is based on an assessment of differences among the States in their revenue raising capacity and costs of providing services at average Australian standards. The funds distributed are important for State budgets. In 2006–07, the GST pool was \$47.6 billion, and provided 42 per cent of State budget revenues, with the actual percentages for individual States varying from 38 per cent for New South Wales to 72 per cent for the Northern Territory.

In 1986, 1989 and 1993, the Commission advised on what was necessary to raise the standard of living and the level of services on the Cocos (Keeling) Islands to mainland standards. In late 1995, it reported on the finances of Christmas Island and what had to be done to bring services in that Territory up to mainland standards. It reported again on the requirements of these Indian Ocean Territories in 1999.

In 1997 and 2006, it reported on the financial capacity of the Norfolk Island Government to provide services.

The Members of the Commission are part-time and are appointed for their expertise and impartiality. They do not represent Australian Government interests or the interests of the State or Territory in which they live. All five members of the Commission will undertake this inquiry.

Mr Alan Morris

Chairperson of the Commission since 1999 and a member from 1997, Alan was appointed after three years as an Executive Director of the European Bank in London. He has been Secretary of the Chief Minister's Department in the Northern Territory; Secretary of the Premier's Department in Tasmania and has worked in three Commonwealth Departments. He undertakes work with the World Bank, USAID and AusAID and is a member of the University Council for Charles Darwin University. Alan was Chairperson for the 1999 Indian Ocean Territories Inquiry.

Mr Glenn Appleyard

Glenn was appointed to the Commission in June 2004. Prior to commencing work as an economic consultant in 2001, Glenn held several senior positions within the public service. These included the roles of Deputy Secretary in the Tasmanian and Victorian Departments of Treasury and Finance, Regional Director for the Australian Bureau of Statistics in Tasmania, and General Manager of the Food, Agriculture and Fisheries Division of the Tasmanian Department of Primary Industries, Water and Environment.

Glenn has an active interest in public finance issues, particularly Commonwealth-State financial relations, and is also a member of the Australian Accounting Standards Board and the Tasmanian State Grants Commission.

Mr Greg Smith

Greg was appointed to the Commission in August 2006. He is a former Executive Director in the Australian Treasury. Greg is now an Adjunct Professor in Economic and Social Policy at the Australian Catholic University, a Governor of the Australian Tax Research Foundation, and a consultant in public policy.

Ms Jennifer Westacott

Jennifer was appointed to the Commission in July 2006. She has held senior positions in NSW Department of Housing; NSW Department of Community Services; NSW Health Council; NSW Department of Infrastructure, Planning and Natural Resources; Housing Victoria; and Education and Training Victoria. Jennifer is a partner with KPMG, a member of the Board of Advice in the Faculty of Economics, University of Sydney, and the Adjunct Professor at the City Futures Research Centre, University of NSW.

Prof Ross Williams

Professor Ross Williams has been a member of the Commission since 2002. He is currently a Professorial Fellow at the Melbourne Institute and was Dean of the Faculty of Economics and Commerce at the University of Melbourne from 1994 to 2002. Ross has a Masters degree and PhD from the London School of Economics. He has held appointments at Monash University, ANU and the World Bank.

ATTACHMENT A: STATE AND LOCAL GOVERNMENT ACTIVITIES

(a) State services

<i>Education</i>	<i>Law, order and public safety</i>	<i>Economic activities</i>
Pre-school	Police	Subsidies for electricity and gas, water and sewerage, fuel
Primary and secondary education	Court services	Transport subsidies (road, air, water)
Post-secondary education	Prisons and corrective services	Roads
	Public safety and emergency services	Industry regulation and development
<i>Health and community services</i>	<i>Culture and recreation</i>	<i>General public services</i>
Hospital services	Culture, artistic and other recreation services	Superannuation for public servants
Community and public health services	National parks and wildlife services	General public services
Welfare services - family and child, aged and disabled, homeless and other		Interest on debt and other debt charges
Publicly provided housing		Depreciation

(b) Local government services

General public services: council, general administration	Garbage and trade waste	Cultural/educational, such as library services, museum, public hall
Administration of facilities: airport, cemeteries, etc	Street lighting	Recreation: maintenance of existing infrastructure, including sporting and public reserve facilities
Public works, including road, bridge and footpath maintenance; cleaning services	Health: including health inspections for foodstuffs, beverages (including alcohol), water quality etc	Rural management: bees and apiaries, non-domestic animals, fences, noxious weeds
Building permits and controls	Community services, such as childcare	Domestic animal control
Planning and development approval, zonings		Water and sewerage

(c) Revenues — State and local

	<i>State</i>	<i>Local</i>
Payroll tax	Vehicle registration fees and taxes	Rates
Land revenue	Other revenue	Waste disposal fees
Financial transaction taxes	Mining revenue	Water/electricity charges
Stamp duty on conveyances, shares, vehicle transfers	Contributions by Trading Enterprises	Other admin fees and charges (airport fees, dog registration, building permits, inspections, licences)
Gambling taxation	User charges for hospital and other services	
Insurance taxation		

Possible comparable Western Australian communities, by function

Expenditure Functions	Christmas Island	Cocos Island
Schools Education		Darkan; Laverton; Mt Magnet; Mullewa
Vocational Education and Training		Remote communities in general
Health	Derby; Fitzroy Crossing; Kununurra; Wyndham	Halls Creek; Exmouth; Halls Creek; Laverton; Leonora; Pannawonica
Police	Derby	Halls Creek; Onslow; Pannawonica; Wyndham
Administration of Justice	Derby	Onslow; Pannawonica
Legal Aid		Remote communities in general
Corrective Services		Remote communities in general
Public Safety and Emergency Services		Remote communities in general
Welfare		Remote communities in general
Housing	Broome; Derby; Fitzroy Crossing;	Halls Creek; Laverton; Leonora; Onslow; Wyndham
Culture and Recreation		Remote communities in general
National Park Management		Remote communities in general
Environment Protection		Remote communities in general
Power supply	Derby; Exmouth	
Water supply		
Sewerage		
Public Transport		Remote communities in general
Ports and Harbours	Exmouth; Derby; Useless Loop	Wyndham
Roads	Broome; Derby-West Kimberley; Fitzroy Crossing; Halls Creek; Turkey Creek; Wyndham-East Kimberley	
Tourism	Derby	Remote communities in general
Services to Other Industries		Remote communities in general
Land Administration		Remote communities in general
Other Services		Remote communities in general