

CHAPTER 8

FINANCIAL CAPACITY TO PROVIDE SERVICES

1. This chapter examines the financial capacity of the Norfolk Island Government:

- to continue providing the range and standard of services it currently provides, given the existing revenue effort;
- to provide at mainland levels the range of services it currently has the power to provide, assuming it makes a revenue effort comparable with that on the mainland; and
- to provide a wider range of services in the future, again assuming it makes a revenue effort comparable with that on the mainland.

It also comments on methods for considering whether the Island could be entitled to general revenue or capital grants from the Commonwealth and on Norfolk's capacity to borrow.

THE EXISTING FINANCIAL POSITION

2. Chapter 5 and Attachment D contain details of the recurrent budget outcomes of the Norfolk Island Government. They indicate that over the years 1993-94 to 1995-96 there was an average annual cash surplus of about \$2.1 million when the operations of the Revenue Fund and the government enterprises are consolidated. Those cash surpluses were used to fund capital expenditures, which averaged about \$1.3 million a year, and to increase cash balances. The cash balances moved from \$4.4 million at 30 June 1993 to \$6.5 million at 30 June 1996.

3. These results are partly due to decisions to increase revenue raising efforts in 1994-95. They are also due to the policies the Government appears to adopt in framing its budgets. Those policies, which exert a strong downward influence on expenditure, include:

- the objective of achieving a balance or a surplus in the Revenue Fund;
- an incremental approach to the budget and the services provided;

- constraining movements in the total public service wages and salaries bill;
- maintaining close controls over the levels of reserves held by each of the business enterprises and reallocating those reserves when it is considered necessary;
- a centralised approach to the setting of priorities for capital expenditure;
- an objective of minimising taxes; and
- a strong preference not to borrow to fund capital expenditures.

4. If the results of the Revenue Fund and the business undertakings are examined separately two points stand out:

- the Government's objective of achieving balance or a surplus on the Revenue Fund depends on transfers of dividends and other funds from the businesses and there was a large increase in those transfers in 1995-96; and
- about two thirds of the increase in cash balances occurred in the accounts of the Norfolk Island Airport.

5. *Net assets.* The value of the net assets of all the government enterprises increased from \$18.285 million at 30 June 1993 to \$18.665 million at 30 June 1996 in nominal terms, an annual increase of less than 1 per cent. That small increase is considerably below the inflation rate and it masks some potential problems. For example, if the figures for net assets are adjusted to remove the cash reserves of the Airport, they become \$17.271 million at 30 June 1993 and \$15.913 million at 30 June 1996, a fall of nearly 8 per cent. Alternatively, if the figures are based on non-cash net assets for all enterprises, they are \$15.781 million at 30 June 1992 and \$13.322 million at 30 June 1996 (a decline of over 15 per cent).

6. These figures imply that, over this period, capital expenditures were less than depreciation provisions, resulting in a run down in the value of fixed assets. Moreover, a cursory examination of the coverage of the capital expenditures that have been made over these years indicates that much of it relates to the purchase of equipment for the telephone exchange and work on the electricity distribution system.

7. A similar picture can be obtained by looking at the relationship between capital expenditure and the value of assets. Information provided by the Norfolk Island Government indicates that, over the ten years ended 30 June 1996, average annual capital expenditure by the business enterprises was about \$750 000. This is about 5.5 per cent of the value of their fixed assets (approximately \$14.0 million), and is less than the average annual amount that would be spent if, on average, the assets were replaced over a 15 year period (around \$950 000).

8. The analysis suggests that, with some exceptions, past policies have resulted in a run down of the fixed assets of the government businesses. Particular examples based on our observations could be the electricity generating equipment (where it seems that at least one, and possibly three, of the five units have exceeded their useful lives as measured for accounting purposes), some heavy vehicles and some hospital equipment.

9. Thus, there is likely to be a need for increased capital expenditures in the future. While, in aggregate, cash reserves are being accumulated to meet those future expenditures, they may not be sufficient, especially if the funds generated by the Airport continue to be earmarked for its future capital needs. Moreover, it is likely that the capital facilities required in the future will need to be of greater capacity and relatively more expensive than those they replace. With the exception of computing equipment, savings that stem mainly from depreciation of historical costs are unlikely to be sufficient to replace an asset, particularly if its technical sophistication has increased.

10. Our conclusion that the value of fixed assets held by the government businesses is falling does not necessarily suggest that the undertakings will be unable to continue to provide their services. During the July conference, it was argued that equipment on Norfolk is often used for much longer than its accounting life with little effect on the provision of services. This is undoubtedly the case and there is nothing inherently wrong with such practices, so long as they are not continued past the point where the savings from deferring replacement are more than offset by higher maintenance costs and increased risk of major breakdowns. Our discussions on the Island suggested that this point may have been passed in some cases because serious concerns were expressed about the high cost of frequent maintenance of equipment, the implications of equipment breakdowns and the difficulty of repairing old equipment when it does fail.

11. If there are large differences between the actual and accounting lives of assets on Norfolk, it might be desirable to amend the accounting practices to use the efficient useful lives in calculating depreciation charges. Such a change would produce a more realistic picture of the cost of equipment used in providing services.

12. The analysis, using the Norfolk Island Government Financial Statements, is thus sensitive to the accounting policies adopted in preparing those accounts. In particular, the criteria used to distinguish between capital and recurrent expenditure (and thus the value of assets) could influence the calculations. Transactions as low as \$485 have been classified as capital. Under criteria used by the Commonwealth, items with a value of less than \$2000 are treated as recurrent. Nevertheless, it is unlikely that the conclusions of the analysis would be much affected by different policies on this matter.

13. It has not been possible to do similar figuring for the Revenue Fund but it is probable that, on the whole, its assets are also being run down. Our observations suggest that this could be the case for some community assets and some plant and equipment used by the works depot.

The Budget Outlook

14. Our analysis indicates that, for several reasons, including the ageing of the population and the run down in its infrastructure, the Norfolk Island Government is likely to face increased expenditures in the future, even if there are no changes in the range or standard of services for which it has responsibility. If there were no downturn in the Island's economy, the Government would be able to fund those additional expenditures, especially if it were to use more of its tax base.

15. If there were a moderate economic downturn, the financing task would become harder. To illustrate such an outcome, we have used the projected movements in the Island's budget provided by Access Economics in its recent report to the Norfolk Island Government. Table 8-1 summarises the recent budgetary results and those projected results up to the year 1999-2000. The projected results are based on the Access Economics forecasts, which assume unchanged government policies and some reductions in income from the tourist industry, and an assumption that the Revenue Fund would be balanced by dividends paid by the businesses.

Table 8-1 ACTUAL AND PROJECTED RESULTS OF REVENUE FUND AND BUSINESS ENTERPRISES, 1991-92 TO 1999-2000

	Revenue Fund Outcome ^(a)	Undistributed Profits of Business Enterprises ^(b)
	\$'000	\$'000
1991-92 (actual)	-212	229
1992-93 (actual)	-257	325
1993-94 (actual)	-134	765
1994-95 (actual)	345	320
1995-96 (actual)	600	-391
1996-97 (forecast)	423	574
1997-98 (forecast)	0	-205
1998-99 (forecast)	0	-111
1999-2000 (forecast)	0	-153

(a) The net surplus/deficit of the Revenue Fund including its capital expenditure and all transfers from business undertakings.

(b) The total profits or losses of business enterprises less dividends and capital amounts paid to the Revenue Fund. For the years 1996-97 and thereafter, the dividends have been estimated as \$2 million plus any deficit on the Revenue Fund forecast by Access Economics.

Source: Access Economics, *Norfolk Island: Recent Economic Performance, Present Situation, and Future Economic Viability*, March 1997, p30.

16. In both 1994-95 and 1995-96, the Revenue Fund required dividend payments from the business undertakings of about \$2 million and, on these projections, larger amounts could be required in the near future. The illustrative projections in Table 8-1 suggest that requiring the business undertakings to contribute those amounts could lead to reductions in their cash reserves or in their capital expenditure programs. Given our expectations that at least some of the businesses will need to increase their capital expenditures, either of these actions could be only short term solutions. Maintenance of existing services and capital stocks in the longer term would require the Government to increase its revenue raising effort.

FINANCIAL CAPACITY TO FULFIL PRESENT RESPONSIBILITIES

17. Chapter 6 concluded that, after taking account of the special circumstances of Norfolk Island, some services are provided at levels below those available in small remote communities on the mainland. It also noted that there are some services, mainly of an administrative or regulatory nature, which the Norfolk Island Government has powers to provide, but generally does not.

Recurrent Expenditure

18. Estimates of the additional recurrent expenditure that might be incurred in providing mainland levels of services are difficult to make, but some estimates, together with a brief explanation of the bases on which they were made, are set out in Table 8-2. These estimates include \$100 000 for additional training of public service officers, a cost that in the longer term should be offset by efficiency savings.

19. The Norfolk Island Government elected in April 1997 has not yet fully considered the range and level of services it provides. However, during the July conference, government representatives noted that action on some of the services listed in Table 8-2, such as the appointment of staff to administer the planning and land administration processes, had been taken during 1996-97. Other representatives suggested that, of the remaining services, vocational education and training would have a high priority. There was a more tentative view that expenditure on social security and welfare might need to be increased. Our view is that vocational education and training, health insurance, social security and some State-type welfare services are the main issues.

Table 8-2 ESTIMATED ADDITIONAL RECURRENT EXPENDITURE TO PROVIDE STANDARD LEVEL OF SERVICES, 1995-96

Service	Basis of Estimate	Estimate \$ each year
Employment, Vocational Education and Training	Average expenditure by the States on technical education for each person aged 15 and over, increased by 30 per cent to allow for scale, isolation and other disabilities, applied to Norfolk's permanent population aged 15 and over.	300 000
Welfare services	Half the average expenditure by the States on family and child welfare for each person under 17 years applied to Norfolk's permanent population aged under 17 years; plus half the average expenditure by the States on services for the aged and disabled for each person aged 60 and over applied to Norfolk's permanent population aged 60 and over; plus half the average expenditure by the States on other welfare services for each beneficiary applied to Norfolk's welfare beneficiaries, increased by 5 per cent to allow for scale, isolation and other disabilities.	160 000
Social security benefits	Australian expenditures on age, and widows' pensions for each person aged 60 and over applied to 75 per cent of the permanent Norfolk population aged 60 and over, plus Australian disability pensions for each beneficiary applied to 75 per cent of the number of handicapped people on Norfolk, less Norfolk's expenditure on social service benefits.	950 000
Housing assistance	Half the Australian average expenditure on housing assistance per capita, applied to Norfolk's ordinarily resident population.	50 000
Health insurance	Australian per capita expenditure on medical and pharmaceutical benefits, applied to Norfolk's ordinarily resident population, less the Norfolk Government contribution to Healthcare Fund and hospital and medical expenses for approved persons.	350 000
	Hospital revenue foregone: Assume 75 per cent of inpatients would receive free hospital treatment under mainland Medicare arrangements.	370 000
Planning and environment, administration	Costs of one middle-ranking officer ^(a) .	40 000
Land administration	Costs of one middle-ranking officer ^(a) .	40 000
Fire services, training	Expenses and salaries for two people to visit Norfolk Island for one week each year.	10 000
Additional training for public service staff	Additional expenditure required to increase training expenditure to three per cent of salaries.	100 000
Other services ^(b)	Estimate.	100 000
Total		2 470 000

(a) An officer was appointed for this purpose in 1996-97.

(b) Includes regulatory and administrative services not provided and support for a pre-school and cultural activities.

Infrastructure

20. Estimates of infrastructure expenditures are more difficult to make because they require information on the condition of existing infrastructure and its remaining useful life, as well as information on the additional infrastructure needed to provide mainland standard services. We think that a useful early step in the long term planning processes for the Island would be to engage experts in the field to conduct a full review of the Island's infrastructure and its future requirements. Such a review would provide independent technical guidance on the condition of existing infrastructure, priorities for individual projects and projections for annual expenditures, which would be invaluable in the budgeting and planning processes.

21. In the absence of such advice, we have prepared indicative estimates of expenditures on infrastructure and capital equipment required to provide mainland standards of services on Norfolk. These estimates are based on information in the submissions to this inquiry, the accounts of the Norfolk Island Administration, and judgement based on what we were told and saw for ourselves. Table 8-3 contains our estimates of total capital expenditures that might be incurred over the next 10 years, and a brief indication of the basis of the estimates.

22. During the July conference, it was noted that funds were already available for some of these items and that action had begun to address them. For example, decisions have been taken on the purchase of a new electricity generator, X-ray equipment for the hospital, computing equipment and some heavy vehicles. With the completion of the undergrounding of electricity mains, the development of the Burnt Pine area, including the provision of street lights, is scheduled to proceed. A long term plan for the airport pavement works and a new terminal has been prepared. These outlays will be funded from reserves and surpluses generated by the airport operations. Moreover, analysis of options for waste management facilities and the stabilisation of Cascade Cliff are well advanced. In the Cascade Cliff case, the Government indicated that the options under consideration could result in the initial stabilisation work being done with no cost to it. However, there would be a loss of future revenue and costs would be incurred in the future when rock products were purchased for roadworks.

23. Obviously, some of the estimates in Table 8-3 are rough. If a general adjustment were made for possible overestimates, it might be that total capital expenditure needed over the 10 years would be about \$55 million. That amount would imply average annual expenditures and/or provisions of \$5.5 million. Assuming a continuation of the policy of not borrowing to fund capital expenditures, provisions of that order would need to be made out of recurrent revenues.

Table 8-3 INDICATIVE CAPITAL EXPENDITURE NEEDS OVER TEN YEARS TO PROVIDE MAINLAND STANDARDS

Expenditure	Basis of Estimate	Total \$m
Harbour	Norfolk and DEST submissions.	11.0
Cascade Cliff	Advice during conference on draft report.	0
Hospital (including aged care facilities) – replace	Norfolk submission.	10.0
Airport – new terminal	Norfolk submission.	2.2
Airport – pavement works	Norfolk submission.	7.0
Waste management minimum facilities	Norfolk submission.	0.8
Electricity service – replace three oldest generators and other works	Three generators at \$650 000 each, plus other works at \$100 000 a year.	3.0
Emergency services – replace equipment	Norfolk submission.	1.2
Burnt Pine development	Norfolk submission.	1.1
Roads – urgent road works, on-going reconstruction and maintenance, replacement of heavy vehicles	DEST submission plus average annual expenditure on reconstruction and, say, \$250 000 for replacement of vehicles.	4.8
Works depot – replace and upgrade equipment	Estimate.	2.0
Water assurance – replace equipment and some extension of mains	Historical value of equipment plus 50 per cent of mains.	2.4
School – refurbish buildings and extend for vocational education	Estimate.	5.0
Telecom – replace and upgrade equipment	Estimate.	5.0
Lightrage service – replace cranes and equipment	Historical value of equipment.	0.4
Broadcasting – replace and upgrade buildings and equipment	Estimate.	0.5
Court house and land registry office – build	Estimate, based on cost of police station	1.0
Building refurbishment	Estimated as an average of \$200 000 a year.	2.0
Vehicles, plant and equipment, furniture and fittings, and other minor works	Average amounts spent in last few years were about \$250 000.	2.5
Total		61.8

Financial Limitations

24. If the figures in Table 8-3 were ‘within the ball park’, the Norfolk Island Government would not have the financial resources under present revenue raising policies to meet the expenditures.

25. However, Chapter 7 concludes that, while the Norfolk Island Government is making a higher effort than on the mainland in relation to the taxes and charges it actually imposes, several taxes imposed on the mainland are not imposed on Norfolk. It is estimated that, if the standard revenue raising effort were applied on the Island, \$15.9 million might be collected each year.

26. Table 8-4 shows the Commission's estimates of recurrent and capital expenditures that might be incurred on Norfolk if services were to be provided at mainland levels. It also shows the estimates of the recurrent revenue that could be raised if mainland revenue raising efforts were to be applied to Norfolk's tax bases and other funds already available to finance capital expenditure. In preparing the table, it has been assumed that the existing Commonwealth expenditure on services provided for Norfolk, such as its contribution to KAVHA, would continue.

Table 8-4 ILLUSTRATIVE 1995-96 NORFOLK BUDGET, ASSUMING MAINLAND EXPENDITURES AND REVENUE RAISING EFFORT

	Amount
	\$
Revenue at mainland revenue raising effort ^(a)	15 900 000
Less: Recurrent expenditure ^(b)	7 500 000
Extra recurrent expenditure to provide mainland standards ^(c)	2 470 000
Surplus on recurrent account	5 930 000
Plus: Undistributed profits of business enterprises ^(d)	280 000
Funds from depreciation provisions	1 200 000
Total funds available for capital expenditure	7 410 000
Less: Annual capital requirement	5 500 000
Surplus, estimated	1 910 000
(a)	From Table 7-12.
(b)	Total 1995-96 expenditure of the Revenue Fund less capital expenditure (\$620 000) and expenses recovered from business enterprises (\$600 000).
(c)	From Table 8-2.
(d)	Surplus of business enterprises for 1995-96 (\$2 100 000) less revenues at mainland revenue efforts for landing fees, Healthcare levy and transfers from business enterprises (\$1 620 000). Actual revenue from the Workers Compensation Levy (about \$200 000) has also been deducted as the analysis assumes it is part of pay-roll taxation.

27. Putting the estimated recurrent revenues and expenditures together indicates that Norfolk Island has the financial capacity for its Government to provide mainland levels of recurrent services. The financial capacity also exists to provide infrastructure at

mainland levels, given the existing cash reserves, the surplus on recurrent activities, the revenue available from the undistributed profits of the business undertakings and the funds generated by the depreciation provisions.

28. This analysis is based on the estimated average annual capital requirement over the ten years commencing 1996-97. That simple approach has been taken to avoid problems presented by the lumpy nature of infrastructure expenditure and to allow for the element of choice in its timing. That is:

- some infrastructure projects have already commenced or are planned to commence in the near future (for example waste minimisation facilities and the replacement of some plant and equipment);
- others could be deferred for a short time, pending the outcome of studies into the best options (for example, harbour facilities); and
- others are further down the track because existing facilities are adequate for the time being (for example, the hospital) or the existing demand does not justify dedicated facilities.

29. These tentative conclusions are based on an implicit assumption that the level of economic activity on the Island would remain at about the levels we estimate in Chapter 4. However, for many reasons, this may not be the case.

30. The forecast movements in the results of the Revenue Fund and government businesses shown in Table 8-1 indicate that even on the basis of unchanged policies the government could face a deteriorating budget outcome. A big downturn in tourism would cause a budget crisis.

31. Any changes in government policy to increase the standard of services and revenue raising efforts towards mainland levels could also affect the level of economic activity on the Island and thus have second round effects on the government budget. These are not likely to be large enough to negate our conclusions, given our conservative estimates of the economy.

Summary

32. Successive Norfolk Island Governments have kept the level of taxes low, resulting in low levels of services and expenditure on infrastructure. If the present Government were to use its financial capacity to the same extent as is done on the mainland, it would have the financial resources to fulfil its present responsibilities at mainland levels.

FINANCIAL CAPACITY TO ACCEPT ADDITIONAL RESPONSIBILITIES

33. At various times, it has been suggested that Norfolk Island should eventually take over responsibility for all the remaining powers reserved to the Commonwealth, except

defence and foreign affairs. In particular, it was suggested during this inquiry, not always by the Norfolk Island Government, that it should take over:

- (i) land management;
- (ii) control of the seas within the 200 nautical mile limit;
- (iii) the activities of KAVHA;
- (iv) the National Park; and
- (v) offshore financial activities.

34. The possibility of a transfer of the powers necessary for Norfolk Island to become an offshore financial centre has not been considered in this section because there is no definite proposal from the Norfolk Government. In any case, Chapter 4 suggested that, although development of an offshore financial centre may be a longer term prospect for economic diversification, there are many issues that would need to be resolved by the Commonwealth and Norfolk Island Governments before such a centre could be developed.

35. The following considers the possible transfer of each of the other functions in terms of the expenditure responsibilities involved and the revenue such a transfer might bring.

36. ***Land management.*** The current dual system of land management on Norfolk Island is both duplicative and inefficient. The Commonwealth and the Norfolk Island Governments propose to address this issue once the new land legislation package is fully operative and working efficiently. As a precursor to transfer of any further land administration powers, the Norfolk Island Land Review Working Group set out detailed arrangements that need to be in place. The Commonwealth has indicated that its view on any transfer would depend partly on whether it is satisfied that adequate resources are available for the continued operation of those arrangements.

37. During 1996-97, a land titles administrator and a planning officer were appointed to undertake tasks required by the August 1996 package of legislation relating to land management and planning (including acts covering lands titles, planning, building, subdivision, Crown lands, land administration fees, roads, heritage and public health). A computerised lands titles system for the Island has also been developed with financial assistance from the Commonwealth. Given those actions, the takeover of further land management powers should not lead to many additional financial burdens for the Norfolk Island Government. Moreover, because land not currently controlled by the Norfolk Island Government is leasehold from which revenues are raised, a transfer of this function could result in the Norfolk Government collecting sufficient additional revenue to offset any additional cost involved. Thus it would seem that the transfer of this function is a matter for consideration in a wider sense — the financial aspects do not impose constraints.

38. ***Control of the sea.*** There was considerable argument from the Norfolk Island Government concerning the prospect of having control of the sea and resources in and under it, out to the international limit of 200 nautical miles. The options for such a

transfer, the expenditures Norfolk might incur and revenues Norfolk might raise as a result of it were discussed in Chapter 4.

39. That discussion concluded that the resulting expenditures would most likely exceed the small additional revenue Norfolk might collect from fishing rights and that any royalties from oil and gas production were most unlikely.

40. ***Kingston and Arthur's Vale Historic Area (KAVHA)***. The Commission views the KAVHA district as one of the prime tourist attractions of Norfolk Island. It is an important part of Australia's history and, during the July conference, we were told that the statement of significance in the heritage listing of the area was recently amended to recognise its importance to the history of the Pitcairners. The interpretative material for the area has also been amended to increase the emphasis on the Pitcairn settlement.

41. It is said that all tourists to the Island visit the KAVHA area. However, there are indications that the Island residents undervalue its tourist potential. The KAVHA Management Board has recently begun to develop a business plan for the area that will, among other things, attempt to identify revenue raising opportunities, with the long term aim of making the area self sufficient. Based on the experience in other heritage listed areas, the achievement of that aim might be assisted if the KAVHA area were to be listed.

42. The only revenue now generated direct from the area appears to be from property leases and the activities of the Norfolk Island Government's museums. This revenue benefits the Norfolk Island budget. Unlike costs in the KAVHA area, the revenue is not shared between the Norfolk Island and Commonwealth Governments. The fact that commercial tourist enterprises are currently using KAVHA assets free of charge indicates that there is some additional revenue raising capacity here, possibly through a levy on the operators.

43. In 1995-96, the Commonwealth contribution to KAVHA was \$392 000, and this seems to be one of the keys to whether or not the Norfolk Island Government could take over this function. Unless those grants continued or the Norfolk Island Government used more of its revenue raising capacity, it would not be able to continue to provide the current level of service. We do not see a lower level of service as appropriate. The area has national, as well as local importance and the Commonwealth should continue to be involved.

44. ***Norfolk Island National Park***. With the exceptions of Uluru and Kakadu, and the park in the Jervis Bay Territory, all National Parks on the mainland are controlled and run by State Governments. Thus, there is some argument for transferring the responsibility for the services currently provided by Parks Australia to the Norfolk Island Government. However, there is a national interest in the park. Moreover, in accordance with international treaties, the National Park is run to international standards, as adapted to the Norfolk environment. Thus, any transfer would need to be conditional on an undertaking that the existing standards would be maintained.

45. The National Park on Norfolk has almost 100 per cent attendance by tourists and the tour operators do not pay any permit fees. Given the nature of the park, it is most

unlikely that a cost effective entry fee could be introduced, although it might be feasible to impose a fee on tour operators.

46. In 1995-96, Parks Australia spent \$659 000 on Norfolk Island. Hence, the Norfolk Island Government would incur considerable additional expenditure if it took over the National Park. Some improvements in efficiency might be possible by integrating the operations of Parks Australia and the Norfolk Island Forestry Department. However, since the objectives of the two organisations are different and because any integrated operation should aim to achieve both sets of objectives, it is likely that any gains would be small, possibly less than ten per cent of the Parks Australia's Norfolk Island budget. Thus, the Norfolk Island Government expenditure could increase by as much as \$600 000.

47. The analysis earlier in this chapter indicated that the Norfolk Island Government could raise such additional revenue if it chose to increase its revenue raising efforts. Thus any decision on the transfer of responsibility for the park could depend on wider considerations, including the extent of the national interest in the park and its environmental assets, and the ability of the Norfolk Island Government to recruit and retain the necessary administrative and technical expertise.

Summary

48. In general, it would seem that, of all the functions considered for transfer to the Norfolk Island Government, only land management would not result in an additional financial burden. The others would result in additional expenditures in excess of \$1 million (about \$600 000 for the National Park, \$400 000 for KAVHA and an unknown amount for control of the seas) and little extra revenue. On the other hand, given the national significance of KAVHA and some aspects of the National Park, there is a case for the Commonwealth retaining an interest in those activities or for some Commonwealth assistance.

49. Using the estimates in Table 8-4, taking over these powers should be within the financial capacity of the Norfolk Island Government, provided it increased its revenue raising effort. In fact, the figures suggest that the Norfolk Island Government could provide mainland standards of service in all areas where it currently has statutory responsibility, meet all the associated infrastructure costs and take over the extra responsibilities, if it increased its revenue raising effort to mainland levels.

COMMONWEALTH ASSISTANCE

50. The previous discussion has been based on the assumption that expenditure on services and infrastructure on Norfolk Island would be funded largely by the revenue raising efforts of the Norfolk Island Government.

51. However, in financial terms, the Australian Federation operates on the Commonwealth raising the bulk of the revenue and paying grants to both States and local government. On average, the States receive about 40 per cent of their recurrent revenue

from the Commonwealth through grants. More than half the funds transferred from the Commonwealth are untied — the States can do with them as they wish. The level of Commonwealth assistance given to a State, Territory or local government authority is not related to its contribution to the Commonwealth budget and some local government areas (for example the remote Aboriginal Councils) would contribute very little indeed.

52. As was seen in Chapter 5, Norfolk Island receives much less revenue per capita from the Commonwealth than do other Territories, either internal or external. There are many reasons why this is so, including:

- the expectation of many, both on and off the Island, that Norfolk Island should be self sufficient¹;
- the degree to which past Norfolk Island Governments have sought independence from Australia rather than reliance on the Commonwealth; and
- the consequent wider powers that the Norfolk Island Government has to raise revenues.

53. While it is ultimately for the Norfolk Island community to decide on the level of services appropriate to Norfolk, its Government's past pursuit of financial self sufficiency (and rejection of specific offers of Commonwealth assistance) has, in our opinion, resulted in lower standards of services and infrastructure than need be.

54. In principle, Norfolk Island's eligibility for assistance from the Commonwealth to fund recurrent needs could be estimated using the Commission's usual methods. Estimating such a level of assistance would require information on:

- the revenues raised by the Commonwealth, State and local governments on the mainland from those taxes which Norfolk has the power to impose;
- the expenditures by the Commonwealth, State and local governments on the mainland on those services which Norfolk has the statutory responsibility or power to provide; and
- the effects of disability factors (such as the small scale of operations, the isolation and the greater proportion of the population in the higher age groups) on the costs of providing services and the capacity to raise revenue.

55. Whether or not a grant could be justified would depend largely on a comparison between the calculated level of assistance required and the contribution the Commonwealth is already making to Norfolk in the form of expenditure on services related to Norfolk.

¹ DEST submission, p41.

56. We have been unable to make these calculations, mainly because adequate data are not available. However, our impression is that, particularly taking account of Norfolk's access to Commonwealth type taxation, and the conservative nature of our estimates of its revenue capacity, the Island would be most unlikely to be eligible for recurrent general revenue grants.

57. On the capital side, the Commonwealth provides very little capital assistance to States — there is no general purpose capital funding and only a small amount of specific purpose payments for capital purposes. A notional entitlement to Commonwealth assistance for capital requirements could be based on an assessment of need for such assistance, taking into account the following points.

- Is infrastructure provided at levels similar to, above or below, that provided in the States?
- Has the Norfolk Island community made a reasonable effort to fund its infrastructure from its own resources?
- Are there special reasons why the Commonwealth should provide capital funds for the Island?

58. A number of submissions argued that the Commonwealth had left the Norfolk Island Government a legacy of sub-standard infrastructure in 1979 and that it had an obligation to rectify this. The Commonwealth noted that, while the problems of Cascade Cliff, the lack of adequate harbour facilities and many other inadequacies with infrastructure existed prior to 1979, the Island community, in its desire to achieve self government, accepted the infrastructure as it was. For its part, the Norfolk Island Government argued that in 1979 it did not have the capacity to do more than concentrate on the major issue, the achievement of self government. Moreover, its actions did not imply that it considered the standard of the infrastructure was acceptable.

59. The Norfolk Island Government also argued that, since 1979, its capacity to improve services has been limited because resources have been required to overcome the inadequacies in the infrastructure transferred to it.

60. We have no way of assessing these arguments. However, we think there is some justification for the Commonwealth making a contribution to overcome safety problems or improve items of infrastructure that were known to be inadequate before self government, such as Cascade Cliff and the harbour.

CAPACITY TO BORROW

61. On the mainland, State and local governments have the power to borrow as and when they see fit, subject to co-ordination through the Loans Council and their capacity to repay such loans.

62. The Norfolk Island Government's capacity to borrow is limited by legislative arrangements and its capacity to repay loans. Its initial submission² outlined its borrowing arrangements. In brief, the *Norfolk Island Act 1979* authorises:

- the Commonwealth Minister for Finance to loan money to the Administration or a Territory Authority;
- Norfolk Island to borrow, other than from the Commonwealth, with the specific, prior and written approval of the Treasurer; and
- the Treasurer to act as guarantor for loans, other than from the Commonwealth.

63. The previous Norfolk Island Government said these arrangements precluded it from obtaining short term credit such as a bank overdraft. It also noted that, while there were no external loans at present, this facility had been used in the 1970s (prior to the establishment of the Norfolk Island Legislative Assembly). If the Norfolk Island Government has responsibility for service and infrastructure provision, it seems reasonable that it should also be given the capacity to take out loans, if it so chooses.

64. The Norfolk Island Government prefers to finance its infrastructure expenditure from its reserves. That is, it saves revenue raised over a period of several years and pays for its infrastructure in cash. The benefits of this approach were said to include:

- consistency with the cultural desire to avoid debt and confine spending within immediate means;
- that the government may get 'a better deal'; and
- by deferring purchase until it has sufficient funds, the government may get the opportunity to purchase a newer model or an older model at a cheaper price.

65. However, there are potential costs in this approach. The most obvious is the deferral of the benefits that flow from the replacement of the capital asset. We see little real distinction between setting aside money in the budget for estimated capital expenditure and buying the asset and setting aside the same money as repayments. Deferring capital expenditure would generally result in some cost increases due to the effects of inflation on the price of the new asset and additional maintenance costs of the old one. It would also result in a deferral of the benefits of the new asset to the community, which might include improvements in the quality of the service and additional income earning opportunities. The question is whether the value of those additional costs and lost benefits is greater or less than the total financing charges (that is, interest foregone on the savings and interest paid on the loan) associated with an earlier purchase.

66. We have some doubts about the strength of the cultural desire to avoid debt. Commercial and residential development on the Island is based, in part, on borrowing and a major sporting club is understood to have built its facilities with loan funds. There is also

² Norfolk Island Government submission, p22.

the question of inter-generational equity. Borrowing ensures that the present and future populations, which receive the benefits of an asset, share the cost of it.

67. Borrowing would increase the Norfolk Island Government's financial capacity in the short term, and maybe also in the longer term if it were to invest in assets which raise revenue, such as electricity generation, airport and port facilities, telecommunications equipment and water assurance. We fully support the argument that borrowing should not be undertaken to fund recurrent operations, and indeed there is a general movement on the mainland to fund as much social infrastructure as possible from recurrent sources.

68. Clearly, governments are best placed to decide whether the benefits of setting aside money now to buy an asset later outweigh the benefits of buying now and paying more later. It seems likely that the balance of advantage varies from time to time and from asset to asset.