

Submission by Luke Johnson
To the
Joint Standing Committee Inquiry into Governance on Norfolk Island Part Two
Financial Sustainability and Governance Arrangements

Joint Standing Committee on the
National Capital and External Territories

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Introduction

I have worked in Local Government for over 20 years and hold a Bachelor of Arts and a Master of Business Management (Local Government).

My family and I moved to Norfolk Island in October 2001 when I commenced in the position of *Executive Director Corporate Support and Business Development* working for the Administration of Norfolk Island.

In October 2002 I accepted the role of Acting Chief Executive Officer.

In July 2003, following a recruitment process, I was appointed to the position of Chief Executive Officer.

In January 2005 I concluded as Chief Executive Officer and my family and I returned to mainland Australia. I am now the General Manager of Goulburn Mulwaree Council.

Importantly, I note that I resigned from the position of Chief Executive Officer and left Norfolk Island of my own volition and on good terms with the Norfolk Island Government. I have no agenda other than a desire to assist.

I appear before the Committee today as an individual and not speaking on behalf of any other organization.

I do not propose to provide specific details about the business of the Administration as I believe that information should be sought directly from the Norfolk Island Government and Administration.

I appear before the Committee to provide an open, objective and independent perspective on the current concerns and how they may be best addressed.

Executive Summary

I do not believe the current arrangements are sustainable.

However I believe it is possible for the Federal and Norfolk Island Governments to reach a mutually acceptable sustainable arrangement. Indeed, I believe it is essential to reach a mutually acceptable sustainable arrangement as a matter of some urgency to ensure Norfolk Island and its people can continue to maintain their core aspirations. This is particularly so given the current financial situation and the potential for already serious issues to worsen rapidly.

Norfolk Island is a unique and special place. The significance of its history, culture and language must surely be one of the key elements in these considerations. Other key elements of course include financial sustainability, equity and environmental protection.

In my submission I will focus my comments on issues concerning Norfolk Island's financial sustainability as I believe it is of fundamental importance to the other key elements.

Before commenting further on the sustainability of the current arrangements, I would like to highlight some important issues.

Norfolk is a Place of Achievements

Clearly, Committee Members are well aware of the broad responsibilities of the Administration of Norfolk Island. To assist in putting this knowledge into context, I ask the Committee Members to imagine a medium-sized local Council (say 200 staff) and in addition to the generally accepted Local Government responsibilities, adding the following:

- Customs
- Immigration
- Police Service
- Legal (Public Prosecutions, Legislative Drafting etc)
- Courts Including:
 - Supreme Court
 - Court of Petty Sessions
 - Family Court
 - Coroners Court
- Land Titles Office
- Births, Deaths and Marriages Registry
- Telecommunications
- Electricity Generation
- Electricity Reticulation
- Postal and Philatelic Services
- International Airport
- Social Services including:
 - Age benefit
 - Invalid benefit
 - Widowed persons benefit
 - Handicapped Children's benefit
 - Special Benefit
 - Supplementary Children's benefit

- Healthcare Scheme
- Company & Business Registrations
- Consumer Price Index
- Education (Kinder to yr 12)
- Quarantine
- Emergency Services
- Historic Restoration
- Forestry
- Lighterage
- Fisheries
- Broadcasting
- Liquor Bond

Is it appropriate to expect the Administration of a small island of less than 2,000 people to be responsible for a broader range of infrastructure and services than any other state or territory in Australia? Clearly it is neither appropriate nor sustainable.

Put simply, this very small and unique community achieves remarkable outcomes in a remote and isolated environment with comparatively very limited financial assistance from the Commonwealth, which is of course a reasonable product of the current taxation arrangements.

Improvisation, determination and a “can-do” attitude are clearly evident among many Administration workers. These attributes are commendable but the lack of tertiary education and professional development is clearly evident within the Administration which has for many years relied on recruiting key professional and management positions from off-shore.

Given Norfolk Island’s small population, isolation, limited training opportunities and broad responsibilities, there are significant staffing and administrative capacity shortcomings.

Nevertheless, I certainly left Norfolk Island with a sincere admiration for the achievements of many staff members within the Administration.

The Need for Financial Sustainability

As the Committee would be aware, The Administration has in place a structured process of receiving annual estimates of expenditure, developing annual budgets, preparing annual financial statements and independent auditing.

This in itself is a very complex process for an organization with responsibilities spanning all three tiers of government.

However I believe that there are several serious and fundamental problems with the current revenue arrangements. In summary, the current revenue regime is:

1. Based on a very fragile economy
2. Very regressive
3. Unsustainable

A Fragile Economy

The current revenue raising arrangements are fragile because:

1. The economy is based (either directly or indirectly) almost solely on tourism and
2. The tourism market is volatile, unreliable and susceptible to price variation.

These are not just my views:

- In 1997, the Access Economics report (*Norfolk Island: Recent Economic Performance, Present Situation, and Future Economic Viability. Is There a Case for Change?*) concluded that the existing taxes and charges are biased against

tourism making Norfolk Island a less competitive tourist destination and posing a threat to its prime income base

- The recent Taxation Options paper prepared by Commonwealth Treasury notes (p.4) that most of Norfolk Islands 349 businesses exist principally because of tourism
- The Commonwealth Grants Commission 1997 report notes (p.149) that in 1995/1996 Tourists comprised about 26% of the population but contributed about 40% of the Revenue.

A Regressive Revenue Regime

The revenue regime is regressive because of the complete absence of marginal adjustments that are an essential and core element of taxation theory and practice.

To put it in the plainest possible terms, the equity that is built into the Australian taxation system is almost completely absent from the Norfolk System. This is not surprising given that building equity into taxation creates complexities. Nevertheless, given the absence of features such as marginal income taxation, the system is very regressive.

On Norfolk Island the less well-off residents contribute a much higher proportion of their disposal income to taxation revenue than the wealthy residents when compared to the mainland Australian system.

Clearly, the Norfolk Island revenue regime is far less equitable than the mainland Australian system. As indicated in the Treasury "Taxation Options for Norfolk Island" report (p.7):

“Norfolk Island’s current taxation regime does not appear to have regard to progressivity or any explicit redistributive objectives. The taxes levied are generally flat, across the board, meaning that lower income earners pay a higher proportion of their income on taxation than higher income earners. In 1995-1996, Norfolk Island raised only 4 per cent of its tax revenue from income and wealth, compared to 54 per cent in mainland Australia.” (underline added)

Even the Island’s Healthcare Levy is highly regressive - a flat \$250 every six months for each adult resident with an exemption for those who can afford private health insurance.

The Treasury paper also states (p.7):

“There is also a range of interests that need to be balanced in developing a new taxation regime. Norfolk Island is small and many of the residents may have multiple interests, for example, politicians and government officials who will be involved in deciding on a new tax regime may also own land and business interests. Although the majority of the population are low to middle income earners who could be expected to benefit from a switch in taxes to a more equitable income tax system, a small number of very wealthy residents may oppose the removal of the ‘tax free status’ they have enjoyed to date.” (underline added)

Indeed, an examination of the Norfolk Island financial statements clearly indicates that the Island is not “tax-free”. The system is simply different to the Australian taxation system and the main difference is that it is far less equitable and does not raise enough revenue to sustain the Island.

As indicated previously, the Taxation Options paper prepared by Commonwealth Treasury refers to the issue of conflicts of interest. This is an important issue and I therefore make the following general comments in relation to this matter.

The range of taxes, fees and charges set by the Norfolk Island Government and Assembly (an Assembly of nine members) is much broader than any other Australian Government because it combines (with few exceptions) all three tiers of government responsibilities. Accordingly, this small Assembly makes financial and policy decisions covering an extraordinarily broad range of issues that directly and comprehensively impact on the people of Norfolk Island. These decisions are then implemented by just one organisation, the Administration of Norfolk Island.

Coupled with this are the unavoidable issues associated with these decisions being made within a small and isolated community.

You might reasonably expect that in this situation the mechanisms for ensuring open, accountable and transparent decision-making would include a combination of the best attributes of that which is found in local, state and federal jurisdictions on the Australian mainland.

However, from my experience I can say with certainty that the requirements on Norfolk Island are far less rigorous than those which apply to local government in New South Wales.

Accordingly, I believe that given the broad responsibilities of the Norfolk Island Government and Administration, the current requirements on Norfolk Island concerning open meetings, conflicts of interest, freedom of information and privacy would benefit from being brought much closer to those that generally apply to all three tiers of government on the Australian mainland.

In 1997 the Commonwealth Grants Commission (p.163) noted that Norfolk Island could broaden its tax base by increasing its taxation of income and/or wealth and that if Norfolk Island were to extend its tax base it could most readily do so by imposing municipal rates or land taxes. However the only land-based tax on Norfolk Island is the Absentee Land-Owners Levy.

A Financially Unsustainable System of Government

Most importantly, I believe that the current system of government is financially unsustainable.

Given the constraints of such a small population, I believe that it is simply not possible to raise sufficient funds to provide on-going services and essential infrastructure at an acceptable level. Indeed, the Australian intergovernmental financial redistributive processes are specifically designed to address horizontal fiscal imbalances of this sort.

That is, to ensure that smaller and more isolated communities receive additional financial support to compensate for their challenging circumstances.

When one considers that costs associated with maintaining and renewing essential infrastructure, on-going service provision, the rapidly escalating costs of social services, healthcare, education, the aging population, the need to vastly improve occupational health and safety and the environmental pressures facing the Island, it is not really surprising that this is well beyond the capacity of such a small population.

In my view, even leaving all other issues aside, the financial magnitude of the revenue short-fall will become apparent with the development of a detailed costing of asset renewal requirements. While on Norfolk Island I successfully negotiated with officers from the Department of Transport and Regional Services for funding to prepare an Asset Management Plan. I understand that this is currently being undertaken.

I suggest that it is equally important to carry out similar examinations of environmental and social priorities.

Typically, given the essential nature of much of the public infrastructure it would be reasonable to expect considerable reserve funds to be set aside annually and detailed

forward plans for asset replacement in addition to sizeable working funds to provide a buffer against unforeseen revenue variations such as might arise from a tourism down-turn.

I believe that the revenue short-fall is a fundamentally serious and rapidly growing problem.

The scale of this problem is, without question, well beyond the capacity of the Island to solve. In the past the Assembly has frequently relied on expenditure cuts and organizational restructures to balance its budgets. Indeed, such an approach only serves to mask the real problem and delay the identification and implementation of a meaningful solution.

There are three fundamentally important issues that need to form part of any meaningful solution to Norfolk Island's fiscal crisis. It is necessary to:

1. Reduce or at least not increase the taxation burden placed on tourists
2. Introduce a meaningful measure of equity into the current revenue raising arrangements
3. And most importantly, significant additional revenue needs to be raised to meet the considerable and rapidly growing financial pressures facing the Norfolk Island Government

The Taxation Options paper prepared by Commonwealth Treasury:

- Reports on six options for taxation review
- Recommends, as the preferred option, some form of integration with the Australian Taxation system
- Recommends that if Norfolk Island wishes to make its own revenue base more robust, it develop either its own income tax system or implement a land tax system
- Notes that a broad based consumption tax is not the preferred model

Having lived and worked on Norfolk Island for three years, and with the experience gained from having held the responsibilities of Chief Executive Officer of the Administration of Norfolk Island for the majority of that time, I agree with the recommendations made by Commonwealth Treasury. The only caveat I would add is that *some form of integration with the Australian Taxation system* only proceed in the context of genuine discussions with the Norfolk Island Government and a joint commitment to maintaining and respecting the uniqueness of Norfolk Island and the core aspirations of its people.

The Proposed Norfolk Sustainability Levy

Norfolk Island is currently planning to implement a broad-based consumption tax (the Norfolk Sustainability Levy). I believe this will do very little to address Norfolk's financial and economic problems and will most likely do nothing more than result in a further deterioration of the current situation because:

1. There are clear and unavoidable constraints associated with attempting to raise the additional revenue required through the implementation of a broad-based consumption tax (such as the proposed Norfolk Sustainability Levy). The main

constraints are Norfolk Island's small population and limited economy. I do not believe a broad-based consumption tax will have the required capacity. It is worth noting that the Government is attempting to better assess the capacity of such a tax by introducing it at a nominal rate (1%) to enable a period of assessment. But it must be clearly recognized that the core challenge is to raise millions of dollars in additional revenue each year.

2. The economy is almost solely reliant on tourism and the extent to which a broad-based consumption tax extracts additional revenue (directly or indirectly) from tourists will have a negative impact on tourism numbers. Thus, a broad-based consumption tax will most likely have a negative impact on tourism.
3. The introduction of a broad-based consumption tax, in the absence of an income tax system such as that which operates in Australia will result in Norfolk Island's revenue regime, which is already significantly less equitable than the Australian system, becoming much less equitable.
4. It is unlikely that a broad-based consumption tax (GST) will meet its revenue expectations because of the potential for avoidance. For example, in 1997 the Commonwealth Grants Commission noted (p.162) that:

"The Norfolk Island Government should look closely at tax mobility issues when any future restructure of the Norfolk Taxation system is being considered. This would apply to any expenditure or goods and services tax. Given what happened when the FIL was increased, it is important to take into account the likelihood of sections of the community avoiding a GST by directing their discretionary expenditure off Norfolk."

Furthermore, it is not clear that the proposed Norfolk Sustainability Levy has been arrived at through a process of carefully considering key issues associated with the

range of realistic options available and a fully informed community debate. Some key matters for consideration would be:

- What is the additional revenue target? (In 1997 the Commonwealth Grants Commission suggested an additional \$8,000,000pa).
- In addition to infrastructure renewal and maintenance costs, what are the costs associated with environmental and social issues?
- To what extent will the proposed Norfolk Sustainability Levy impact on Norfolk's aging population and vice versa?
- To what extent is the Norfolk Sustainability Levy proposed to replace existing taxes and levies in addition to raising substantially more revenue?
- Do other options proposed in the Taxation Options paper prepared by Commonwealth Treasury have greater (and more equitable) revenue raising potential?
- To what extent does the proposed Norfolk Sustainability Levy address the serious equity problems inherent in the current revenue regime?
- To what extent is it appropriate to look to a broad-based consumption tax without giving serious consideration to "land-based" imposts such as property rates, land tax and developer contributions?
- How efficient is it to develop a unique broad-based consumption tax for a population of less than 2,000?
- To what extent does the proposed Norfolk Sustainability Levy reduce, or at least not increase, the disproportionate taxation burden being met by tourists?

- To what extent does the proposed Norfolk Sustainability Levy address the potential for tax avoidance?

Perhaps the most important question is what are the possibilities and revenue implications of some form of integration with the Australian Taxation system and what sort of process is required to ensure the people of Norfolk Island can participate in a meaningful and informed debate about the options?

It appears to me that the decision to implement the Norfolk Sustainability Levy has preceded a detailed analysis of the broad range of fundamentally important issues associated with such a decision.

I have witnessed, first-hand, much of the debate on Norfolk Island regarding the Joint Standing Committee's deliberations. I suggest that it would assist in addressing much of the concern on Norfolk Island if the Federal Government was to enunciate a model for consideration and in doing so, provide clear examples of the financial implications by preparing and distributing a *Family Impact Statement* so the people of Norfolk Island will be better informed about the options available. For example: the Taxation Options paper prepared by Commonwealth Treasury notes (p.19):

"The total direct outlays allocated to Christmas Island in the Commonwealth Budget for 2002-03 was approximately \$49 million, including for local government services".

The range of possibilities in terms of financial impact, access to health, social services, environmental protection and the ability of Norfolk Island to retain meaningful self-government need to be clearly and openly debated on Norfolk Island in an informed manner.

There is a clear and growing need for the Federal and Norfolk Island Governments to reach a mutually acceptable arrangement to address these issues - an arrangement that maintains Norfolk Island's unique and positive attributes while at the same time establishing and ensuring a sustainable future.

Finally, I simply note that any decision to change the revenue regime to bring in substantially more revenue (in the millions of dollars annually) will be a difficult one indeed for the Assembly. This would certainly be more difficult than introducing compulsory seat-belts and random breath-testing, however, after considerable community consultation and expert briefings from the Australian Transport Safety Bureau, the current Norfolk Island Legislative Assembly rejected both of these initiatives.

Recommendation

1. That the Federal Government enunciate a preliminary draft of a revised constitutional model for Norfolk Island to address financial, social and environmental issues.
2. That the model include a detailed Family Impact Statement.
3. That following dissemination of the preliminary draft model to the people of Norfolk Island, discussions take place with the Norfolk Island Government and broader community to establish a time-frame and parameters for negotiations to resolve the current concerns while maintaining the core aspirations of the people of Norfolk Island.