

Pacific trade liberalisation and tariff revenues: a comment

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In the *Pacific Economic Bulletin's* 'Policy dialogue' section (Kaufmann 2009), I argued that trade liberalisation is a necessity if Pacific island countries wish to enjoy the benefits that integration with the world economy can bring. I outlined the antagonistic view towards trade liberalisation of many non-governmental organisations (NGOs) such as the Pacific Network on Globalisation (PANG). In particular, I discussed that most often raised topic—namely, the loss of tariff revenue. I argued that although the loss of tariff revenue from the reduction of tariffs is an important issue, the revenue loss can be offset relatively easily by reforming the financial and fiscal structures of the island states. The article discussed the introduction of a value-added tax (VAT) and concluded that, if implemented wisely, a VAT can be effective in offsetting the tariff revenue loss.

In response, Maureen Penjueli and Wesley Morgan (2010) from PANG voiced their opposition to a Pacific Agreement on Closer Economic Relations (PACER) Plus agreement involving a preferential trade agreement between the Pacific island countries and Australia and New Zealand in an article titled 'Putting development first: concerns about a Pacific free trade agreement'. These authors argued that

Pacific trade liberalisation would have serious negative revenue consequences and would not lead to consumer gains for Pacific islanders. Penjueli and Morgan proposed an alternative in the form of a so-called 'SPARTECA Plus' (South Pacific Regional Trade and Economic Cooperation Agreement). 'SPARTECA Plus' would involve the continuation of non-reciprocal, preferential trade between the Pacific island countries and Australia and New Zealand and the rejection of tariff reductions by the Pacific island countries.

What the authors did not do, however, was answer the crucial questions of trade liberalisation that I had posed. I would like to pose them again: who pays for the more expensive imports as the result of the imposition of tariffs or non-tariff barriers on imports? Would it not be a good idea for consumers to pay less for higher-quality goods and have more disposable income for other goods and services?

As has become so clear from the recent reform of telecommunication markets in the Pacific, local enterprises that do not have to worry about competition have no incentive to invest in improved production techniques or produce better-quality, lower-cost, more consumer-friendly products. Would not the additional disposable consumer income

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resulting from the lower prices of imports following tariff reductions increase business opportunities for Pacific Islanders—not only for domestic industries, but for those who distribute the imports?

To all these questions—which should be key issues in an honest discussion of trade liberalisation in the Pacific—the response was the typical one of how ‘dangerous and wholly unnecessary’ a free-trade agreement with Australia and New Zealand would be. Penjueli and Morgan (2010) argued that ‘the Pacific Agreement on Closer Economic Relations (PACER) was not designed to ensure cheaper goods for Pacific islanders or address constraints faced by Pacific businesses’, but instead is ‘a defensive mechanism’ for ‘Australian and New Zealand exporters and investors’.

Additionally, the authors portray Manjula Luthria, senior economist with the World Bank, as an opponent of a free-trade agreement between the Pacific island countries and Australia and New Zealand. This was done by presenting Luthria’s concerns over potential tariff revenue losses as well as her thoughts on the implementation of free-trade agreements. Luthria (2009) writes that the ‘pain’ arising from a reciprocal, preferential trade agreement could be permanent: ‘This is where the stark reality of many small states facing preference erosion will need to be faced in bilateral, regional and ultimately multilateral trade liberalisation fora. For many small states this pain is permanent, because they simply do not have the size and location advantages to operationalise their comparative advantage.’

The authors did not, however, present the other side of the story. Luthria, in the next sentence, states that ‘recent emphasis on economic geography has also shown that efforts to push economic activity out from hubs to the periphery either through conventional policy prescriptions or through aid to build state capacity are fraught with

failure. Instead, small states would do better by attempting to become economic extensions of their nearest large market.’ And ‘this is best achieved by reducing any economic “frictions” that create economic barriers between the islands (the periphery) and the nearest hubs—be they barriers of language, transport costs, costs of telephony, or trade tariffs’.

With regard to tariff reductions, Luthria has some clear advice

Tariff reductions on imports from Australia and New Zealand (ANZ)—who are the main suppliers of imports into the Pacific—can significantly increase the welfare of Pacific denizens. This is primarily because it is already very expensive to get goods to the Pacific doorstep due to their small size and extreme remoteness. Adding on tariffs, which result in increasing the final price of goods to Pacific consumers, is akin to the islanders being shot in the foot twice, once by geographical distance and a second time through protectionist policies. (Luthria 2009)

I agree with Luthria and urge readers to read her opinion piece in full.

The rest of this article is structured as follows. In the next section, there is an update and revision of statistics relating to government revenues. Next, there is a review of the claim by Penjueli and Morgan (2010) that Tonga and Samoa have experienced serious revenue shortfalls after lowering tariffs and implementing a VAT. The following section is a discussion of the importance of the recognition of non-tariff barriers to trade and the consequences of a non-reciprocal ‘SPARTECA Plus’ that would leave the Pacific island countries outside the world economy.

An update on the revenue structure of the Pacific island countries

Updated and revised figures are available for the consolidated revenue structure of the Pacific island countries for the years 2008 and 2009 (Table 1) (2008 figures are in brackets). The table presents total government revenue and grants as percentages of GDP and customs revenue and revenue raised from a VAT—or similar consumption tax, if in place—as shares of total revenue and grants. In addition, the table shows the average applied tariff rates. Total revenue and grants as a percentage of GDP ranges widely between 27 per cent for Vanuatu and almost 100 per cent for Nauru. For most Pacific island countries, however, the share of revenue and grants as a percentage of GDP is between 30 and 38 per cent.

The table shows that tariff revenue remains an important source of government revenue. For some countries, however, the updated figures show a movement away from taxes on international trade as a revenue base. This trend is underpinned by the fall in average applied tariff rates, for which the Pacific island countries should be congratulated.

Although the data indicate a decline in VAT revenue as a percentage of total revenue and grants for some countries, for most of them it remains constant. The decline is likely to be an adverse outcome resulting from the global economic crisis. For those countries where the VAT has declined, such as Tonga or Vanuatu, budgetary forecasts and forecasts from the International Monetary Fund (IMF) for 2010 indicate a recovery to 2008 levels.

In comparison with 2008, Niue and Nauru had the largest movements in revenue and grants as a percentage of GDP. In 2009, Niue introduced the Niue Consumption Tax (NCT)—a consumption

tax of 12.5 per cent. This tax was adopted in accordance with the country's preparations for trade liberalisation with other Pacific island countries under the Pacific Island Countries Trade Agreement (PICTA) and with Australia and New Zealand under PACER, and as a response to Niue's continuing reductions in applied tariffs. With some exceptions, such as alcohol and fuel, Niue reduced its applied tariffs to zero. Early results of income generated from the NCT indicate an above-estimate out-turn of 2.3 per cent of total revenue and grants. This, as well as the expected demand impact from lower-priced products, led to an increase in total tax revenues. According to recent budget documents, this increase was offset by a reduction in donor grants. Thus, revenue and grants declined from 95.5 per cent in 2008 to 71.3 per cent in 2009.

Another Pacific island country at the forefront of tax reform is Tuvalu, which recently introduced a 3 per cent consumption tax. At this early stage, the tax applies to all imports as well as companies with high turnover. It is planned to increase the tax rate gradually to 10 per cent to offset tariff and sales tax cuts. Additionally, the threshold will be lowered as tariffs fall to broaden the tax base. Revenue estimates for the consumption tax are not yet available.

Niue and Tuvalu should be congratulated for the introduction of consumption taxes. More importantly, their moves show that it is possible to reduce dependency on highly resource use-distorting trade taxes without adverse impacts on government revenues.

As mentioned above, between 2008 and 2009, Nauru also recorded large changes in government revenues and grants as a percentage of GDP. The share fell from almost 120 per cent to less than 100 per cent. According to Nauru's budgetary figures for 2010, the reasons for the decline are lower donor grants and less revenue generated from fisheries.

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Table 1 Statistics relating to government revenue, for 2009 (2008)

| | Total revenue and grants/GDP (%) | Average tariff rate (%) | VAT rate (%) | Customs revenue/total revenue and grants (%) | VAT/total revenue and grants (%) |
|--------------------------------|----------------------------------|-------------------------|--------------|--|----------------------------------|
| Cook Islands | 31.7 (30.5) | 7* | 12.5 | 10.4 (11.3) | 35.2 (35.9) |
| Fiji Islands | 28.1 (29.4) | 14.39 (39.55) | 12.5 | 17.0 (16.1) | 28.5 (31.0) |
| Federated States of Micronesia | 56.4 (59.1) | 3.84 (4.21) | - | 5.5 ^c (5.6) | - |
| Kiribati | 96.7 (101.3) | 17.13 (17.22) | - | 9.5 ^c (11.3) | - |
| Nauru | 99.8 (119.6) | ... | - | 20.3 (16.7) | - |
| Niue | 71.3 ^c (95.5) | See notes | 12.5 | 7.9 (6.0) | 2.3 (-) |
| Palau | 38.3 (38.9) | 3.05 (3.02) | - | 6.7 ^x | - |
| Papua New Guinea | 30.5 (32.7) | 3.35 (4.88) | 10.0 | 5.8 (5.8) | 11.0 (8.6) |
| Republic of Marshall Islands | 67.9 (70.4) | 9* | - | 8.5 (8.4) | - |
| Samoa | 34.2 (32.5) | 7* | 15.0 | 9.5 (9.4) | 23.4 (23.1) |
| Solomon Islands | 37.5 (38.2) | 9.72 (13.05) | - | 22.5 (24.7) ^x | - |
| Tonga | 28.8 (28.3) | 7.63 (24.09) | 15.0 | 8.1 (23.5) | 23.4 (34.7) |
| Tuvalu | 93.0 (98.1) | 7.93 (15*) | 3.0 | 6.2 (7.7) | - |
| Vanuatu | 27.0 (28.6) | 15.32 (25.13) | 12.5 | 23.2 (23.1) | 26.0 (27.4) |

e Estimate using projections from International Monetary Fund (IMF), 2010a. *International Finance Statistics (IFS) 2009*, International Monetary Fund, Washington, DC; and figures from Asian Development Bank (ADB), 2010b. *Outlook 2010*, Asian Development Bank, Manila.

- zero n.a. not applicable

* Average customs duty for 2006 according to Watergall Consulting Limited, 2007. *Responding to the revenue consequences of trade reforms in the forum island countries*, Final report, September, Watergall Consulting Limited, Port Vila, Vanuatu.

Notes: All figures shown in brackets are for the year 2008, unless otherwise noted. Tonga: average tariff rate applied on agricultural products (ATAoAP) is 36.05 per cent (60.07 per cent); the average tariff applied on industrial products (ATAoIP) is 11.24 per cent (18.15 per cent). Federated States of Micronesia: ATAoAP is 5.33 per cent (4.42 per cent), ATAoIP is 3.61 per cent (4.19 per cent), for 2006 (2004). Kiribati: ATAoAP is 27.55 per cent (49.21 per cent); ATAoIP is 15.58 per cent (15 per cent), for years 2006 (2004). Niue: *e* reflects the estimate for Niue's GDP according to budgetary forecasts; note that the allocated grants from New Zealand have expired, which reduced total revenue and grants. While the domestic revenue increased, it was not able to offset the decline in external grants. This is the reason for the increase in the customs revenue and grants ratio. It is likely, however, that, in the eventuality of a large budget deficit, external grants will be provided. This of course would change the figures. Further, Niue implemented the Niue Consumption Tax (CIT) in 2009. The projected revenues are higher than the estimates. Niue's CIT was set at 12.5 per cent. Also, Niue's VAT is in response to a cut in tariffs to zero, with the exception of some products such as alcohol. Palau: ATAoAP is 2.78 per cent (1.68 per cent); ATAoIP is 3.09 per cent (3.11 per cent); X = year 2006; the customs revenue/total revenue and grants ratio is from the year 2006. Papua New Guinea: ATAoAP is 12.39 per cent (19.32 per cent); ATAoIP is

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2.04 per cent (2.48 per cent), for years 2008 (2007). Republic of Marshall Islands: according to Watergall Consulting Limited, 2007. *Responding to the revenue consequences of trade reforms in the forum island countries*, Final report, September, Watergall Consulting Limited, Port Vila, Vanuatu, the duty rate for food is 5 per cent, for most other products it is 8 per cent; variable higher rates are applied on tobacco, alcohol and fuel; customs revenue/revenue statistics are estimates based on current trends of the Marshall Islands economy. Samoa: according to Watergall Consulting Limited, 2007. *Responding to the revenue consequences of trade reforms in the forum island countries*, Final report, September, Watergall Consulting Limited, Port Vila, Vanuatu, import duties are declining gradually; customs/total revenue ratio includes all customs revenue, import duty only gives 7.5 (7.0) per cent. Solomon Islands: ATAoAP is 17.85 per cent (39.18 per cent); ATAoAP is 8.45 per cent (8.84 per cent), for years 2008 (2007); x includes all customs revenue—import duty only, gives 7.5 per cent (7 per cent). Vanuatu: ATAoAP is 33.43 per cent (90.05 per cent); ATAoAP is 12.63 per cent (14.49 per cent).

Sources: Central Statistics Office of Mauritius, 2010. *Economic and Social Indicators 2010*, Central Statistics Office, Ministry of Finance and Economic Development, Republic of Mauritius, Port Louis. Available from <http://www.gov.mu/portal/site/cso/>; Fiji Islands Bureau of Statistics, 2010. *Economic Statistics*, Government of Fiji, Suva. Available from http://www.statsfiji.gov.fj/Economic/ecostats_index.htm; Government of Niue, 2010. *Niue Statistics 2010*, Government of Niue, Alofi; Samoa Statistics Department, 2010. *Economic Indicators 2010*, Ministry of Finance, Government of Samoa, Apia. Available from: http://www.spc.int/prism/wstest/about_us/contact.htm; Vanuatu National Statistics Office (VNSO), 2010. *Economic Statistics*, Ministry of Finance and Economic Management, Government of Vanuatu, Port Vila. Available from <http://www.spc.int/PRISM/country/vu/stats/ECONOMIC/ecoindex.htm>; Watergall Consulting Limited, 2007. *Responding to the revenue consequences of trade reforms in the forum island countries*, Final report, September, Watergall Consulting Limited, Port Vila, Vanuatu). Average tariff rates were derived from International Trade Centre (ITC), 2010. *Market Access Map—Making import tariffs and market access barriers transparent*, International Trade Centre, Geneva. Available from <http://www.macmap.org>. Cook Islands: Government of the Cook Islands, 2010. *The Cook Islands Budget Policy Statement 2010/11*, March 2010, Government of the Cook Islands, Avarua. Fiji: Fiji Islands Bureau of Statistics, 2010. *Economic Statistics*, Government of Fiji, Suva. Available from http://www.statsfiji.gov.fj/Economic/ecostats_index.htm; Reserve Bank of the Fiji Islands, 2010. *Quarterly Review*, March 2010, Reserve Bank of the Fiji Islands, Suva. Federated States of Micronesia: US Department of the Interior, 2009. *Federated States of Micronesia Fiscal Year 2008 Economic Review*, August 2009, Office of Insular Affairs, US Department of the Interior, Washington, DC; International Monetary Fund (IMF), 2008. *Federated States of Micronesia: 2008 Article IV Consultation—staff report*, International Monetary Fund, Washington, DC; and IMF Public Information Notice on the Executive Board Discussion; E = estimate using IMF projections and Asian Development Bank (ADB), 2010b. *Outlook 2010*, Asian Development Bank, Manila. Nauru: Republic of Nauru, 2010. *Budget 2009–10*, Budget Paper 1 and 2, Republic of Nauru; GDP derived from Asian Development Bank (ADB), 2010a. *Key Indicators 2009*, Asian Development Bank, Manila, and Asian Development Bank (ADB), 2010b. *Outlook 2010*, Asian Development Bank, Manila. Kiribati: E = estimate based on a budgetary projection of a 21 per cent drop in imports, from International Monetary Fund (IMF), 2009a. *Kiribati: 2009 Article IV Consultation—staff report*, International Monetary Fund, Washington, DC; IMF Public Information Notice on the Executive Board Discussion; and Kiribati National Statistics Office, 2010. Statement by the Executive Director for Kiribati, Kiribati National Statistics Office, Bairiki. Niue: Government of Niue, 2010. *Niue Statistics 2010*, Government of Niue, Alofi. Palau: Bureau of Revenue, Customs and Tax, Palau, 2010; International Monetary Fund (IMF), 2010b. *Republic of Palau: 2010 Article IV Consultation—staff report*, International Monetary Fund, Washington, DC; an IMF Public Information Notice and a Statement by the Executive Director of the Republic of Palau on the Executive Board Discussion. Republic of the Marshall Islands: International Monetary Fund (IMF), 2009b. *Republic of the Marshall Islands: 2009 IMF Article IV Consultation—staff report*, International Monetary Fund, Washington, DC; an IMF Public Information Notice and a Statement by the Executive Director of the Republic of the Marshall Islands on the IMF Executive Board Discussion; Economic Policy, Planning and Statistics Office, 2010. Samoa: Central Bank of Samoa, 2010. *2009 Annual Report*, Central Bank of Samoa, Apia. Tonga: National Reserve Bank of Tonga, 2010. *Quarterly Bulletin*, 21(1) (March), National Reserve Bank of Tonga, Nuku'alofa; Government of Tonga, 2010. *Budget Statement for Year Ending 30th June 2010*, Government of Tonga, Nuku'alofa; International Monetary Fund (IMF), 2009c. *Tonga: 2009 IMF Article IV Consultation—staff report*, International Monetary Fund, Washington, DC; IMF Staff Supplement and Public Information Notice on the IMF Executive Board Discussion; and Statement by the Executive Director for Tonga. Tuvalu: Government of Tuvalu, 2009. *Tuvalu National Budget 2009*, Government of Tuvalu, Funafuti; GDP estimates for 2008 and 2009 using growth rate and inflation projections from United Nations Statistics Division (UNSD), 2010. *National Accounts 2009*, Statistics Division, United Nations, New York; and Asian Development Bank (ADB), 2010b. *Outlook 2010*, Asian Development Bank, Manila. Vanuatu: Reserve Bank of Vanuatu, 2010. *Quarterly Economic Review*, March 2010, Reserve Bank of Vanuatu, Port Vila; International Monetary Fund (IMF), 2009d. *Vanuatu: 2009 IMF Article IV Consultation—staff report*, International Monetary Fund, Washington, DC; Public Information Notice on the IMF Executive Board Discussion and Statement by the Alternate Executive Director for Vanuatu.

For most of the Pacific island countries, however, revenues and grants as a percentage of GDP remained constant; for some there was a minor decline, which was likely to have been an adverse effect of the global financial crisis. The cuts in average applied tariffs helped to reduce this adverse result due to the impact of the lower prices on demand.

According to the International Trade Centre (2010), Fiji, Solomon Islands, Tonga and Vanuatu are at the forefront of applied tariff cuts. Fiji's applied tariffs were reduced from almost 40 per cent in 2008 to less than 15 per cent in 2009. Interestingly, the tariff reductions did not show up as reductions in customs revenue as a share of total revenue and grants.

For the Solomon Islands, the slight reduction in applied tariffs from 13 per cent to about 10 per cent resulted in a minor decline in revenues generated from customs. Customs revenue as a percentage of total revenue and grants fell from 24.7 per cent in 2008 to 22.5 per cent in 2009. Tonga's applied tariffs declined from 24 per cent in 2008 to about 7.6 per cent in 2009. Not surprisingly, this led to a large fall in the share of customs revenue in total revenue and grants—from 23.5 per cent to 8.1 per cent. According to the Asian Development Bank's *Outlook 2010* (ADB 2010b), Tonga's merchandise imports are estimated to have declined by 5 per cent in 2009. In combination with Tonga's projected negative 0.4 per cent GDP growth and the decline in remittances due to the global financial crisis, the decline in imports would explain Tonga's reduced VAT collection. According to budgetary projections, the consumption tax outcome declined from 34.7 per cent in 2008 to only 23.4 per cent in 2009. Total revenue as a percentage of GDP, however, remained constant.

Average applied tariffs in Vanuatu declined from more than 25 per cent to about 15 per cent between 2008 and 2009.

Vanuatu's revenue and grants as a percentage of GDP and its customs and VAT as percentages of total revenue remained almost unchanged.

These updated and revised figures underline the suggestion in my earlier article that the potential tariff revenue losses as a result of a PACER Plus will continue to decline in significance. Further, if the Pacific island countries continue to reform their revenue structures wisely by implementing a VAT in combination with an excise tax on 'sinful' goods, such as has been done by Niue, tariff revenue losses can be offset while serving a social agenda.

Non-tariff barriers to trade and the importance of a reciprocal PACER Plus

With their 'SPARTECA Plus' alternative, Penjueli and Morgan (2010) show that they do not understand the problems that the Pacific island countries face—nor do they comprehend the benefits and opportunities a preferential trade agreement with Australia and New Zealand offers. A 'SPARTECA Plus' deal would mean a continuation of the failed strategies and policies of the non-reciprocal trading arrangements of the past. Not only would it contravene WTO rules, according to Article XXIV GATT and Article V GATS, it would also place obstacles in the way of the Pacific island countries' integration into the world economy and ignore the welfare losses being experienced by Pacific island consumers.

Erasmus (2010) provides an interesting discussion on non-reciprocal trading agreements for developing countries and why it is necessary for developing countries to sign up to regional or free-trade agreements. Erasmus argues that many developing countries have been trapped in non-reciprocal preferential trading

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arrangements that did not solve problems such as their marginalisation from global markets. Furthermore, such arrangements have often led to failure in implementing domestic reforms. Legal arrangements and structural conditions have been created that work against the developing countries' integration into the global economy. Penjueli and Morgan (2010) and Morgan (2009) acknowledge that this is the case for the Pacific island region by asking for 'improved' rules of origin for the island nations as well as industrial-market access through the removal of quarantine barriers. How this would help the Pacific island countries become competitive in world markets remains unanswered. All that it would do is create additional economic frictions. Instead of 'improved' rules of origin and lowering the quarantine barriers facing the Pacific island countries,¹ they should implement domestic reforms targeted at meeting international standards.

As noted by Erasmus (2010), it is common knowledge that non-reciprocal preferential trade agreements between developing and industrialised countries have resulted in adverse effects for the developing-country partner and have not led to economic progress. Instead of trade creation and economic growth, trade diversification took place. The developing countries focused their resources on the sectors granted preferential market access by subsidising their mostly inefficient production, instead of implementing necessary reforms for an internationally competitive market structure. With PACER Plus, the Pacific island countries have an opportunity to achieve gradual integration into the global economy by gradually lowering their tariff and non-tariff barriers and reforming their markets accordingly. Unilateral liberalisation with the rest of the world would be the ideal. With a preferential trade agreement such as PACER Plus there is still

the possibility of some trade diversion; but, given the relatively large size of Australia and New Zealand and the fact that their trade barriers are at low levels, trade diversion should be small.

Penjueli and Morgan's 'SPARTECA Plus' suggestion indirectly raises the important question of how to deal with non-tariff barriers to trade, which are at least as important as tariffs; however, they are very often downplayed or even ignored.

Non-tariff barriers to trade (NTBs) are defined as any measure other than tariffs that restricts or disturbs trade among countries. There are five major categories: 1) quantitative restrictions and similar specific limitations (mostly implemented through import and export quotas and licences); 2) customs procedures and administrative practices (customs surcharges, classification and classification and clearance procedures); 3) non-tariff charges and related policies (sales and consumption taxes and border tax adjustments, anti-dumping and countervailing measures, rules of origin); 4) government participation in trade, restrictive practices and general policies (export subsidies and promotion, tax exemptions); and 5) technical barriers to trade ('standards and regulations adopted by countries to meet the needs of the worldwide increasing demand for safe and high-quality products' [World Trade Organization, 2008, www.wto.org], including quality standards such as health and sanitary regulations, safety and industrial standards and regulations, packaging and labelling, and advertising and marketing regulations).

The first and fourth categories create resource allocation distortions similar to those created by tariff barriers. The other three categories essentially cause obstacles to trade when they vary among countries. For example, differences in customs classifications and procedures lead to disturbances in the form of time and cost inefficiencies of

Box 1 Introducing a VAT to replace tariff revenue: lessons from Samoa, Tonga, Vanuatu and Mauritius

In their Box 1, 'Introducing a VAT to replace tariff revenue: lessons from Samoa and Tonga', Penjueli and Morgan (2010) argue that Samoa and Tonga have had negative experiences from the introduction of a value-added goods and services tax (VAGST) and a consumption tax, respectively. The authors claim that the implementation of the taxes 'has been difficult and raises serious questions about the ability of both countries to respond to future revenue losses under PACER Plus'. According to Penjueli and Morgan, 'Samoa has struggled to maintain the revenue needed to pay for essential services and raised the VAGST twice in the past decade to meet its budgetary needs'. Furthermore, due to the reduction of tariffs and the implementation of a VAGST, Samoa had to 'cut 8 per cent and 14.9 per cent, respectively, from [its] education and health budget' as the country 'continues to struggle to pay for social services and infrastructure projects'.

In regard to Tonga, the authors state that the country faces a dramatic downturn in government revenue due to its implementation of the Tonga Consumption Tax (TCT) and a reduction in tariffs in 2008–09. To blame the shortfall of revenue on the tariff reduction and implementation of the TCT is not valid. As noted earlier, the shortfall is due mostly to the negative impact of the global financial crisis, including lower remittances, and the reduction in imports.

It is correct that the implementation of the VAGST in Samoa and the TCT in Tonga was not easy. Is it ever easy to introduce a major policy change, especially a new tax? The countries should be praised for moving away from tariff revenue dependency. Also, adjusting the consumption tax or VAGST rate parallel to a reduction in tariffs is good policy and has little to do with a 'struggle to pay for social services'.

How 'bad', however, is the situation in these countries since the reduction in tariffs and the introduction of a consumption tax/VAT? The following figures present an overview of total government revenue as well as revenue collected from taxes on international trade and from VAT/consumption tax.

For Tonga, there is no evidence of a decline in government revenue since Tonga lowered its applied tariff revenues (Figure 1). Indeed, the figure indicates the opposite. Since 2003, when Tonga implemented its TCT to offset the revenue lost from the reduced tariffs, Tonga's total government revenues have increased from about P100 million to more than P200 million in 2009. The outcome of the TCT was a success, too. Even though the revenue generated from the TCT declined slightly in 2007

and 2009, total revenue from these taxes has now more than offset the loss in tariff revenue.

For Samoa, there is a similar story. Samoa implemented its VAGST in 1994 as part of its commitment to the World Trade Organization (WTO) to lower tariffs. It is clear that since then, revenue from taxes on international trade has fallen (Figure 2). Income from the VAGST has increased from less than T10 million in 1994 to more than T110 million in 2009. In the same period, total government revenue has increased from less than T200 million to more than T500 million and VAGST revenue increases have more than offset the loss due to the reduction in applied tariffs.

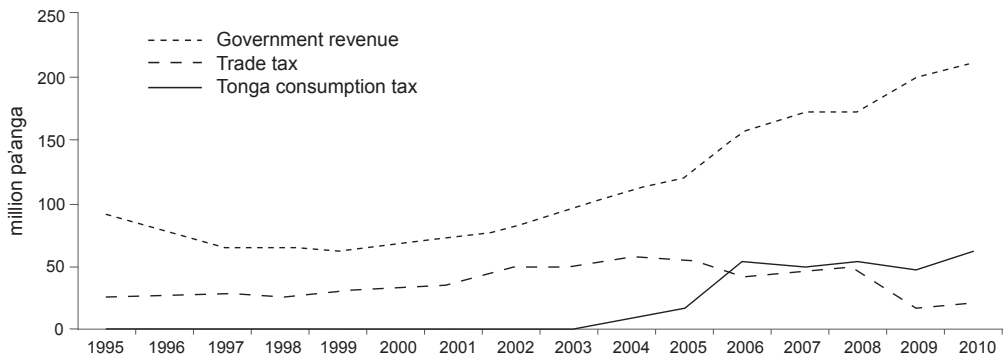
For Vanuatu, the picture is not as clear, due mainly to the fact that the country has not lowered its applied tariffs as much as anticipated. Nevertheless, since Vanuatu reduced its tariffs, total government revenues have increased greatly (Figure 3).

Mauritius implemented a VAT in 1998 to replace its sales tax, which suffered from tax base erosion due to misuse of exemptions. The VAT was also set up to compensate for the revenue loss from a gradual reduction in tariffs. The VAT did exactly that (Figure 4). As Mauritius lowered its tariffs gradually, the increase in imports due to the lower tariffs led to an increase in VAT revenue. In 2007, Mauritius cut its applied tariffs sharply, leading to a fall in revenue from taxes on international trade. Nevertheless, despite the arguments of those who anticipated a collapse in revenues, there was a huge increase.

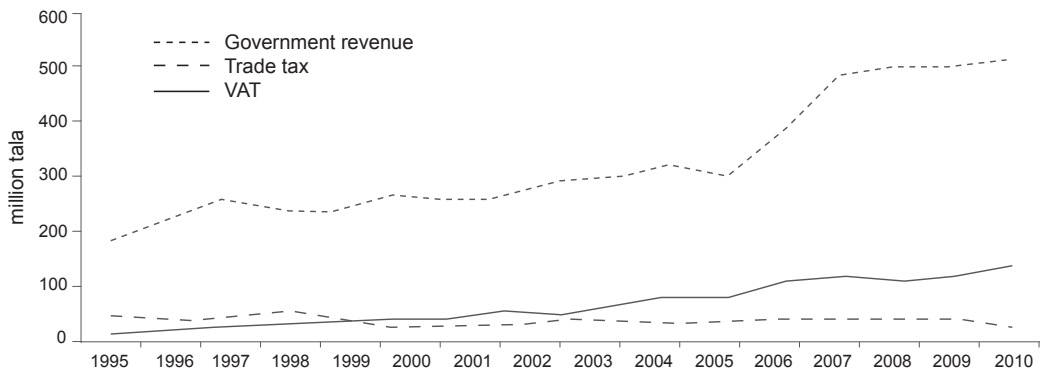
These data show that, contrary to the arguments of Penjueli and Morgan that small Pacific island countries will not be able to manage trade liberalisation and will face serious revenue consequences, there is no evidence to support such a scenario. Instead, we see the developments that economic theory predicts: a lowering of tariffs leads to lower prices, higher-quality products and increased purchasing power, which leads in turn to greater turnover and higher domestic tax and non-tax revenues.

Instead of unnecessarily raising false alarm about the negative impact on government income from the implementation of a consumption tax to offset lower tariff revenues, the focus should be on better management of government spending. In many cases, government expenditures have been increasing more than revenues. Leaving aside short-term needs for fiscal stimulus in the face of the global economic crisis, the Pacific island countries must reform and downsize loss-making government enterprises that are a burden on the economy. This would be something positive for the welfare of their citizens.

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Figure 1 Revenue developments in Tonga, 1995–2010 (P million)


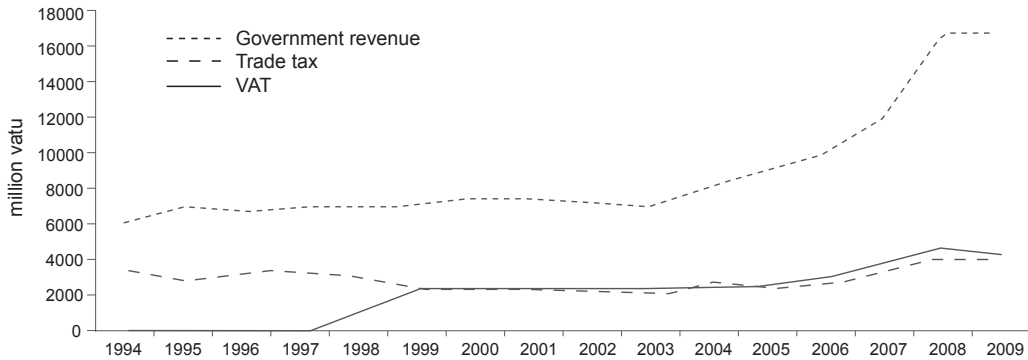
Sources: International Monetary Fund (IMF), 2010a. *International Finance Statistics (IFS) 2009*, International Monetary Fund, Washington, DC; Government of Tonga, 2010. *Budget Statement for Year Ending 30th June 2010*, Government of Tonga, Nuku'alofa.

Figure 2 Revenue developments in Samoa, 1994–2010 (T million)


Sources: International Monetary Fund (IMF), 2010a. *International Finance Statistics (IFS) 2009*, International Monetary Fund, Washington, DC; Central Bank of Samoa, 2010. *2009 Annual Report*, Central Bank of Samoa, Apia. Central Bank of Samoa, 2010a. *Annual Reports 2002–2009*, Central Bank of Samoa, Government of Samoa, Apia. Available from <http://www.cbs.gov.ws/publications/reports/ann/index.html>; Central Bank of Samoa, 2010b. *Quarterly Bulletins*, Central Bank of Samoa, Government of Samoa, Apia. Available from <http://www.cbs.gov.ws/publications/reports/qbull/index.html>; Government of Samoa, 2009a. *Budget Address 2009/2010*, Government of Samoa, Apia; Government of Samoa, 2009b. *Fiscal strategy statement, Budget 2009/2010*, Government of Samoa, Apia; Government of Samoa, 2009c. *Parliamentary Paper 2008/2009 No. 2*, Government of Samoa, Apia; Government of Samoa, 2010a. *Budget Address 2010/2011*, Government of Samoa, Apia; Government of Samoa, 2010b. *Fiscal strategy statement, Budget 2010/2011*, Government of Samoa, Apia; Government of Samoa, 2010c. *Parliamentary Paper 2010/2011 No. 2*, Government of Samoa, Apia; Samoa Statistics Department, 2010. *Economic Indicators 2010*, Ministry of Finance, Government of Samoa, Apia. Available from: http://www.spc.int/prism/wstest/about_us/contact.htm

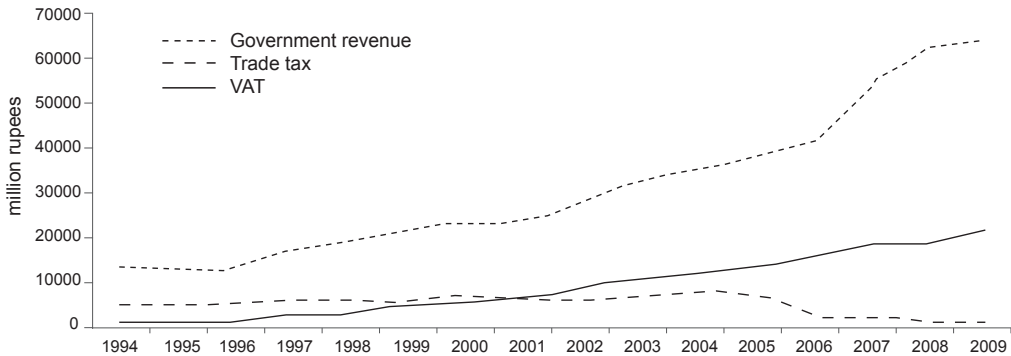
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Figure 3 Revenue developments in Vanuatu, 1994–2009 (V million)



Sources: International Monetary Fund (IMF), 2010a. *International Finance Statistics (IFS) 2009*, International Monetary Fund, Washington, DC; Vanuatu National Statistics Office (VNSO), 2010. *Economic Statistics*, Ministry of Finance and Economic Management, Government of Vanuatu, Port Vila. Available from <http://www.spc.int/PRISM/country/vu/stats/ECONOMIC/ecoindex.htm>; Reserve Bank of Vanuatu, 2010. *Quarterly Economic Reviews 2003–2010*, Government of Vanuatu, Port Vila. Available from <http://www.rbv.gov.vu/QtrEconomic.htm>; Government of Vanuatu, 2010. *Budget 2010*, Government of Vanuatu, Port Vila. Available from <http://www.governmentofvanuatu.gov.vu/documents/category/20-2010-budget.html>.

Figure 4 Revenue developments in Mauritius, 1994–2010 (R million)



Sources: International Monetary Fund (IMF), 2010a. *International Finance Statistics (IFS) 2009*, International Monetary Fund, Washington, DC; Central Statistics Office of Mauritius, 2010. *Economic and Social Indicators 2010*, Central Statistics Office, Ministry of Finance and Economic Development, Republic of Mauritius, Port Louis. Available from <http://www.gov.mu/portal/site/cso>

reclassification or information costs about the different classification systems (for example, SITC versus HS classification).² Furthermore, disturbances of trade flows can occur when the customs administration is inefficient—for example, due to a lack of capacity. NTBs can also be used deliberately as instruments of protectionism. For example, countries can support domestic industries by slowing customs procedures or increasing the bureaucratic burden by increasing regulations.

The most widely used NTBs for purposes of protection are the technical barriers to trade. Unnecessarily high standards and regulations disturb trade flows and support domestic industries. Even if the government does not favour protectionism, varying standards among countries make trade much more difficult for producers, exporters and importers. In the end, all of these barriers increase the costs of trade, which are eventually borne by consumers.

How do the Pacific islands fare in terms of non-tariff barriers to trade?

Measuring the impact of NTBs is difficult; however, the World Bank's annual *Doing Business* reports offer one approach to the measurement of the effects of NTBs by comparing regulations across 183 countries. For example, the category 'trading across borders' provides an overview of the costs of regulations affecting trade. The reports compile the procedural requirements for trading a standardised cargo of goods, whereby every official procedure required has been recorded. Further, the time taken and the costs for completion of the processing of the cargo are reported (for more detail, see doingbusiness.org).

The World Bank's 'trading across borders' indicators for the Pacific island countries and Australia, Hong Kong,

Mauritius, New Zealand and Singapore are summarised (Table 2). It can be seen that the bureaucratic burden in the form of documentation and the time to trade are major constraints on trade in the Pacific. This is an indication that Pacific island countries have not managed to integrate into the international economic system yet, as they have remained outside due to their special preferential trading arrangements for market access to Australia, New Zealand, the European Union and the United States. Recently, Tonga has made progress by reducing the number of documents required to trade. On the other hand, Fiji—one of the more developed countries in the Pacific—still requires the processing of 13 documents in order for trade to take place.

Comparative advantage and the importance of a services trade chapter

Penjueli and Morgan (2010) urge Pacific island countries not to consider the inclusion of a services trade chapter in PACER Plus, as it would not bring additional benefits to their comparative advantage in the services sector—identified as labour mobility. Instead, 'they could simply end up with what they already have'. Again, the authors demonstrate that they do not understand the importance of trade liberalisation and the benefits that services trade liberalisation can bring.

As noted previously, the services-trade liberalisation that has recently taken place in Fiji, Papua New Guinea, Samoa, Tonga and Vanuatu in aviation and telecommunications has brought huge welfare benefits in the form of lower prices and better-quality services, as well as resulting in significant GDP growth and employment. Even services such as health and education, which are probably not the main priorities of services-

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Table 2 Costs of trading across borders

| Country | Imports | | | Exports | | |
|--------------------------------|----------------|--------------------|----------------|----------------|--------------------|----------------|
| | Cost (US\$) | Documents (no.) | Time (days) | Cost (US\$) | Documents (no.) | Time (days) |
| Fiji | 630 | 13 | 24 | 654 | 13 | 24 |
| Federated States of Micronesia | 1,295 | 3 | 30 | 1,295 | 6 | 30 |
| Kiribati | 1,070 | 7 | 21 | 1,070 | 6 | 21 |
| Palau | 1,132 | 10 | 33 | 1,190 | 6 | 29 |
| Papua New Guinea | 722 | 9 | 29 | 664 | 7 | 26 |
| Republic of Marshall Islands | 945 | 5 | 33 | 945 | 5 | 21 |
| Samoa | 848 | 7 | 31 | 820 | 7 | 27 |
| Solomon Islands | 1,237 | 4 | 21 | 1,023 | 7 | 24 |
| Timor-Leste | 1,015 | 7 | 26 | 1,010 | 6 | 25 |
| Tonga | 725 | 6 | 24 | 650 | 7 | 19 |
| Vanuatu | 1,392 | 9 | 30 | 1,497 | 7 | 26 |
| Australia | 1,119 | 5 | 8 | 1,060 | 6 | 9 |
| Hong Kong | 583 | 4 | 5 | 625 | 4 | 6 |
| Mauritius | 689 | 6 | 14 | 737 | 5 | 14 |
| New Zealand | 850 | 5 | 9 | 868 | 7 | 10 |
| Singapore | 439 | 4 | 3 | 456 | 4 | 5 |

Notes: Cost is measured as the fees levied on a 6-metre container in US dollars, including all fees associated with completing the export/import procedures (documents, handling charges, inland transfers). Tariffs or taxes on trade are not included. Documents comprise all documents required to export or import, including bank documents, customs classification and licences for import/export. The time is recorded as the calendar days required for the processing of imports and exports.

Source: World Bank, 2010. *Doing Business 2010*, The World Bank, Washington, DC.

trade liberalisation, can benefit from similar liberalisation movements. Opponents of free trade will argue that all services-trade liberalisation does is lower consumer benefits, increase prices and increase unemployment by destroying government-run entities. Indeed, this argument is true in part. Yes, services-trade liberalisation can displace government-run enterprises that are inefficient and mismanaged, have high costs and deliver low-quality services. What we have seen from telecommunications liberalisation in the Pacific, however, is that the government enterprises have remained in business and have become much more efficient and are offering competition to the

private sector entrant in the form of lower prices and better-quality services.

Should Pacific island countries unwind liberalisation in these areas? How would the opponents of liberalisation explain such a backward move to the many beneficiaries, such as, for example, those who have obtained employment in the expanded tourism sectors and those who are benefiting from lower international travel costs, which enable them to afford to visit their relatives overseas or for their overseas relatives to travel back home? Similarly, what explanation could be offered to those islanders who work for the many Vodafone and Digicel shops that have opened up throughout the Pacific?

Services-trade liberalisation is just one part of a successful liberalisation story. The importance of including a foreign direct investment (FDI) chapter in PACER Plus also needs to be emphasised. FDI liberalisation is crucial to the successful and sustainable development of Pacific island countries. As noted earlier, Mauritius is an example of how a country can liberalise its key sectors and become an internationally competitive participant in the world economy. Mauritius has liberalised several service sectors, especially tourism, telecommunications and financial services. The direct benefits of lower-cost, higher-quality services, as well as the spill-over effects on their manufacturing and agricultural sectors, have been significant. It could be argued that there is more that can be done; however, the doomsday scenarios forecast for Mauritius did not even come close to occurring.

For the Pacific island countries, there is a lot of work to be done. By reforming their markets wisely, however, and with a view to becoming internationally competitive, Pacific island countries do not have to fear gradual trade liberalisation. Therefore, Pacific island countries would do well to move away from tariff revenue dependency, by implementing long-overdue, comprehensive domestic reforms. Furthermore, international agencies such as the International Monetary Fund (IMF), the World Bank, the ADB and the United Nations and their major industrialised trading partners, Australia, New Zealand, the European Union and the United States, understand the issues Pacific island countries are facing. Thus, Pacific island countries should ask these organisations and countries for technical assistance.

Conclusion

Pacific island countries should sign a PACER Plus agreement with Australia and New Zealand to assist them to overcome the major obstacles to economic growth currently faced in the form of tariffs and NTBs and to enjoy the benefits that integration with the globalised world offers. Tariff revenue loss does not have to be a major issue if Pacific island countries reform their revenue and tax systems in an appropriate manner, such as by implementing a VAT or a similar consumption tax, in addition to excise taxes on 'sinful' goods.

Recent figures indicate that tariff revenues are still an important component of total government revenues in most Pacific island countries, although the data also show that the Pacific islands are moving away from dependence on tariff revenue. Pacific island governments should be congratulated for these steps; however, more still needs to be done.

What is often misunderstood by many NGOs, such as PANG (2009), is that trade liberalisation is about more than tariff revenue reductions. Even though tariff revenues play an important role, other obstacles to trade such as NTBs must be recognised when discussing trade liberalisation. Here, Pacific island countries can benefit from regional trade arrangements by reducing and eliminating NTBs such as sanitary and phytosanitary and quarantine limitations, and inefficient customs administrations and processes. Furthermore, Pacific island countries should seriously consider signing up for services and FDI chapters in PACER Plus to benefit fully from international trade and to create an investor-friendly environment, which is key to a successful future.

Notes

- ¹ Pacific island countries certainly need assistance in overcoming quarantine barriers, especially those facing potential agricultural exports. This should be done, however, through assisting them to raise their production standards to legitimate international levels or through help in reducing illegitimate quarantine barriers.
- ² SITC stands for Standard International Trade Classification; HS is the Harmonised System of trade classification.

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