Session 2: Rethinking public finance for a sustainable future

Question: The Pacific is at the frontier of fighting against climate change and environmental degradation. The sub-region is also facing challenges of poverty, vulnerability and inequality. What are your perspectives on the potential of tax and public expenditure policies in addressing these challenges? And how can the Pacific Islands Forum facilitate the adoption and implementation of socially and environmentally responsible fiscal policies in the sub-region?

Response: Thank you, Chair.

Potentials of Tax & Public Expenditure Policies

Noting that we have very diverse group of countries represented, let me start by giving an overview of tax and expenditure issues in Pacific economies before focussing on the potential of taxation and expenditure to finance overall development in the Pacific Island countries. This will also set a platform to discuss socially and environmentally responsible fiscal policy responses.

Taxation has been a preeminent economic policy tool for almost all countries and the Pacific is no different. However, a narrow economic base and limited drivers of economic growth, as compared to the Asian economies, are major challenges to sustaining and increasing tax revenue for development expenditure. This is exacerbated by the weak and limited capacity of tax administration authorities in a number of Pacific countries which severely impacts on tax compliance and collection.

Consequently, direct budget support and development programmes funded by development partners are a critical supplement to tax revenues in the Pacific. With the support of development partners, almost all the Pacific countries are now focussing on reviewing non-tax revenues to cover the costs of delivery of public services. A significant share of non-tax rates were set during the early independence days (with very minimal revisions), and do not adequately cover the minimum costs of associated public services today.

Such support from donors, and reforms, are crucial to complement tax revenues in meeting the burgeoning development expenditures in the Pacific countries.

With regard the potential of tax in funding future expenditures – whether it be social transfers or adaptation to climate change – the focus must be on the productive capacity of the economy. That is, given that tax is intrinsically linked to the level of economic activity, we must persevere in growing our economies for sustainable tax revenues.

Pacific economies have had to explore innovative options/ways to broaden their revenue base to meet their national development needs as well as international goals.

This includes trade. Being small open island economies, Pacific countries must be part of the global economy through trade in goods and services, based on our comparative advantages.

In particular, labour mobility and ensuing remittances and income transfers have been a crucial source of revenue and driver of economic growth in a number of countries in the Pacific. To this end, let me acknowledge the seasonal worker programmes in Australia and New Zealand and the ensuing benefits for Pacific economies.

Similarly, the focus on the development of blue and green economies, including enhancing the economic returns from the oceans and renewable energy with low carbon footprints, have the potential to add to our economic base and tax revenues of Pacific economies.

On the expenditure side, Pacific economies continue to play catch-up on supporting economic development, impacted by the costs of adaptation to climate change, and managing impacts of disasters and associated risks. Challenges in effective allocation of expenditures to get the most 'bang-out-of-the-buck' is contingent (in large part) on the vulnerability of our economies to catastrophic events.

Given the narrow base of tax revenue and the limited fiscal space/buffers of many Pacific economies, recent experience (of cyclones and droughts) in the Pacific has shown that government expenditure is severely constrained in the event of a disaster and social expenditures are often re-allocated to reconstruction and rehabilitation initiatives. This also distorts the linkages and creates asymmetries between the short-term national budgeting and medium-to-long-term economic plans, as planned objectives may not be fully financed due to these unexpected shocks. These gaps in finance mean that national plans remain unachieved which then have a snow-ball financing effect over time, with the finance needed to achieve the same objective in the future costing more.

Hence, Pacific fiscal policy is in a constant state of balancing between revenue and expenditure to grow and sustain our economies as per our development plans; allocating financing for adaptation to climate change; and maintaining enough flexibility to respond to unexpected catastrophic events. For Pacific economies, this is not easy, which Pacific Finance Ministers will attest to.

Despite these challenges, Pacific economies continue to look at innovative financing options for resilient and sustainable development – that is – looking at specific revenue and expenditure measures. Some of the notable specific examples are:

1. Palau’s green fee levy (of US$30.00) built-into the departure tax for sustainable investment and management of their environment; and
2. Fiji’s environmental levy (of 6% on purchased value) for the tourism sector and associated luxury services to support environmental protection programmes.

In addition to these specific examples, almost all countries provide significant tax incentives and breaks for renewable energy projects, waste management, etc. Moreover, tax incentives for foreign investment offered by Pacific countries to varying degrees can also be used for the development of productive economic sectors coupled with the promotion of green economy initiatives, such as renewable energy, waste and water management, investment and introduction of smart technologies for climate adaptation.

It should be highlighted that revenue and expenditure measures are two-sides of the same coin – that is – a tax break or incentive means that the government provides the incentive to the private sector to effectively deliver the service on their behalf. Hence, tax breaks are de-facto expenditure measures outsourced to the private sector to deliver envisaged public services and create value. This is a form of effective public-private- partnership.

Pacific Islands Forum Role in Responsible Fiscal Policies

With regard the second part of the question, the overall aim of socially and environmentally responsible fiscal policy is to look beyond the traditional revenue and expenditure measures, and embed risk management and contingency policies.

From a regional perspective, a coordinated regional fiscal policy can produce immense benefits for the region, such as delivery of cost-effective regional public goods and services, regional risk pooling and transfer of inherent risks to capital markets, development of regional financing options for cross-border mobilisation and investment to broaden and sustain the regional economic base.

The Pacific Islands Forum, in its role as independent adviser to its Pacific member countries, facilitates such regional discussions and assists in the implementation of regional initiatives in partnership with relevant development partners.

The Pacific Island Forum Economic Ministers Meeting (FEMM), which is the premier regional meeting on economic and finance issues in the region led by the Ministers of Finance and Economic Planning, is a key regional policy platform coordinated by the Pacific Islands Forum Secretariat.

Some of the specific responsible fiscal policies that the Pacific Islands Forum Secretariat has facilitated recently are:

- Development of an independent Disaster risk insurance programme for five (5) Pacific countries with support from the World Bank Group. Last year, the Pacific Catastrophe Risk Assessment and Financing Initiative (PCRAFI) Facility was established and domiciled in the Cook Islands. The PCRAFI Program is supported by the PCRAFI Multi-Donor Trust Fund (MDTF) of US$40 million with the World Bank as trustee, and the aim of this is to provide the participating Pacific countries with catastrophe risk insurance coverage on competitive terms and associated technical assistance;

- At the 2015 FEMM, the Forum Secretariat facilitated a discussion on contingent credit lines for post-disaster finance to dissuade member countries from reallocating funds from the economic and social sectors which diverts the planned development path. This has now been translated into a financial product by the Asian Development Bank for its Pacific Developing Member countries, and the Cook Islands is the first country to benefit from this;

- The Forum Secretariat has developed and carried out climate finance assessments with relevant development partners to assist Pacific countries in their assessment of options for improved access to, and management of climate change resources; and

- Recently, PIFS has led policy research and advice on developing a regional finance facility to mobilise part of regional savings for regional investment. This facility proposes combining national government and private sector financial markets with innovative financial instruments to fully exploit the integration dividend. This would include developing a regional trust fund for reducing the burden of accessibility of global funds for supporting fiscal positions on Pacific Island countries.

These are some of the examples together with support from the Forum Secretariat to expand trade and private sectors initiatives to improve the productive sectors of the Pacific economies.