



Improving Pacific governance?

Potential implications of PACER-Plus for government revenue and public services in the Pacific island countries

What is PACER-Plus?

At the 2009 Pacific Island Forum Leaders' Meeting, held in Cairns, Australia, Pacific leaders agreed to begin negotiations for a regional trade agreement between the Pacific island countries and Australia and New Zealand (PACER-Plus).

The PACER-Plus negotiations are likely to result in a binding international agreement that will affect Pacific economies and societies for decades to come. PACER-Plus will have wide-reaching implications for all Pacific islanders. A new agreement could affect ownership of land, employment, how much tax people pay, how much they pay for goods at the local store, the prices they get for their produce at the local market, and even their ability to access services (like local clinics and schools).

Both the Australian and New Zealand governments have shown they are interested in negotiating PACER-Plus as a free trade agreement that will allow their firms to export more goods and services to the Pacific and invest in new enterprises in the island countries¹. The Australian government explains that "Australia's primary motivation in supporting PACER Plus is to help the Forum Island Countries (FICs) to promote sustainable economic development. We nonetheless expect that improved market access may enhance

some opportunities for Australian exporters, investors and service providers in Pacific markets"². The Australian Trade Minister Simon Crean describes PACER-Plus as a "trade-plus' free trade and economic integration agreement"³.

Will PACER-Plus lead to losses in government revenue?

Yes, if designed as a free trade agreement, PACER-Plus will lead to serious revenue losses in many Pacific island countries.

Most governments in the Pacific are struggling to provide public services paid for through taxes (like health, education, water, electricity, police and emergency services). One of the ways Pacific countries collect these taxes is through a tax on imported goods (often luxury goods). PACER-Plus will force Pacific governments to stop collecting some of these taxes, which means governments will have difficulty supporting already struggling public services.

A report commissioned by the Pacific Islands Forum Secretariat, and completed by Washington-based consultants *Nathan Associates*, found that under PACER-Plus, Pacific countries stand to lose tens of millions of dollars each year. That report found Vanuatu stands to lose around 17% of its annual government revenue, as does Tonga, while Samoa and Kiribati stand to lose around 14% of

¹ A 'national interest' assessment undertaken regarding the Pacific Agreement on Closer Economic Relations (PACER), the precursor to PACER-Plus, found that "without ratification of PACER, Australia would be denied an enhanced opportunity to negotiate better market access to Pacific markets for Australian business and industry while any other country could enjoy duty free access to FIC's for their goods".

² 'Pacific trade negotiations commence', see: <http://www.aei.gov.au/AEI/MIP/Activities/09Activity24.htm>

³ Crean, S. McMullan, B. 2008. 'International engagement begins in own backyard'. *Canberra Times*. 26/8/08. Fairfax, Canberra

their revenue⁴. For many Pacific island countries, the projected revenue losses under PACER-Plus equate to a significant proportion of, or exceed, their entire health or education budgets⁵.

It is unclear how Pacific governments would continue to provide services to their people if they lose this much revenue. One of the ways they might save money is to downsize their public sector – putting more people out of work. Any loss of jobs for nurses, teachers and public servants would place an added burden on women who work in these sectors and increase the push to migrate.

Will PACER-Plus lead to higher taxes?

Yes, if designed as a free trade agreement, PACER-Plus will lead to higher consumer taxes in many Pacific island countries.

PACER-Plus would force Pacific governments to look for other ways to raise money they need to provide public services. This usually means introducing a new tax in the form of a value-added tax (VAT) or goods and services tax (GST). Governments that already have these taxes will be forced to raise them.

Taxes on goods and services unfairly penalise the poor. This is because everybody pays the same tax on what they buy, regardless of how much income they earn. A poor person buys bread, cooking oil or other basic goods (and pays tax on it), just as much as a rich person.

Even if these taxes are introduced, it is unlikely that Pacific governments will be able to recover the revenue lost through PACER-Plus. Studies by the International Monetary Fund have found that over the past 25 years, low income countries have completely failed to recover government revenue lost from the reduction of import taxes (and that introducing VAT has little impact on meeting the shortfall)⁶. There are recent examples of this in our region – when the Asian Development Bank forced Vanuatu to lower tariffs and introduce a VAT as part of conditions for a new loan in the late 1990s for

example, the country suffered massive revenue losses that it took many years to recover from.

Will PACER-Plus lead to cheaper goods for consumers?

Not necessarily. Proponents of a new free trade agreement with Australia and New Zealand argue that such an agreement will see cheaper goods for consumers when tariffs are lowered. However, experience suggests that even if tariffs are lowered, in many cases exporters and distributors (middle men) tend to increase their prices almost back to the same level after tariffs are removed, and fail to pass on the benefits to consumers.

There are recent examples of this from within our region. For example, when the Asian Development Bank forced Vanuatu to lower tariffs as part of conditions for a new loan in the late 1990s, benefits *were not* passed on to consumers. A report commissioned by the United Nations Development Programme on *Leveraging Trade for Human Development in Vanuatu* found that one of the 'benefits of trade liberalisation – a fall in retail prices of consumer items – *is not evident in Vanuatu*'⁷.

Any fall in the price of consumer goods as a result of a reduction in tariffs is likely to be at least partially offset by increases in consumer taxes (introduced to meet government revenue shortfalls).

Indeed, governments that already have these taxes have steadily raised them in recent times. Samoa for example has raised its Value Added Goods and Services Tax from 10% to 15%, and Tonga, which introduced a Consumption Tax in 2005 to offset losses incurred by joining the WTO, gathered 20% less revenue than it expected to in 2008/09 and is likely to raise its Consumption Tax in the near future.

Find out more

This fact sheet is produced by the Australian Civil Society Network on Pacific Trade, which links unions, churches and non government organisations that work to ensure trade rules for the Pacific island countries are fair and just.

For further information contact the network at pacifictrade@gmail.com

⁴ Nathan Associates. 2007. *Pacific Regional Trade and Economic Cooperation – Joint Baseline and Gap Analysis*. Pacific Islands Forum Secretariat, November 2007.

⁵ Oxfam Australia and Oxfam New Zealand. 2009. *PACER Plus and its alternatives: Which way for trade and development in the Pacific*. Oxfam Australia, Melbourne and Oxfam New Zealand, Auckland.

⁶ International Monetary Fund, 2005. *Tax revenue and (or?) trade liberalisation*. (prepared by Thomas Baunsgaard and Michael Keen). June 2005.

⁷ Wagle, S. 2007. *Leveraging Trade for Human Development in Vanuatu – Summary of Issues*. Asia-Pacific Trade and Investment Initiative UNDP Regional Centre in Colombo.