THE NATIONAL RESEARCH INSTITUTE
PAPUA NEW GUINEA

ISSUES PAPER

THE CHALLENGES TO TAX REVENUE COLLECTION BY THE AUTONOMOUS BOUGAINVILLE GOVERNMENT

Nelson Atip Nema

www.pngnri.org

Issues Paper 33

Abstract

There have been discussions centred around the possible challenges on the income aspect of the ABG, especially, in the collection of tax revenue. According to Chand (2018), the 2017 financial year ending report, estimated that a budget of K300 million is needed by the ABG government to function well. The budget ceiling was K162 million while falling short of K138 million. The year 2018 has seen an improvement with the budget outcome amount of K226 million, which means there is still a revenue gap of K74 million. It is of interest to know how best this revenue can be collected to fill the gap or the shortfall. One of the most appropriate options currently available would be to increase the collection of tax revenue to fill the gap. Challenges surrounding the tax policy exemplify the loopholes created by the Bougainville Peace Agreement (BPA) where there is no clear evidence that the PNG government is using the recurrent grant formula to calculate its annual grants towards the Bougainville Government. Income taxes are currently seen to be the major contributor to the total tax revenue (90%); however, this is not sustainable for a future country's economy that is planning to be self-governed. Consumption taxes such as Goods and Services Taxes (GST) are more efficient and would play a major role in tax revenue of any future self-government of Bougainville. Citizens of Bougainville and the ABG are informed that it is possible to manage self-government on the conditions that the revenue challenges are met or will be met in the transition period for a while before being stabilised. The Bougainville Tax Office needs to build its capacity of highly skilled personnel to efficiently collect tax revenue. Prudent management of tax revenue finances in the treasury department of the ABG is also a vital condition for development.

inquire
inform
influence

October 2019

THE NATIONAL RESEARCH INSTITUTE
PAPUA NEW GUINEA

ISSUES PAPER
October 2019

THE CHALLENGES TO TAX REVENUE COLLECTION BY THE AUTONOMOUS BOUGAINVILLE GOVERNMENT

By Nelson Atip Nema

Introduction

I focus on the possible challenges in the collection of tax revenue in Bougainville. If the people of Bougainville vote for independence, decisions will have to be made on whether to adopt Papua New Guinea's (PNG's) current tax code or not (Hill & Fletcher, 2018). That means the future independent Bougainville government will have to make certain amendments to the legislations to suit its own needs if it decides to adopt PNG tax laws. But if the Autonomous Region of Bougainville (AROB) decides to be part of PNG then it means that AROB and the PNG Government will have to review the existing fiscal arrangements such as the one under the Bougainville Peace Agreement (BPA).

Collection of Tax Revenue is a function of tax rate and tax base (Hammer, 1973). All throughout this discussion I hold the tax base constant; assuming that factors affecting the tax rate do not affect the tax base and focus my discussion on challenges to tax policy and collection of taxes. Previous research such as the one by Chand (2018) focused on the subject of financing for fiscal autonomy of a future Bougainville government and the potential challenges to take on board. He has used useful information to point out important background analysis which may be of paramount importance to educate Bougainvilleans, Papua New Guineans and other key stakeholders who are looking forward to the coming referendum discussing issues on revenue. In September 2017, the ABG hosted a Revenue and Tax Summit. Experts from key institutions gave presentations that emphasised revenue generation and funding for a future Bougainville government.

Bird & Zolt (2003) pointed out that the manner in which countries raise taxes differs as widely as do the amounts they raise. The pattern of taxes found in any country depends upon many factors such as its economic structure, its history, and the tax structures found in the neighboring countries (Bird & Zolt, 2006). The pattern of taxes collected by the PNG government through the Internal Revenue Commission (IRC) and the ABG has been dependent upon the economic structure, history and the tax structures of both the PNG government and the ABG region including Solomon Islands and Vanuatu as its closest neighbours. The ABG's tax design may be strongly influenced by the economic structure of the region. As is the case in the rest of PNG, the ABG has a large informal agricultural sector which is not easily taxed. It also has a significant informal economy that is largely left outside the tax structure. Therefore, the potential reachable tax base constitutes a smaller portion of total economic activity.

A budget of K300 million is estimated for the ABG government to function well (Chand (2018). (Note that the budget amount of K300 million was projected for the 2017 estimates, however, by now there could have been some increase). The budget ceiling was K162 million; a shortfall of K138 million. In 2018 there has been an improvement with the budget outcome amount of K226 million, which means there is still a revenue gap of K74 million. It would be interesting to know how best this revenue can be collected to fill the gap or the shortfall. One of the most appropriate options currently available would be to increase the collection of tax revenue to fill the gap.

Methodology

This study is an evidence-based desktop research which was conducted using secondary data most of which was available on the internet. Therefore, the arguments presented are supported with evidence. Some literature has also been obtained from the PNG National Research Institute to conclude the study. This research analyses the challenges faced by ABG in the collection and administration of its tax revenue. Discussions are done in two parts: first, from the perspective of policy; and second, from the perspective of administration. More emphasis is placed on Part II, considering that most challenges arise from the actual collection of tax revenue.

Historical and cross-sectional qualitative data were used to write this paper. Most data were obtained from the ABG website under the Department of Treasury and Finance tab from the research presentations done at the Tax and Revenue Summit in 2017. The data and historical events are analysed to support the arguments I present.

Part I: Challenges relating to the tax policy

Good tax policy influences economic development, but economic development also influences the way we think about tax policy (Bahl & Bird, 2008). Fiscal autonomy is multi-faceted and must be assessed using several distinct indicators such as the share of tax revenue allocated to sub-central governments, the discretion of those taxes, the share of transfers allocated to sub-central governments and the percentage of earmarked transfers (Blochliger, 2006). A potential future government of Bougainville is no exception to that and clearly has a great need of raising much needed revenue to fund its public services and contribute to infrastructural development. The Bougainville Peace Agreement states that fiscal self-reliance would have been deemed to be achieved in "the first year in which the revenues from company tax, customs duties and 70% of value added tax collected in Bougainville are equal to the value of the recurrent grant on a sustainable basis" (BPA, para. 137). The Organic Law, the Bougainville Constitution, and amendments to the PNG National Constitution all use the above definition of fiscal self-reliance (Chand, 2018).

Revenue sharing issue

Tax sharing concept is understood as an arrangement where tax revenue is divided vertically between the central and sub-central governments and/or horizontally across-sub-central governments (Blöchliger & Rabesona, 2009). The ABG has vertical arrangement with the PNG Government under the BPA where income taxes on companies and individuals, Goods & Services Tax, Motor Vehicles registration levies in Bougainville are collected by the PNG Government through the IRC while the ABG collects sales taxes on beer and cigarettes, liquor licence fees, housing rentals and fees from grant of mining exploration licences (Chand, 2018). One thing that is more compelling here is that the details of revenue sharing tax arrangement in paragraph 137 of the BPA has narrowed down to only three specific groups of taxes: customs duties (100%), Company taxes (100%) and Goods & Services Taxes GST (70%). A proper definition of fiscal self-reliance would have been more easily taken as 'all revenues' generated within the AROB rather than just the three groups of taxes. Moreover, on the reasoning part, paragraph 137 has not stated on what grounds those specific revenue sources were chosen. In 2016, for example, company taxes collected stood at K727,850 followed by GST K1,532,118 and customs duties totalled to K2,379,009. Self-reliance according to definition of paragraph 137 was achieved at only 5.66 percent whereas, looking at the other definition, if all revenues were taken together (K23,233,617) then self-reliance would have been achieved at 56.27 percent in the AROB including GST at 100 percent if all are taken into account. Olsen (2017) also made mention of that in his presentation during the Revenue and Tax Summit. The 70 percent revenue value, in effect, has the limiting effect to adding to the total revenue generated, which in turn has the effect of lowering the percentage of self-reliance — this if otherwise done at 100% GST remittance to the ABG would have been a better arrangement.

Policy legislation issue

Another flaw in the BPA is lack of clarity about the formula used to calculate grants disbursed annually by the PNG government to the ABG. It is uncertain how these grants are determined; that is, what formula is used to calculate them. Moreover, the recurrent grant formula as stated in the peace agreement has not been clearly applied. In 2016, for example, a grant amount of K41,291,300 was remitted back to the ABG from the total tax revenue of K2,379,009 that was collected by the PNG government on behalf of the ABG. The question is what formula or basis was used by the PNG government to come up with the grant figure of K41,291,300. The PNG government has not clearly elaborated a way in which the grants are to be determined, however, has been disbursing funds upon mere estimates annually. That evidence can be seen also when looking at the total value of grants to the ABG by the PNG Government in the years 2014 (K155 million), 2015 (K60 million) and 2016 (K57 million) where there was no steady formula used. Similar sentiments were expressed by Bell and McVeigh (2018) that a clearer, indefinite, more formula-driven grant allocation would be desirable to negotiate post autonomy which would be an incentive for good fiscal management and moves towards self-reliance. Chand (2018) also expressed a concern that the current fiscal regime as legislated in the Organic Laws and the two Constitutions fail to fully reward the ABG for fostering growth of the local economy (Chand, 2018).

A fiscal autonomy is the devolution of all tax and spending decisions by the central government to the sub-central government so that it performs its own inland revenue function, raising its own revenue, and making a contribution to the central government for shared services such as spending on public services. On the other hand a fiscal self-reliance in this context would mean a country or sub-central government not depending on financial aid from the central government or foreign donors but can be able to raise its own revenue to meet its needs. Therefore, a fiscal autonomy rather than self-reliance would have been a better choice to consider when designing the Bougainville Peace Agreement in 2001. Issues of tax competition would not have been encountered as well as double taxation. In as much as each local government unit is empowered to create its own sources of revenues and to levy taxes, fees and charges, there exists the real possibility that business enterprises will be subject to more than double taxation of the same business activity. This will not only complicate the tax regime, it will also increase the cost of doing business beyond the budgets of business enterprises (Donato, 2016). The impending referendum has heightened awareness within the ABG for fiscal autonomy rather than fiscal self-reliance as defined in the legislations (Chand, 2018).

Part II: Tax revenue collection challenges

Challenges to collecting income and consumption taxes

Income Tax as major source of tax revenue in AROB

The primary sources of direct or income taxation are individuals, through a personal income tax, and companies through a corporate income tax. Since Personal Income Taxes are generally administered through a wage withholding system where employers withhold part of employees wages and remit that amount to the tax administration, generally the administration of it would be straightforward and involve less complications (Carnahan, 2015). There may be a few notable challenges faced by tax administration especially in cases of exemptions and deductions on certain individuals income. At this stage, in the case of AROB this may not be of great concern because of the small size of the economy where collection of individual income tax is not complex. This may be the reason why taxes collected from individuals make up the largest share of total revenue collection in the AROB over the last successive fiscal years especially 2014, 2015 and 2016. For instance in 2016, of the K20,716,002 total revenue collected K19,403,000 (94%) came from Group Tax. For the time being the ABG's revenue strength is in that area, therefore, it may be a good place to start with for a future Bougainville government intending to build its tax base. To do so, one immediate and possible way would be to encourage the growth of the local economy through the growth of Small & Medium Enterprises (SMEs) to create employment.

The informal economy and the Small & Medium Enterprises (SMEs)

Small and Medium Enterprises (SMEs) are the largest source of employment across the world (OECD, 2010). PNG recently released a new SME Policy with the fundamental aim of promoting and driving inclusive economic growth through employment and wealth creation (Nicholas, 2016). Currently PNG is a lower middle income country, however, the overall vision of the policy is that the SME sector would be a major contributor toward PNG becoming a middle income country by 2030 and a high-income country by 2050 and that includes Bougainville as well to this time. As noted above, the National Government and ABG's strength of revenue collection lies in the area of Group Tax collection, therefore, SMEs would serve as a reliable option of growing the local economy through job creation and revenue generation through individuals income taxes. However, the progress on the rollout of the SME policy by the national government to the ABG has been ineffective if not has seen very minimal progress to this stage. A presentation done by Maken (2016) revealed that, under the policy set for each of the provinces, the target set for AROB is to achieve 14,950 SMEs by the end of 2030. The statistics show that for other provinces there is existence of SMEs and there is progress in growth, however, AROB has no record of established SMEs and also no record of growth which poses a great challenge for the region.

Obviously the ABG enjoys access to a wider suite of policies than revenue and tax policies but a focus on these two will serve to highlight the causal linkages involved. The success of revenue and tax policies would be marked by growth in the formal (i.e. monetised) economy which in turn would contribute to broadening of the tax base (Chand, 2018). There is a greater need for the investment climate to be conducive for generating economic growth and thus increasing the tax income and consumption tax bases by transforming the large informal sector gradually into formal registered businesses compatible for paying taxes. A large level of informality has resulted in AROB economy being vulnerable with low levels of productivity thus low levels of business activities and job creation. However, with the SME policy in place the ABG can opt for a better future in 2030 which would increase private investment and diversify the economy resulting in jobs creation in tourism and manufacturing sectors. Since the economy of AROB is small and is export-driven it may benefit from its exports of especially primary products accessing increasingly higher value markets internationally. The SMEs fit well to our definition of defining informal sectors in PNG as well as AROB. One of a greater challenge currently faced by the Bougainville Taxation office is its ability to collect information and registration of small and medium sized businesses operating in the region in order to capture them in the tax net. This was revealed by the Bougainville Tax Office (BTO) during the Revenue and Tax Summit.

The growth of SMEs have dual impact on the local economy. Firstly, SMEs grow the economy through employment, therefore, tax revenue can be collected from those who are employed, however, that is not said to be efficient and sustainable. For a future Bougainville Government to grow and expand it may not be an ideal thing for the ABG to rely mostly on tax revenue from individual income earners. Secondly, the growth of SMEs also increases consumption tax base and that consumption taxes are said to be sustainable and efficient.

Consumption tax

Indirect taxes or consumption taxes make up the mainstay of the revenue base. In terms of a general tax on consumption, over 150 countries have some form of value-added tax – VAT (Carnahan, 2015). VAT was introduced in PNG in 1999 -— the most common indirect taxation in PNG. It was replaced by the Goods & Services Tax (GST) in 2004. The PNG Taxation Review Committee in their 2015 report stated that GST would continue to be a major source of PNG's revenue in the years to come as PNG looks at broadening its tax base and reduce reliance on income taxes. The current GST threshold is K250,000 or around USD90,000; this is a relatively high threshold. By comparison, GST thresholds in the region include Samoa USD35,000, Vanuatu USD37,000, Indonesia USD47,000 and Fiji USD49,000. Looking more widely, Thailand's threshold is USD39,000, Cambodia USD122,000 (for goods) and Singapore USD750,000 (PNG Taxation Review Committee, 2015).The challenges of GST in PNG include Zero-rating for resource companies (and others), Discretionary Exemptions, Payment of Refunds, Refund Fraud, General Non-Compliance and GST refunds to educational institutions. The ABG is part and parcel of these highlighted challenges. Learning from PNG's case the future Bougainville government may and can make amendments to the GST Act (2004) if it adopts the GST legislation amendments to improve on revenue collections especially to adjust the threshold levels to encourage investment and also the zero rating of resource companies.

Other forms of General Consumption Tax in the AROB include: Motor Vehicle Registrations, Liquor Licensing Fees, Beer Sales Tax and Cigarette Sales Tax which are all collected by the ABG and retained within the region. The GST and other taxes are generally applied to broader bases than tariffs, excises or service taxes, thus, they are seen to be more economically efficient. In other words economic efficiency calls for taxes which have broader bases than those with narrower bases. Carnahan (2015) further pointed out that out of all consumption taxes, VAT is considered to be the most economically efficient consumption tax. Tariffs, excises and services taxes are less economically efficient as they only apply to a subset of goods or services. However, the trade-off is that given its comprehensive coverage, the VAT is more difficult to administer — because it applies to more taxpayers. Even in its simplest form, it is more complex to administer, because intermediate producers need to get credit for the tax they pay. These complexities are multiplied when there are multiple rates or some products are 'zero-rated', while others are exempt. On the other hand, import tariffs are the easiest to administer because the border represents a natural collection point. This is particularly the case for island economies, but also the case in many developing countries with limited transport infrastructure.

Once again, the most effective way to tax consumption would be obviously GST. However, that depends on AROB's context, particularly in terms of its economic structure and the level of administrative capacity.

Goods & Services Tax (GST) – for broader base and economic growth

One would understand that GST is a consumption tax which would serve as a good overall tax indicator to show whether an economy is growing or slowing down (Nema & Howess, 2017). So to say that the Bougainville economy did well in terms of the increase in Group Tax would be misleading since this tax is paid by mostly the formal sector of the economy whereas GST is a tax that is paid by both the formal and informal sector consumers. Therefore, the challenge here for ABG is not to rely too heavily on revenue from income tax but must have the vision and aspirations to shift onto consumption taxes. One of the most notable way as mentioned earlier is through the promotion of SMEs in the region and through the conduct of taxation education awareness campaigns on a regular basis.

In the lead-up to the referendum, the IRC, represented by a special delegation of senior executives meets quarterly to discuss issues that surround taxation matters and has been conducting awareness programs educating both the Bougainville citizens and the ABG about the importance of expanding its tax base to grow the economy. The primary focus of these awareness programs is to make known to the public and also to encourage businesses – both small and medium enterprises to register formally with IRC so that they can benefit from tax concessions for income taxes and for GST. They would then be able to claim input credits for GST taxes paid to other suppliers. Therefore, registering formally helps not only to claim those input credits but also be able to trade with bigger suppliers who require registered taxpayers to trade with. By doing so the system produces results which are fair to the taxpayers themselves as well as the ABG – a win-win situation.

Challenges to collection of resource taxes

Mineral Resources

For many developing countries, natural resources represent the only way to fund the investments in human, physical and institutional capital needed to produce sustained improvements in standards of living and basic development indicators (Carnahan, 2015). There are three options for taxing mining projects: royalties, profit-based royalty or tax on resource rent. The Bougainville Copper mine began production in 1972 with the national government as a 20 percentshareholder of which the Bougainvilleans received 0.5–1.25 percent share of the total profit. It provided over 45 percent of PNG's national export revenue and was incredibly important to the economy. It was then shut down due to the conflict in 1989. In August, 2014 the national government transferred the mining powers to the Bougainville government to take care of its own mineral operations within its region under the ABG. *The Bougainville Mining Act 2015*, among others, allows for fees, annual rents and royalties. Landowners receive equity of 1.5 percent and a regional development royalty of 1.25 percent of mineral sales revenue are paid to the ABG. A further production levy for operations budget for mineral sector development of 0.5 percent of mineral sales is also collected as tax revenue. The New Panguna mine, when developed and operational, could generate significant tax revenue of USD560 million per annum; that is, about K2 billion per year which is more than six times the revenue needed to run the economy (BCL, 2017). In relation to that it is projected that the ABG needs K300 million to run the economy annually (Chand, 2018). However, there are certain challenges as mentioned by the BCL presenters during the Revenue and Tax Summit. The ABG has expressed concerns over large mining projects such as Panguna need fiscal surety as a major challenge that stands in the way. *The Bougainville Mining Act 2015* is not comprehensive in that some areas of longer-term fiscal uncertainty — especially of what the Tax regime would be — that is whether the PNG government would legislate taxes or a new ABG Tax Act is needed. As a consequence of that uncertainty project viability, decision making and funding are at risk .Therefore BCL and financiers must have certainty of fiscal regime. Also concerns expressed by the ABG that an excessive tax burden, like PNG's additional profits tax, reduces project value and probability prevents the Panguna mine from ever being redeveloped. All in all, it is predicted that the mine will also have a wider multiplier stimulus to the economy. A potential pathway is a joint agreement between the ABG and the national government regarding applicable taxes, specific to the Panguna project is another concern expressed by the ABG. This, however, as mentioned previously, that under a fiscal autonomy, a revenue sharing agreement would not have to be considered and the ABG would have all powers to make its decision regarding the tax revenue of the mine. Also there is the challenge that they must also develop other formal sectors — fisheries, agriculture and tourism which must be done through SMEs so that there is a balance in the economy. Apart from the Panguna mine there are also other potential mines to be developed including Tore, Isina, Jaba, Manetai and also other several small alluvial mines which would even add on more to the tax revenue take when all combined.

Land taxes

As mentioned by Carnahan (2015) land taxes are notoriously hard to introduce because of the significant political power and influence wielded by landowners. But with tenure contested, there is an opportunity to put the tax on the books, build the collection capacity and then actually collect when ownership is settled. The ABG collects land taxes through Statutory Board fees, technical fees, technical material sales, developed property sales, and freehold land management fees (Nagual, 2017). Since the ABG sets the rates for these taxes it is more flexible to collect. As suggested by Nagual (2017) a property tax of two percent would be imposed and collected by the ABG on unimproved valuation. Also Statutory board fees, land board fees and physical planning board fees. A minimum of four physical planning board meetings with a total of K20,000, at K5,000 per Board meeting, could be raised and that the land board fees would be K50,000 annually. There are several potential challenges to collecting land tax revenue including: firstly, the ABG validate property register on those current properties that are not formally documented to increase the number of leasehold properties. Currently there are about 2,375 properties and that number could increase when property register is validated and the valuation rolls are updated through physical inspection of all state properties in all the towns and districts of AROB. Another challenge on land rentals would be to establish a policy to increase land rental property annually by both the ABG and the national government and that requires awareness to justify the increases to all stakeholders. Plantations land properties also pose the challenge of establishing a policy that would benefit the leaseholders, the landowners and the ABG and that requires the decision of both the ABG and the national government. That would help clearly see which plantations are freehold, leasehold, under mortgage or already sold plantations.

Fisheries taxes

The current major fisheries exports of Bougainville include sea cucumber, tuna and other mixed species. Potential revenue sources of fisheries in AROB as listed in the Revenue and Tax Summit by the Fisheries Department of Bougainville include the following: Licence to fish (commercial/recreational), Catch quotas, Licence to buy and sell fish products, Licence to process fish products, Licence to farm or sea ranch fish, Licence to operate fishing vessels, Port landing tax (commercial sales), Export tax (national level only) and Company and wage earner income tax. Recent trends have estimated that PNG's share of revenue from fisheries resource would have been at a value of USD1.112 billion (Auhi et al., 2017). At least 30 percent of the PNG catch is taken in waters associated with Bougainville which would put the value at over USD333 (Betitis & Tsiroat, 2017). Obviously the need here is to set up fisheries tax rates which would be more transparent and efficient than the current auction basis trading.

Challenges to collection of Export and Import taxes

Export taxes

Export taxes are levied mostly on agricultural and mineral products in the primary producing countries. They are largely confined to developing countries. Few export taxes are now imposed by industrialised countries. Export taxes are employed to compensate for the devaluation of a country's currency and as a means of stabilising the economy during a period of fluctuating prices (Goode & Ojha, 1966). Although the economy of AROB is small in size, export taxes may play a significant role on especially all primary agricultural resources. Bougainville cocoa provided 33 percent of overall PNG production from 2007–2016. In 2016 PNG's export volume was 40,508 tonnes valued at K360.7 million; AROB produced 10,554 tonnes (26%) valued at K93.7million (Betitis & Tsiroat, 2017). Chand (2018) highlighted that a cocoa levy of one percent would at least raise revenue of K680,000 which is equal to 1.6 percent of the recurrent grant provided by the national government in 2016 for the ABG. The challenge now is to get other agricultural products such as copra and palm oil on board for exports which may also help contribute to tax revenues earned from primary exports. According to the Kopra Industry Koporesen statistics (http://www.kik.com.pg/industry/statistics/), copra contributes approximately K125 million per annum to PNG's economy. In 2015 PNG exported more than 86,000 tonnes and of that the AROB export of copra was 19,193 tonnes at an average price of K1500 per tonne which had a total value of K28.8 million. Thus export levy was valued at K767,720 which is equivalent to 2.7 percent. There is also tax revenue potential in other primary products including oil palm resources and forestry resources .They can all add up to build tax revenue from primary resources. Among some of the challenges mentioned by Bougainville primary resource department in their presentation during the Revenue and Tax Summit was the challenge of narrowly based resource sector in AROB which the BPA did not cater for. For sustainability purposes export taxes would be much better to collect than import taxes for a future Bougainville government. Export taxes will help bring in more tax revenue as well as encourage appreciation of the local currency which would in turn boost the economy in creating more income opportunities therefore broadening the tax base. Revenue raising through export taxes is more preferable to import taxes basically for the reason that, on the demand side, import taxes attract inflationary pressures on the prices of goods and services being imported into the local economy especially when there is inflation from the importing country or when there is an economic downturn in the local economy. Being a small open economy the AROB may choose to export more of its local agricultural products.

Import taxes

A presentation by the PNG Customs Commissioner during the Revenue and Tax Summit revealed some of the challenges faced by the PNG Customs Commission regarding Bougainville. Almost all imports of commodities for Bougainville which come through Lae and Rabaul are not declared except for some imports from Solomon Islands. The common challenges faced by the Commission include: increasing global trade and movement of people and conveyances across the borders; revenue leakages through devaluation; fraud and corruption; weaknesses in the Tariff & Excise policies; manpower shortages; lack of institutional capacity and capability, training of officers and productivity; border protection capability; and best practice international standards.

Export taxes more suitable for AROB

Developing countries continue to use export taxes today as a source of government revenue: to encourage value added and infant industries, to attract foreign investment, for price stability, to improve terms of trade, or to deal with currency devaluations and inflation and as a method of addressing tariff escalation in importing countries. The ABG may also have the option of using import taxes to raise its revenue. I argue that, given ABG's current economic situation and for a potential future self-government, AROB may rely more on export taxes to raise its revenue because of the reasons stated above. Furthermore, a good strategy for the ABG would be to levy export taxes especially when the local currency revalues or appreciates so that it benefits together with the local exporters . Import taxes may have the effect of raising domestic prices causing inflation in the domestic economy which may be detrimental to grow the economy especially in such a period of time where growth is much needed. Thus taxing the primary resources for exports such as cocoa, copra, forestry and so on, as mentioned above would be the way forward for raising the much needed revenue for the ABG.

Challenges of minimising costs of taxation

Costs of taxation here are referred to as the costs incurred by tax administrators when in the process of collecting tax revenue. Taxes are simply a means of transferring resources from private to public and are not a cost in economic terms; that is, economic costs are incurred when taxes have the impact of reducing resources available to society (Bird & Zolt, 2003). Therefore, so long as taxes generate revenue for economic growth and development without being a burden to the society at large they do serve as a cost to the economy. Depending on the types of tax, the actual cost of collecting taxes in developed countries is roughly one percent of tax revenues while in developing countries it may cost substantially higher. During the Revenue and Tax Summit, the Bougainville Tax Office (BTO) presented some of its challenges, one of which is that of non compliance by taxpayers especially from beer and cigarettes. Sales tax revenue collections from these two items are very low due to the very high rates imposed on them. One of the possible root causes would be the weakness of the legislation of the *Sales Tax Act 2011*. Another greater challenge expressed is that the ABG tax office has all new officers employed under BTO organisational structure and therefore officers need proper training in order to deliver as expected. There is a need for a better management system for the current National Tax collection in Bougainville. There is a greater need to establish a fully operational BTO and that would mean a new Revenue House and a new system for identification for a new tax regime to support the revenue management system for the ABG. Similar concerns were expressed by the IRC Commissioner of Taxation who also stated that the most important tool the BTO needs is the technology in place to collect taxes (Personal interview, 10/01/2019).

Challenges on tax incentives as an option to encouraging economic growth and development

With large informal sectors and tax evasion pressures, tax incentives can be a means of enhancing productivity and economic growth by preventing firms from shifting into the informal sector or evasion-prone activities (Forstater, 2017). However, if incentives are overgenerous or poorly designed they can result in giving money away without affecting investment and operating decisions. Even worse, incentives can be captured by politically connected firms and used as a merry-go-round for diverting public funds into political finance. When taxing the income of especially the corporate bodies, Carnahan (2015) stressed that tax incentives raise concerns which may sometimes work against their primary objective of achieving development goals. They may cause revenue leakage in developing and developed countries because they erode the tax base. Some types of incentives are likely to be more successful than others, and generate more benefits than others - for example; an investment tax credit may be preferable to simply exempting profits. Designing effective tax incentives is a challenge for well-resourced tax administrations in developed countries. However, in developing countries with weaker administrations, the likelihood for serious revenue leakages and negative spillovers from incentive schemes is much greater.

Chand (2018) also expressed similar sentiments in the case of AROB where the architects of the Peace Agreement did not contemplate upon the effects of the legislation on the ABG in which the fiscal transfer in the form of the grants would erode the incentives for the ABG to grow its own tax base. The lack of clarity in policy erodes the purpose of the grants and makes the ABG ‘lazy’ to work hard and smart on ways to raise revenue. The mandatory nature of the grants lent the incentives for the ABG to blame the PNG government for shortfalls in funding and supply of public services. The important point is that whatever the incentives may be they must not erode the tax base and that is the challenge for the Bougainville Tax office.

Conclusion

The challenges to growing the economy of Bougainville in order to broaden the tax base of any future Bougainville government depends primarily on how the current structure of the economy and the amount of revenue it generates to finance its public utilities. Discussions in this paper have narrowed down to some of the possible challenges to the income or revenue aspect especially in the collection of tax revenue in ABG. The large informal economy of Bougainville presents a great challenge. In order to broaden the tax base, more businesses, especially the SMEs need to be encouraged and be formally registered. The Peace Agreement does not clearly cater for that and thus the BTO has had difficulties over the past years doing the coordination work. Challenges surrounding the tax policy further exemplifies the loopholes created by the Peace Agreement which does not show the basis on which the PNG government calculates its annual grant towards Bougainville. Also it does not provide the reasoning for apportioning GST revenue of 70 percent to be collected by the PNG government and 30 percent GST revenue to be collected by the ABG. Income taxes are currently seen to be the major contributor to the total tax revenue (90%); however, this is not sustainable for a future country's economy that is planning to be self-governed. Consumption taxes such as GST are more efficient and will play a major role in tax revenue of any future self-government of Bougainville since it broadens the tax base and is also a good economic indicator to performance apart from GDP as an indicator .However, given the current limitations of low formal registrations and business activities especially by the SMEs, progress has been slow. Resources taxes also have a great potential of growing the Bougainville economy whereby the Panguna mine alone has three times the potential to generate tax revenue that would be more than enough to run the economy. However, certain political and legal issues surrounding the operation of the mine has temporarily put on hold the opening of the mine. For sustainability purposes export taxes would be much better to collect than import taxes for a future Bougainville government. Export taxes would help bring in more tax revenue as well as encourage appreciation of the local currency which would in turn boost the economy in creating more income opportunities and therefore increasing the tax base. The major challenge to the BTO with regards to the costs of running its office is the establishment of appropriate technology and skilled staff to manage the administration of the different taxes that are to be collected. Tax incentives may be provided by the ABG to promote economic activities to encourage broadening of the tax base, however, the major challenge is that those incentives must be carefully scrutinised so that they do not have the end effect of eroding the tax base.

Based on the findings the citizens of Bougainville and the ABG are informed that it is possible to manage self-government on the conditions that the revenue challenges are met or will be able to meet during the transition period for a while before being stabilised. The BTO would need to recruit more staff and train them with high skills to manage the revenue collection effectively. Also prudent management of tax revenue finances and other finances in the treasury department by the ABG is needed as prerequisites for sustainable economic development.

References

Bahl, R., and Bird, R. (2008). Tax policy in developing countries: Looking back—and forward. *National Tax Journal,* 61 (2): 279–301. Retrieved from https://www.jstor.org/stable/41790445

Bell, C., and McVeigh, R. (2018). *Economic implications of the Referendum: Bougainville Referendum outcome issue*s (PNG NRI Research Report 05). Port Moresby: Papua New Guinea National Research Institute.

Betitis, T., Auhi, M., and Mounsey, R. (2017). A brief outline of Bougainville's revenue potential from living aquatic resources and tasks required to be undertaken (Presentation at the ABG Revenue and Tax Summit). Retrieved from http://www.abg.gov.pg/images/misc/15._Fisheries_Tax_Revenue_presentation.pdf

Betitis. T., and Tsiroats. A. (2017). Presentation by the ABG Department of Primary Industry & Marine Resources at the ABG Revenue and Tax Summit. Retrieved from http://www.abg.gov.pg/images/misc/16_ABG_Dept_Primary_Industries_presentation.pdf

Bird, R., and Zolt, M. (2006). *Introduction to tax policy design and development in developing and transitional countries.* Retrieved from https://www.researchgate.net/publication/255586182_Introduction_to_Tax_Policy_Design_and_Development/download

Blöchliger, H., and Rabesona, J. (2009). *The fiscal autonomy of sub-central governments – An update.* Retrieved from https://www.oecd.org/tax/federalism/42982242.pdf

Bougainville Copper Ltd. (2017). Presentation on the development of the new Panguna project — Potential revenue streams (Presentation at the ABG Revenue and Tax Summit). Retrieved from http://www.abg.gov.pg/images/misc/18._BCL_Paguna_Project_Presentation_-_ABG_Tax_Conference_-disclaimed.pdf

Chand, S. (2018). *Financing for fiscal autonomy: Fiscal self-reliance in Bougainville* (PNG NRI Research Report 03). Port Moresby: Papua New Guinea National Research Institute.

Carnahan, M. (2015). Taxation challenges in developing countries. *Asia & the Pacific Policy Studies,* 2 (1): 169–182. Retrieved from https://onlinelibrary.wiley.com/doi/epdf/10.1002/app5.70

Donato, B. (2016). Advantages and disadvantages of local autonomy. Retrieved from https://docplayer.net/61865231-Advantages-and-disadvantages-of-local-autonomy.html

Forstater, M. (2017). The good, the bad, and the ugly: How do tax incentives impact investment? Message posted to https://www.cgdev.org/blog/good-bad-and-ugly-how-do-tax-incentives-impact-investment

Goode, R., George, E. L., and Ojha, P. D. (1966). Role of export taxes in developing countries. Retrieved from https://www.jstor.org/stable/pdf/3866452.pdf?ab_segments=0%252Fdefault-z2%252Fcontrol&refreqid=excelsior%3Acd038af8a8e951fce9bf6a5ceda47c46

GoPNG. (2001). *Bougainville Peace Agreement.* Retrieved from www.abg.gov.pg/peace-agreement Hammer, P. (1973). Critique of role of time allocation in River Basin Model (Project Document Grant No: R-801521). Retrieved from https://books.google.com.pg/books?id=DWtTdnfGpoQC&pg=PA193&lpg=PA193&dq

Hill, C., and Fletcher, L. (2018). *Growing Bougainville's future: Choices for an island and its people.* Jubilee Australia Research Centre. Retrieved from http://GrowingBougainvillesFuture_14112018%20(1).pdf

Howes, S., and Nema, A. N. (2017, 8 December). Looking at the PNG economy through a tax lens. Message posted to http://www.devpolicy.org/looking-png-economy-tax-lens-20171208/

IMF, OECD, UN and World Bank. (2011). Supporting the development of more effective tax systems: A report to the G-20 Development Working Group,. Retrieved from https://www.imf.org/external/np/g20/pdf/110311.pdf

Maken, S. (2016). Experiences on the implementation of the SME Policy and Master Plan (Presentation at the Consultative & Implementation and Monitoring Council (CIMC) Development Forum — 18–20 October 2016, Port Moresby). Retrieved from http://www.cimcpng.net/images/Steven MakenSMECorp.pdf

Nagual, R. (2017). Presentation at the Bougainville Revenue and Tax Summit on the Overview of ABG Department of Lands Physical Planning Environment and Conservation(DLPPEC),. Retrieved from http://www.abg.gov. pg/images/misc/17._ABG_Land_Revenue_Generation_Streams.pdf

Nicholas, W. (2016, 18 July). PNG's SME policy: The right aim, but dubious means. Message posted to http://www.devpolicy.org/png-sme-policy-right-aim-dubious-means-20160718/

OECD. (2010). Small businesses, job creation and growth: Facts, obstacles and best practices. Retrieved from https://www.oecd.org/cfe/smes/2090740.pdf

Olsen, M. (2017). Revenue and tax: Opportunities and options (Presentation at the ABG Revenue and Tax Summit). Retrieved from www.abg.gov.pg/images/misc/13._Revenue_and_Tax_-_Opportunities_and_Options.pdf

Pantei, G. (2017). Overview and functions of the Bougainville Tax Office (Presentation at the ABG Revenue and Tax Summit). Retrieved from http://www.abg.gov.pg/images/misc/9._ABG_Tax_Office_presentation.pdf

PNG Taxation Review Committee. (2015). Goods and Services Tax (GST) (Issues Paper No. 9). Retrieved from http://taxreview.gov.pg/wp-content/uploads/2015/09/15.09.17_issues.paper_.9_goods.services.tax_.pdf

Tongo, G. (2017). Bougainville regulatory framework in the mining sector (Presentation at the ABG Revenue and Tax Summit. Retrieved from http://www.abg.gov.pg/images/misc/14._ABG_Dept_of_Mineral_Resources_mining_sector_regulatory_framework.pdf

ABOUT THE AUTHOR

Mr Nelson Atip Nema is a lecturer in the Economics Department, School of Business & Public Policy, at the University of Papua New Guinea. He is currently teaching and researching in regional economic development issues specialising on resource economics. Mr Atip completed a Masters in Economic Development at the University of Tsukuba, Japan in 2015. Prior to that, he worked as a tax policy officer in the Internal Revenue Commission of Papua New Guinea.

ACKNOWLEDGEMENTS

The author would like to thank Dr Thomas Webster, Professor Satish Chand and Professor Eugene Ezebilo for their very helpful comments which resulted in the final draft of this paper. The views expressed in the article are those of the author and do not necessarily reflect the views of either the PNG Government or the Autonomous Bougainville Government.

THE NATIONAL
RESEARCH INSTITUTE
PAPUA NEW GUINEA

inquire, inform, influence

The National Research Institute, PO Box 5854, Boroko, Port Moresby, National Capital District 111, Papua New Guinea; Telephone +675 326 0300; Email: pngnri@pngnri.org

This and other PNG NRI publications are available from www.pngnri.org