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Impact of Revenue Reform on Vulnerable Communities in Tonga

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***Abstract*—**This paper provides an overview of the impact of the revenue reform programme on vulnerable communities in the Kingdom of Tonga. Economic turmoil and mismanagement during the late 1990s forced the government to seek technical and financial assistance from the Asian Development Bank to undertake a comprehensive Economic and Public Sector Reform (EPSR) programme. The EPSR is a Western model recommended by donor agencies as the solution to Tonga's economic challenges. The EPSR programme included public sector reform, private sector growth, and revenue generation. Tax reform was the main tool for revenue generation, which set out to strengthen tax compliance and administration as well as implement a value-added consumption tax. The EPSR is based on Western values and ideology but failed to recognise that Tongan cultural values are important to the local community. Two participant groups were interviewed. Participant group one consisted of 51 people representing vulnerable communities. Participant group two consisted of six people from the government and business sector who were from the elite of Tongan society. The Kakala Research Methodology provided the framework for the research, and the Talanoa Research Method was used to conduct semi-structured interviews in the homes of the first group and in the workplaces of the second group. The research found a heavy burden of the consumption tax on the purchasing power of participant group one (vulnerable participants), having an impact on nearly every financial transaction they made. Participant group one's main financial priorities were kavenga fakalotu (obligations to the church), kavenga fakafāmili (obligations to the family) and kavenga fakafonua (obligations to cultural events for the village, nobility, and royalty). The findings identified inequalities of the revenue reform, especially from consumption tax, for vulnerable people and communities compared to the elite of society. The research concluded that government and donor agencies need ameliorating policies to reduce the burden of tax on vulnerable groups more susceptible to the impact of revenue reform.

***Keywords*—**Tax reform, Tonga vulnerable community revenue, revenue reform, public sector reform.

I. Introduction

IN January 2005, we provided technical consultancy advice and support to Tonga's Ministry of Finance on their revenue reform project which formed a key component of the EPSR programme. The core part of the technical advice was to support Tonga's tax reform and especially the implementation of the Consumption Tax (CT) which was a Value Added Tax similar to New Zealand's Goods and Service Tax (GST).

Upon reflection, we have always had an uncomfortable feeling about the impact of the revenue reform on the poor, due to the one-sided economic lens used to justify the need for the programme. Now, we want to analyse the impact of the programme from a social angle to highlight the experiences of those whose voices were not considered during the implementation stage of the reform in 2005. In 2018-2020, we conducted research to examine the impact of the revenue reform programme on the vulnerable community using a Pacific research methodology.

This paper presents the findings of the research to identify the impact of the revenue reform on the vulnerable communities by utilising the Kakala Research Methodology [1] as the framework and the Talanoa Process Method [2] for communicating between participants and interviewer. We have analysed the information gifted by the 51 village participants (cohort one) and six government and business sector members (cohort two). We will evaluate the research results to determine whether we have answered the research question: What is the impact of the revenue reform on the vulnerable communities in Tonga?

II. Economic Development Origins

The EPSR was developed in response to the declining squash crop industry, the loss of the Tonga Trust Fund, and the failing domestic economy [3]-[5]. The squash industry decline was the catalyst for donors and the government to consider other forms of economic development in the early 2000s [6], [7]. Interestingly, when we discussed agriculture and crops with participants, none were involved in growing squash except for participant 46, who also had the highest income. The key to growing squash is having access to land, knowledge about growing squash and financial support. The 14 participants who did possess land, used it to grow crops for their own family consumption, and any excess was sold in small quantities. This way of life was evident in participant 12's comments:

> Participant (12): Ko e ‘api eni ia e famili hoku mali. Mau too ngoue pe ke kai pea ka toe pea toki fakatau atu ki maketi ke ma'u ha ki'i seniti. Ka ‘oku si'isi'i pe he ‘oku mau fakafalala pe he ngoue ki he ‘emau kai.
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> *Interpretation:* This land belongs to my wife's family. We grow food to eat, and if there is any excess crops, we might sell at the local market to make some money. But not a lot because we rely on the crops for our own consumption.

At the height of the squash crop industry during the early 1990s, when market prices were high, the government provided subsidised development loans and tax exemptions for growers

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[8], [9]. This form of assistance was designed to assist the poor farmers and people from the vulnerable community but, instead, the wealthier sector of the community entered the squash crop industry. Even members of the nobility were involved because they had extensive land holdings and influence that allowed them to take advantage of this new cash crop [10], [11]. The involvement of high-powered growers in the sector crowded out micro-growers with small parcels of land.

The government seems to have failed to learn from the mistakes of the past, and to be only interested in the bigger growers and not the small micro farmers, according to participant 19:

> Participant (19): ‘Oku tokoni pe ngaahi ngaue fakalakalaka ia ki he kau too ngoue lalahi hange ko e kautaha lalahi mo nautolu kae hala pe ‘a ki mautolu ia e kau too ngoue iiki. ‘Oku kai ke ‘i ai ha fu’u ‘aonga ia e kau too ngoue iiki pea hala ke tokoni mai e pule’anga, ka ‘oku fakalele ‘a e sekitoa ia ‘e he ngaahi kautaha lalahi mo tu’umalie.
>
> *Interpretation:* The development initiatives benefit the larger growers but nothing for us smaller growers. Small growers are insignificant and get no support from the government while the large businesses and wealthy control the sector.

The government decision-makers and donor agencies need to be aware of the issues experienced by the vulnerable communities. According to [12], “the smallholder farmers are by far, the most important element of agriculture development in Tonga, but there is little prior analysis of their needs and capabilities by planning bureaucracies in designing development projects”. The social relationships of vulnerable communities are complex, and that lack of understanding can cause a mismatch in development policies.

When the squash crop industry declined in the latter half of the 1990s, along with the Tonga Trust Fund loss in 2001, and a shrinking domestic economy, the government and donors once again returned to the planning table to map out a new solution to provide sustainable economic growth [3], [4]. This policy reaction in the early 2000s is where the New Public Management-influenced EPSR programme was first discussed [13], [14]. The EPSR was based on the New Public Management framework that is linked to broader changes in the political economy, advocating for privatisation and reforming the public service. One of the critical components of the EPSR programme was revenue reform [15].

III. Efficient Revenue System with High Compliance Costs

The revenue reform programme originated from the New Public Management (NPM) policies of the 1980s [16]. The lack of accountability, corruption and fiscal crises led to the development of the NPM as a public service model [17]. The NPM provides a foundation which has flowed on to the EPSR and revenue reform programme. The NPM may be credited with providing the framework for the EPSR, which produced the revenue reform policy [4].

A. Revenue Reform

The objective of the revenue reform was to modernise Tonga’s tax system so that tax collection would be more efficient and effective [18]. The reform aimed to stimulate business development and provide an efficient taxation system that would reduce the administrative burden for taxpayers [19]. The government participants agree that the revenue reform has modernised Tonga’s tax system and made tax collection more efficient. The business participants acknowledge the improvements but consider the compliance requirements, such as the Point of Sale (POS) system, as unnecessary because this increases the cost of operating a business.

The main criticism of the tax reform by the business owners was the 15% CT applied on all goods and services. The government representatives, GBA and GBD, believed that the revenue reform created a fairer and more efficient tax system for taxpayers which is in contrast to the experience of the vulnerable community representatives.

IV. Vulnerable (*Tu’u Laveangofua*) to the Effects of Revenue Reform

The first cohort of 51 village participants in this study is respectful members of society, their communities, families and church. By hearing their stories, we were able to understand how they were valued and treated with dignity and love by their *kainga*. Through their stories in the data collection and analysis phases, it was evident that the participants saw themselves not as vulnerable people but as key members of their community. This learning was their contribution to Pacific culture. As the researcher, we assumed that every participant with limited assets or financial resources was vulnerable. The participants in this study showed a whole new outlook that we did not fully comprehend. In a way, it was similar to how the revenue reform technical advisors thought about the so-called vulnerable sector of Tongan society.

The participants in this study are not vulnerable or *tu’u laveangofua* people because they have support and access to resources, and they have a vital role in each community. As the researcher, we were able to identify the ‘vulnerability' of the participants to the effects of the revenue reform policy. The participants may not fully comprehend the impacts. However, through their stories, we can track how the revenue reform impacted on their way of life in terms of decision-making and purchasing behaviour. The revenue reform added a new layer of tax compliance and cost that the participants did not realise but, through their stories, we can highlight these and identify which points of their decision-making resulted in them paying taxes without their knowledge.

Concerning the aim of this study, the vulnerable were precisely those who had a change in their tax status as low-income earners or were not employed in the formal sector, so they are ‘*vulnerable to the impact of the revenue reform*' based on their way of life. The participants’ way of life is community-centric and based on collectivism. The revenue reform impacts on that collectivism. The participants do not recognise this impact, but we can analyse and identify this effect through their *talanoa*.

V. The Highest Burden of the Reform

The most substantial burden of the reform was disproportionately carried by the cohort one participants in this study. The regressive nature of CT added severe hardship to the lives of participants from the rural and outer island communities. Many of these vulnerable participants were exempted from income tax due to their low-incomes, but their expenditure is heavily captured by indirect taxes at the shops and the border.

Our main concern is the impact on vulnerable communities. The analysis and results articulated a heavy burden of indirect taxes on the poor compared to the government and business elite cohort. The government and business cohort had no financial hardship problems with CT. However, the spending patterns of participants identified the significant impact of taxes, especially CT, on their financial transactions.

The wealthy citizens earn the highest incomes but are not paying their fair share of taxes. Some of their incomes are hidden, such as capital gains from properties and other commercial activities. Tongan business owners are able to set up overseas bank accounts to accept payments from foreign clients which evades the tax system. Tax evasion among Chinese business owners is a problem which has caused the tax authorities to impose the POS system. The rich business owners aim to reduce their tax payments using a range of methods available through the business operation continuum. In contrast, the poor village participants have limited options because their incomes are under the personal income tax threshold. The poor have limited options and are exposed to the broad-based nature of CT in all their spending.

The analysis of the expenditure and revenue generation behaviour of the two cohorts indicated that the village participants actually pay a higher proportion of their income on CT and customs duties compared to the elite sector of Tongan society. Wealthy citizens benefit from Tonga's free public health system and most of their children are educated in the top state secondary school, Tonga High School. The village participants struggle just to make it to the public hospital as well as buying medication. All the participants' children were enrolled in church schools rather than Tonga High School.

The income inequality between the rich and poor is quite prominent in Tonga and evident with only six participants earning more than the TOP$10,000 income tax threshold. Three earn their income from local salaries or wages (participants 46, 2 and 11). Two are RSE workers (participants 13 and 40) but is not subject to the income tax threshold. One participant earns TOP$12,000 (participant 19) from his subsistence farming but not employed formally. The threshold is designed to alleviate the financial burden on the poor and increase the tax collected from the high-income earners who are taxed between 10-25% on incomes above the income tax threshold. Income tax is the direct-tax but the largest tax collection system is indirect tax made up of CT. There is no CT threshold for taxpayers and no differentiation between the low and high-income earners. All consumers pay the same indirect tax. The main difference is that the low-income earners who are potentially vulnerable pay a higher proportion of their income on CT compared to the higher income earners.

VI. Severity of CT on the Poor

This study is part of our attempt to provide a balanced approach to the reform programme we supported in 2005. It is important that the voices of the potentially vulnerable village participants are captured and used to provide knowledge for decision-makers so that remedial action may be considered in the future. The findings provided unmistakable evidence of the severity of CT, which puts excessive pressure on the financial resources of participants with the lowest household incomes.

Excise tax duty and customs duty also affect participants but to a much lesser extent compared to CT, which collects taxes from nearly all transactions. The broad-based power of CT is evident in the mapping exercise where it captures taxes in utility expenses, educational costs, household costs and the three priority kavenga.

The responses of village participants provided a complete picture of their experiences with the reform. This response in turn provided rich information on activities that were taxed and what the applicable tax was. The large array of topics and depth of discussion in the talanoa process enabled the thematic analysis method to identify the main themes for the research.

The secondary data and government reports on tax collection are very positive, with taxpayers, businesses, NGOs and public servants paying the correct amount of income tax and CT. The tax administration system is modernised and is more effective and efficient in collecting direct and indirect taxes. In contrast, most of the village participants interviewed had no recollection of the tax reform consultation or how it worked. They were not involved in the public consultation process.

The village participants do understand the informal economy, especially katoanga, roadside stalls and cash transactions, being outside the tax net. Some of the participants consider their incomes to be at the lower end, so they use this to justify not declaring or paying income tax. The katoanga and koloa fakatonga activities are productive financial activities that are outside the tax net so there may be an opportunity to undertake specific research on the financial value of these transactions and, if it is worthwhile, bringing these into the tax net.

The primary learning from Tonga's revenue reform is the imbalance of the tax burden on the vulnerable village participants compared to the privileged government and business cohort. The research identified CT as impacting on nearly every aspect of the life of the village participants. The reform was implemented during a politically tumultuous period, and the five components of the EPSR programme experienced challenges from all sectors of society. This type of situation is not ideal for any reform that is likely to disadvantage the vulnerable community, especially one that includes changes to tax collection.

This study provides a platform for vulnerable participants to highlight their experiences by describing their way of life. We were able to understand their stories to determine the impact of taxes on their wellbeing. Revenue reform places a heavy burden on the vulnerable, especially from CT. The reform policy creates inequities between the vulnerable participants and the wealthy citizens, represented by the six government and business sector respondents. The policy has failed to protect the vulnerable participants but instead made them worse off. It has increased the severity of hardship within the village participant cohort. This problem needs to be rectified, and recommendations are offered for the government and donor agencies to consider alternative amelioration policies.

Tonga's excessive public debt is a significant concern for the next generation, and we fear that the lessons from the revenue reform programme will be forgotten as the government and donors attempt to control the situation. Any future policy must consider the impact on the vulnerable people as the first step in the policy development process and ensure systems are in place so they are not worse off.

The government and business sector cohort represented the elite and privileged of Tongan society. Their views and priorities were in contrast to those of the 51 village participants. They were high-income earners who had more options and choices that were not available to the village participants. This cohort focused on their wellbeing and what is in their best interest.

VII. Policy Implications

The study presents policy implications for the government and donor agencies for developing and implementing economic and public sector reform policies. Policy development needs to be comprehensive and must consider all the potential impacts of any decision, most importantly, on the vulnerable sector of society. It is necessary to research the full implications of policies, not only the economy but also the social implications, especially in Tonga where collectivism is the way of life, as opposed to individualism. Consideration must be given to alternative economic development options and adverse impacts need to be rectified with ameliorating actions.

Community consultation on the revenue reform was inadequate because it did not reach the vulnerable communities, as evidenced by the village participants. Proper and effective consultation is essential and more effort needs to be made to hear the voices of the marginalised community.

The monitoring function of government agencies needs more capacity to monitor price volatility in stores so that consumers, especially the vulnerable, receive a fair deal. The daily price changes are causing animosity and mistrust between participants and store owners. The Ministry of Revenue and Customs should monitor prices to ensure price changes are valid and not taking advantage of the vulnerable communities. It is also necessary to eliminate the perceived corruption at the border and treat Tongan and Chinese importers equally. Customs duty charges for boxes of goods need full transparency and more explicit guidelines.

This research adds much-needed literature for Pacific nations considering revenue reform, especially with regard to Tonga's experience and the impact on the vulnerable community. However, the relatively small sample size and diverse range of participants make a single study on the implications of the reform difficult. This research does provide a foundation for further research on tax policy in the Pacific.

Donors need to consider alternative options through better research to ensure the vulnerable are not disadvantaged or made worse-off. The experience of the village participants under the revenue reform highlights the heavy burden of CT on their livelihoods without any form of support to maintain their standard of living. The revenue reform, under the framework of the EPSR programme, was primarily driven by economic reasoning. However, as identified in the talanoa with participants, no consideration was given to the social impact on the vulnerable community. Also, it is necessary to understand the values and traditions of Pacific nations such as Tonga, as this will guide how reforms should be implemented.

This study shows that the enterprising activities of the poor are very important for economic and social development. The skills and potential of the village participants, if supported and effectively harnessed, has the ability to transform the vulnerable into a stronger and more economically productive part of society.

VIII. Conclusion

The revenue reform component of Tonga's EPSR programme was designed to lift the economy out of a stagnant position and its deteriorating fiscal and foreign exchange situation between 1999 and 2001 [4]. The revenue reform was part of five components of the EPSR and one which had a mixture of success and failure. The revenue-generating mechanisms, such as the introduction of CT and modernising the taxation regime, provided much-needed tax revenue to replace the heavy reliance on trade taxes.

The reform was unpopular among Members of Parliament, some government officials and community leaders. The major changes being proposed did not go down well with some factions such as the farmers and the political opposition. The revenue reform caused farmers to protest while the public sector reform programme led to the public servants' strike in 2005. The destructive riots of 16 November 2006 followed, causing further challenges for the government.

The revenue reform has provided higher tax revenues for the government, but the question we want to answer concerns the impact it has had on the vulnerable communities. This study aims to provide sustainable solutions that support the poor and builds resilience among the vulnerable communities. Tonga's experience of the revenue reform will become a tool for other Pacific nations embarking on development policies. The voices of the vulnerable must be considered in any type of policy decision. In conclusion, the impact of the revenue reform is discussed in detail and proven that it has a disproportionate effect on the wellbeing of the village participant cohort who represent the vulnerable communities in Tonga. We hope this study is the start of future discussions for government, non-government organisations, community and donor agencies on how to work with development policies. The study has provided the missing voice of the vulnerable community on a policy that was intended to deliver economic benefits but has made them worse off. However, we believe that we have an opportunity to do better for our vulnerable people and the findings from this study provide an excellent platform to start that discussion.

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