**The National Research Institute**

**A Discussion Paper**

# GOODS AND SERVICES TAX: AN APPRAISAL

**by**

**Agogo Mawuli**

Paper presented at the PNG Taxation Research and Review Symposium
29-30 May, 2014
Holiday Inn, Port Moresby

---

This paper was prepared as a basis for discussion at a Symposium organized by the National Research Institute (NRI). It is circulated to inform interested persons with regards to research in progress at the Institute. As work on this manuscript is still in progress, it is not a publication and is subject to revision; comments are invited to improve the final version. The views and opinions expressed, which are exposed in this paper for further public debate, are those of the author and do not necessarily represent the views of NRI or its directors.

---

This research was supported by funds provided to NRI by the Australian Department for Foreign Affairs and Tradeï none of these institutions endorses the views presented in this paper. The author benefitted from numerous comments and suggestions of the participants at the Symposium organised by NRI, and by Ron Duncan, Emeritus Professors at the Australian National University. The author remain entirely responsible for the contents.

**CONTENTS**


**1. INTRODUCTION ........ 1**

1.1 Purpose of Reviewing the GST ........ 1

1.2 The Method of this Appraisal ........ 1

1.3 The Organisation of the Paper ........ 1

**2. PNG GST ........ 2**

2.1 What is the PNG GST? ........ 2

2.2 Why adopt the GST? ........ 2

**3 THE GST ANALYTICAL FRAMEWORK ........ 3**

3.1 Nature of the GST ........ 3

3.2 GST Reform Principles and Axioms ........ 4

**4. IMPACTS OF GST ........ 5**

4.1 Impacts Focus ........ 5

4.2 How the GST Impacts Individuals ........ 5

4.3 How the GST Impacts Businesses ........ 6

4.4 GST Impacts on Companies ........ 6

4.5 GST Impacts on SMEs ........ 7

4.6 GST Impacts on Grassroots Businesses ........ 7

4.7 The GST Package Impacts the National and Provincial Governments ........ 7

4.8 The GST Impact on the Least Developed Provinces ........ 8

4.9 Fiscal Policy Implications of the GST Impacts ........ 9

**5. CONCLUSIONS AND RECOMMENDATIONS ........ 10**

**6. RECOMMENDATIONS ........ 11**

**REFERENCES ........ 14**

# 1. INTRODUCTION

A Goods and Services Tax (GST) was introduced on 1st July 1999 in the midst of a protracted economic slump, which prevailed between 1995 and 2002. During this period, the PNG economy experienced high budget deficits, inflation, interest rates, and public debt ratio, and discriminatory and distorted indirect taxes, cascading provincial sales taxes, declining revenues from mineral and petroleum sources, and perceived pressures to liberalise trade and investment. There was a fervent search for policy reforms to revamp the economy. The crises-prone economy did not recover until a commodity price boom emerged in 2002. This paper explains the main GST impacts and emphasises the adverse impacts on disadvantaged payers. It puts forward suggestions for reforming the GST and minimising the significant negative impacts.

## 1.1 Purpose of Reviewing the GST

This paper appraises the Goods and Services Tax (GST) of Papua New Guinea (PNG), which has been in place since 1st July 1999. The GST was introduced as a Value Added Tax (VAT). But later, the name VAT was replaced by GST, without any change in the design or application of the VAT.

The National Research Institute (NRI), a think-tank of the Government of Papua New Guinea (GoPNG), commissioned this paper, requesting an appraisal of the GST and suggestions for reforming it, if necessary. This paper was presented at the Tax Review Symposium held from 29-30 May 2014. The symposium was organised by the NRI in partial fulfilment of the Instituteøs aim to contribute to the GoPNGøs agenda for reviewing and reforming the taxation system. The Institute intends to follow up with recommendations to the PNG Tax Review Committee, which the GoPNG has tasked to conduct a comprehensive review of taxes and make recommendations for reforming the tax regime.

## 1.2 The Method of this Appraisal

A desktop review of PNGøs GST was carried out to examine the following questions for the purpose of making recommendations for reforming the GST:

- What is the PNG GST and why was the GST adopted?
- What are its main impacts?
- How should the GST be reformed, if at all?

Using existing data and information, the appraisal focuses on how the GST package has impacted individuals, businesses, and both the National and Provincial Governments.

## 1.3 The Organisation of the Paper

The paper is structured into five sections. Following this introduction is an explanation of why the GST was adopted and the nature of the GST. Section three presents the analytical framework for assessing the GST principles and axioms that underpinned the formulation. Section four discusses the GSTøs impacts on individual payers, businesses, and provinces and its fiscal policy implications, focusing on disadvantaged payers, businesses, and recipient provinces doing least well from the GST distribution. The last section puts forward recommendations, with a defence.

## 2. PNG GST

### 2.1 What is the PNG GST?

The GST is a consumption tax applied as value added tax on a product. The final consumers or end users of the product pay the GST. Businesses that purchase the product and use it in the course of the business pay the GST at the sales outlet, but receive a refund for the GST paid, hereafter referred to as input credit.

Many issues were raised and debated at the time of the introduction of the GST. A GST package emerged, comprising a 10 per cent GST on virtually all taxable products with:

- Few products exempted or zero rated. For example, the services of a few institutions such as hospitals or schools are exempted and exports are zero rated;
- Tariff reductions on a wide range of goods;
- Customs and excise duty reductions;
- Abolition of Provincial sales tax; and
- GST revenue sharing between the National and Provincial Governments; which was mentioned at the time of its introduction, but the formula for the GST distribution was not specified and critically examined (Independent VAT Study Group, 2000).

### 2.2 Why adopt the GST?

Generally, governments introduce consumption taxes or increase their tax rate in order to raise revenues or reduce the consumption of the product on which the tax is imposed. The reason for introducing a new consumption tax or effecting a change in an existing one is justified by a prevailing economic problem or a political motivation that the tax is aimed at. A consumption tax is an indirect tax that may be in the form of a sales tax, a turnover tax, or a value added tax, with the tax passed onto the final consumer or end user.

The GST was introduced by the GoPNG amidst a general downturn of the economy and deepening recession. In the second half of the 1990s, the economy experienced budget deficits, high inflation, declining government revenues, and a rapid depreciation of the exchange rate of the kina that followed the exchange rate floatation in 1994. The Government then searched for new policies for remedying the economic decline. Several authors have written on aspects of the economic problems that PNG faced in those years, including: King and Sugden (1996) on increasing public debt; Mawuli (1997) on shortfalls in GoPNG revenues, the public debt, and budget deficits; Standish (1999) on extensive budget cuts; and Duncan (2002) on uncontrollable government expenditures. Later when the crisis was over, Batten (2010) reasoned that the GST was introduced to reassure aid providers and development partners of GoPNGôs commitment to responsible fiscal policy.

PNGôs economic slumps have been mainly due to a derailment of fiscal policy, which have been usually short-lived. Policies play no ostensible role in the recovery. The fiscal crisis often ends as a result of the resurgence of resource revenues. For example, in the early 1980s excessive budget deficit caused economic overheating, which was rescued by the development of the huge Ok Tedi Mine in 1984 and the Misima Gold mine in 1988; the fiscal slump of 1989-90, due mainly to the closure of the Bougainville Copper mine, recovered when Porgera Mine, a world class gold mine came into production in 1991. However, the adverse impacts of the macroeconomic mismanagement of the first half of the 1990s lasted longer than usual despite the Kutubu Petroleum development in 1996.

The introduction of the GST in 1999 following the kina floatation in 1994 and the structural adjustment programs and drastic budget cuts (1996-2001) did help in softening the fiscal crisis and recession that lasted until the commodity price boom began in 2002.

Proposed during the economic crisis of the second half of the 1990s, the GST was motivated by several reasons. The former Deputy Prime Minister and Minister for Finance, Chris Haiveta and then Secretary of Finance, Rupa Mulina, at a seminar titled óIndirect Tax Summit 1996ö, officially claimed that the new tax was aimed at (Millet, 1996:2 and 10):

- Deficit reduction
- Tariff and excise cuts
- Cuts in personal income taxes.

The Summit was organised by the Internal Revenue Commission and Institute of National Affairs. These reasons seemed politically tolerable. However, there seemed to be a perceived pressure on the Government to:

- Broaden the tax base. Prior to the introduction of the GST, less than five per cent of the population paid most of the taxes (Millet, 1996: 238)
- Reduce tariffs and export duties that were considered too high, with numerous exemptions, economic incentives, and discriminatory or protective tariffs (ibid, 223)
- Abolish provincial sales taxes at various rates, which significantly contributed to cascading of indirect taxes and high transaction costs to the provinces to collect these taxes, leading to tax evasion and corruption. Sales tax cascading was real within and between provinces. For example, since domestic commerce was least developed in some Provinces such as Enga, Central and Gulf which buy trade store goods from Western and Morobe Province and the National Capital District to sell in their Trade Stores. Sales taxes were applied in all provinces, which meant that the payers in the least commercially developed provinces were doubly taxed. Even within the same Province this situation prevailed; and
- Liberalise trade and investment in conformity with the global trend or PNGôs commitment to some international organisations.

## 3 THE GST ANALYTICAL FRAMEWORK

### 3.1 Nature of the GST

By and large the theoretical formulation of the GST, which is administered as a VAT, is illustrated by Tables 1 and 2.

**Table 1: Illustrating the GST of 10 per cent (from the perspective of a product transformation)**

| Stage Trade Transaction | Supplier | Item | Price inclusive of the GST | Input Credit | GST to IRC |
|---|---|---|---|---|---|
| 1 | Logger | Log | 50 | - | |
| 2 | Saw Miller | Plank | 70 | 7 | 7 |
| 3 | Furniture Factory | Table | 80 | 8 | 1 |
| 4 | Store | Table | 110 | 11 | 3 |
| | | | | | 11 |

**Table 2: Illustrating the GST of 10 per cent (without a product transformation)**

| Supplier | Item | Price inclusive of the GST | Input Credit | GST to IRC |
|---|---|---|---|---|
| Importer | Table | 110 | -- | 11 |
| GST Reg. Shop | Table | 140 | 11 | 3 |
| GST Reg. Shop | Table | 160 | 14 | 2 |
| | | | | 16 |

Tables 1 and 2 illustrate the application of the GST at each stage of the trade transactions. The sum of the GST collections at all stages of the trade transaction will be greater than that of a one-off application of the 10 per cent GST, since the services of each GST registered supplier will be taxed. The GST is therefore broad-based. The Tables also illustrate implicitly that the final consumers or end users who buy the product at a later stage of the supply-consumption chain will pay a higher GST.

### 3.2 GST Reform Principles and Axioms

Theoretically, the classical principles for a good tax are equity, efficiency, and simplicity. However, a consumption tax is well known to be regressive. Despite the fact that indirect taxes are regressive, governments generally apply them in order to raise revenues or to influence consumption. The GST, like other consumption taxes, must be justified by other principles, such as.

- Broadening the tax base sustainably: Broadening the tax base can be inferred from the illustrations in Tables 1 and 2, whereby the services of the intermediary suppliers are taxed. These suppliers are not taxed if one-off indirect tax is applied. A broad-based tax like the GST is more sustainable and dynamically stable because changes in the elements of the indicator are influenced many varied factors that that are unlikely to change in the same direction for the numerator and the denominator which measure the growth of the indicator. Furthermore, as the economy grows huge collections are expected due to increased purchases by existing and new payers of the tax
- Enhancing competitiveness and transparency: As businesses do not pay the GST, they face a level playing ground and thrive on competition which promote growth and progress
- Minimising tax distortions, avoidance, and cascading All these tax features surface when businesses pay the tax, which is not reimbursed.

## 4. IMPACTS OF GST

> *"There seems to have been good reasons to support a case for introduction and application of the value added tax (VAT) which subsequently has been replaced by the goods and services tax (GST). However, it has the potential to impoverish the poor and the rural economy and needs an overhaul."* (Mawuli and Sanida, 2004)

### 4.1 Impacts Focus

This section identifies the GST impacts and focuses on those that are important for reforming the GST. They are: GST impacts on poor people; impacts on micro and own-account enterprises, particularly informal economic activities; and impacts on provinces with the least developed trading environment, which are hereafter referred to as óleast GST recipient provincesô or óleast developed provincesô.

### 4.2 How the GST Impacts Individuals

The GST is a consumption tax: an indirect tax applied as a value added tax. The consumers ultimately bear the tax burden. The GST is applied at different stages of selling and buying a product in the supply-consumption chain (Refer Table 1 and Table 2), which distinguishes it from other indirect taxes that are applied as one-off taxes.

The value of the GST is greater, if a specified product ï say, as in Table 2ð is purchased at later stage in the trade transaction. The consumer who purchases the product at a later stage pays more than the user who buys the same product at an earlier stage. Disadvantaged payers are relatively poor people, rural or urban settlement dwellers, or informal businesses who suffer the brunt of the GST. The impact on the latter will be discussed in the next sub-section. In a developing country such as PNG, this negative GST impact, that is, a higher GST payment by the poor, urban settlement residents and rural dwellers impoverishes the GST payers.

The GST favours the relatively rich over the poor, urban residents over rural residents, and urban settlement dwellers. Advantaged GST payers generally purchase the product at a lower price in the supermarkets in the cities and towns or by making bulk purchases at a discounted rate.

### 4.3 How the GST Impacts Businesses

Four dimensions of how the GST impacts businesses are discussed according to a business type classification. The GST is applied to a broad range of products that are marketed by GST-registered businesses. Like individuals, businesses pay the GST if the product is outsourced from a GST-registered supplier, but get reimbursement for the tax. For example, the GST is paid on products and services such as canned beef, soft drinks, potatoes, or legal service from a GST-registered supplier. Also, staple foods such as bananas or taro become GST taxable product if purchased from a GST-registered supplier, but they are non-taxable if sold by a non-registered GST trader. This means that there is a ôhiddenö aspect of the GST on ex-factory, farm-gate, or imported products or services that are sold by GST-registered businesses.

It was mentioned earlier that in the production/importï distributionï end-user chain, the GST increases at each stage of a trade transaction, making the GST broad-based, and therefore more desirable. But it is this virtue that is flawed in its application in a less developed economy where there is less transformation of one product to another. Thus, Table 2 is more relevant than Table 1 in respect of the application of the GST in a predominantly primary producing county. There are myriad businesses that do not generate GST revenues because they are not GST-registered or do not comply with the requirement of submitting monthly returns.

However, the GST has the ability to undermine the viability of unregistered businesses that lose their competitiveness. These businesses are predominantly small; producers of agricultural staples; smallholders of cash crops; own-account operators of trades such as carpenters, plumbers, and mechanical repairers; and informal activities that should be nurtured to grow. In simplifying this evaluation of GST impacts on businesses, the paper classifies PNG businesses into three categories, namely:

- Companies that are GST-registered businesses;
- Small and medium enterprises (SMEs) that are GST-registered and comply with the requirements; and
- Grassroots businesses (GBs) and enterprises. GBs comprise of those SMEs that are GST-registered but do not submit monthly GST returns as required by law, plus a host of unregistered businesses that undertake informal income-generating activities.

### 4.4 GST Impacts on Companies

The services performed by GST-registered companies are taxed at each stage of a trade transaction, making the tax broad-based. Excise taxes or customs duties are one-off and hence have a narrow base. There are several positive aspects of the GST in respect of companies, and these include:

- Minimising the tax burden on the companies that pay the tax but receive a refund, the input credit;
- Enhancing a domestic companyÆs competitiveness in producing import substitutes;

- Providing an incentive to the companies to pay the tax and receive a refund and hence minimises tax avoidance, especially by providers of professional services; and
- Providing companies with a competitive advantage over their unregistered domestic businesses that produce the same product. For example, a barber at a Port Moresby settlement pays the GST on a pair of scissors bought at Vision City with no refund, whereas the barber shop at Vision City receives the full refund for the same tax paid.

However, the input tax credit benefits come at a cost. The transaction costs of meeting the GST registration requirements in order for companies to secure input tax credits are likely to be high. The costs include the financial costs expended on preparing the GST return and the time to make a trip to a GST centre to submit a monthly GST return to IRC for the input tax credit.

**4.5 GST Impacts on SMEs**

The SMEs that comply with the registration requirements and become GST-registered receive similar benefits to companies. However, there are many unregistered SMEs. There are some that register but do not submit the GST returns for their input tax credits. These SMEs carry a GST burden that undermines their viability or expansion.

**4.6 GST Impacts on Grassroots Businesses**

Grassroots businesses include micro businesses or own-account enterprises that are unqualified for GST registration or are unlikely to voluntarily register for the GST; and SMEs that are registered but do not claim the input tax credit. At this present level of PNGꞌs development, grassroots businesses are predominantly rural or urban businesses, agricultural enterprises, semi-subsistent farmers, and informal trades and craft providers. All GBs pay the tax but are not entitled to or claim a refund. For example, if a barber buys a clipper for haircuts, or a wood-cutter buys an axe, or a farmer buys a bush knife for clearing the garden in order to produce staple crops, the tax is paid but not refunded. The barber, wood cutter, or farmer therefore bears a double tax burden. The GST is likely to be higher because it is bought at a later stage or at the end of the supply-distribution-end-use chain. Moreover, the GST will not be refunded. Wouldnꞌt it be better to grow these businesses in a low-income economy?

**4.7 The GST Package Impacts the National and Provincial Governments**

The GST package included the following:

- Abolition of provincial sales taxes, which were applied at different rates;
- The introduction of a nation-wide system of tax collection without cost to the Provincial governments; and
- Establishment of a revenue sharing arrangement between the National Government and Provinces. The Inland (i.e. collected within the border, not collected at the border such as tariff duties) GST collected is shared 60:40 between the Provincial governments and the National Government. The provincial distribution is based on the provincial origin of derivation of the Inland GST. The National Government receives 40 per cent of the Inland GST collection plus all of the GST on imports, which is usually greater than the Inland GST collection.

Arguably, the above conditions of GST policy have been well intended. But to this day, some provinces have complained about the GST distribution, calling for restoration of their fiscal powers to impose sales taxes. The use of a nation-wide system of GST collection is administratively costly for the IRC and hence for the National Government. However, it has relieved the provinces of a difficult and costly task of collecting the sales tax and eliminated tax cascading. In many cases, the net revenues received by many provinces increased because of the efficiency of the GST collection. However, the least developed provinces are disadvantaged. The GST distribution has three main negative dimensions and these are:

- First, the GST collection and hence the distribution favours the urban-based (more developed) provinces. The provinces where commerce is least developed shopped in the more developed provinces where they pay the GST. The goods purchased are traded in medium and small trade stores or tucker trading outlets, which are not GST registered, or if registered, they do not have the capacity to comply with GST requirement. Consequently, the least developed provinces of PNG are disadvantaged GST revenue sharing which is patterned on provincial GST collection. The National Capital District (NCD) alone takes nearly 50 per cent of the total of the provinceȂs share. If the revenue were used to finance development, it would enhance the attraction of rural-urban migration. NCD and Morobe ProvinceȂs share is about two-thirds of the total. The top five provinces, namely, NCD, Morobe, Eastern Highlands, East New Britain, and Western Highlands are recipients of 88 per cent of the entire provincial GST distribution;
- Second, the five least developed provinces received only one per cent of the total in 2012, and the middle ten GST provinces received 11 per cent (see Table 3); and
- Third, because the recipients of the GST distribution are not directly involved in the GST collection, the payers do not pressure the provinces to discharge their development responsibilities. When roads and schools are in disrepair, who do the local tax payers turn to? In the past they held the Provincial governments responsible and refused to pay the sales tax or delayed payment. Now silence prevails and development sort of stagnates.

**4.8 The GST Impact on the Least Developed Provinces**

It is not unexpected that the GST collection is low in the less developed provinces. The GST collection is greater at the next generation stage of trade transactions in the supply-distribution-consumption chain, if the suppliers are GST-registered.

In a less developed province, the supply-distribution-consumption chain is likely to be zero or only one stage for the SMEs. Some registered SMEs do not submit GST returns because they lack the needed capacity or the expected input credits are too low to serve as incentive. Consequently, the GST collection is low and the GST receipts are low. Another reason why the GST is low in some less developed province is that their people and traders commute frequently to the neighbouring, more developed, provinces for shopping. For example, many people and GBs from Central and Gulf Provinces do their shopping in NCD; and likewise Engans shop in places such as Mt Hagen and Lae. As final consumers or end-users, their GST payments are credited to other provinces. Gulf and Central provinces have sought compensation from the NCD because their population mostly shop in the NCD. This is a solid evidence of a flawed GST distribution in PNG.

A low GST collection and therefore a low distribution to a province would tend to perpetuate underdevelopment of the province. The GST is meant to improve the expenditure on development or growth enablers such as Health-Posts, basic education schools, and feeder roads. Without enough GST revenues, these provinces languish in their development for a longer term than without the GST.

**Table 3: Provincial GST distributions by level of development, in 2012**

| Level of Distribution | Provinces (abbreviated) | Number | Percentage Share |
|---|---|---|---|
| Top GST Recipients | NCD, Morobe, WHP, EHP, ENB | 5 | 88 |
| GST Recipients | Mad, ESP, WNB, NI, WP, MB, CP, SIM, SHP, Oro, Sun | 10 | 11 |
| Least GST Recipients | Gulf, Man, Bou, Sun, Eng | 5 | 1 |

**Source:** Derived from National Economic Fiscal Commission (NEFC), 2012 Data.

### 4.9 Fiscal Policy Implications of the GST Impacts

The fiscal impacts of the GST seem insignificant at present. The GST share in total government revenue or total tax revenues has been between 6 and 12 percent (as shown in Table 4 below). The total GST collection comprises Inland collections and non-Inland collections, i.e. tariffs. PNG is a long way from getting rid of import taxes, given its heavy dependence on imports. Furthermore, at PNGĝs stage of underdevelopment, GST revenues fluctuate widely, which does not augur well for fiscal stability. However, the fiscal impacts are not as important as those discussed earlier to merit serious consideration in thinking about GST reform.

**Table 4: GST Impacts: GST Growth, GST Contribution to Total Revenues, and to Total Tax Revenues**

| Year | GST Percentage Annual Growth | GST as percentage of Total Revenues | GST as percentage of Total Tax Revenues |
|---|---|---|---|
| 2012 | 0.9 | 10.6 | 12.4 |
| 2011 | -0.3 | 7.7 | 6.7 |
| 2010 | 0.1 | 9.4 | 12.1 |
| 2009 | 0.2 | 10.6 | 14.1 |
| 2008 | 0.1 | 8.6 | 10.6 |
| 2007 | 0.4 | 7.9 | 9.5 |
| 2006 | 0.5 | 6.4 | 8.1 |
| 2005 | 0.1 | 5.0 | 7.0 |
| 2004 | -0.2 | 5.5 | 7.4 |
| 2003 | 0.1 | 8.6 | 11.6 |
| 2002 | 0.5 | 9.0 | 12.2 |
| 2001 | -1.0 | 6.2 | 8.6 |
| 2000 | - | 7.2 | 9.4 |

**Source**: National Economic and Fiscal Commission, 2004-2013 series. Goods and Services Database.

## 5. CONCLUSIONS AND RECOMMENDATIONS

As a fiscal tool for development, the GST has a poor case in a low-income country with the following economic features:

- Inadequate transport infrastructure trading environment
- Predominance of grassroots enterprises comprising semi-subsistence and smallholder cash cropping, and family or self-employment businesses.
- Heavy dependence on imports of manufactured goods.

Low-income countries need a low-rated GST, if at all. But many developing countries have a higher GST rate than that of PNG. Retention of traditional or existing taxes for public development finance has lost its appeal. Yet, in the nineteenth and most parts of the twentieth century the developed Western countries relied heavily on trade taxes and other indirect taxes for public finance. The main public finance sources are:

- Trade taxes ï tariffs and export duties
- Excise taxes excise
- Personal income tax with an appropriate tax-free threshold;
- Company taxes.

In a predominantly primary exporting country like PNG, a reliance on broad-based consumption taxes and doing away with instruments such as tariff walls, economic incentives or subsidies, and all kinds of tax distortions is tempting. However, advocates of economic globalisation underrate these taxes. Instead, they encourage measures such as trade and investment liberalisation and value added taxes. But these globalisation policies are likely to hurt poorer economies because of structural constraints and capacity problems. Poorer economies cannot seize on opportunities that are offered by comparative advantage. Their exports and industrial and non-tradeable sectors cannot respond to comparative advantage. Promoting income tax and indirect tax reductions ahead of putting in place sufficient enablers of economic growth will perpetuate underdevelopment.

Policy makers should bear in mind that a low-income country like PNG needs to raise revenues from its income generation sectors for development finance. In PNG, the mining, petroleum and gas sectors should provide the bulk of revenues. Relying heavily on indirect taxes like the GST for increasing revenue tax is simply unsound policy. Duncan (2010) warned that it is not revenues per se that cause the fiscal constraints:

- It is one thing to have effective control over the revenues
- It is important to note that the primary management problem has been with effective expenditure of the resource revenues.

Although Duncan sounded this caution in respect of resource revenues, we can take a cue from his warning and apply it generally in the revenue raising context. For example:

- Is it not unsound taxation policy to maintain or increase the GST in order to reduce income tax or reduce other indirect taxes like trade taxes?
- Why increase these other taxes at a time when resource revenues are not disappearing?

This Paper does not attempt to provide a resolution to the last question, which falls outside its topic.

Anecdotal evidence suggests that the GST is the most broad-based tax in PNG. However, it imposes a heavy burden on disadvantaged payers including very poor individuals and rural people, least developed provinces without supermarkets, and myriad SMEs that cannot register for the GST or lack the capacity to submit monthly GST returns for input creditsð even if they are registered. Even the GST revenue sharing is based on the total collection when it is well known that people from the least developed provinces make their purchases from the more developed neighbouring provinces. Thus, it can be concluded that the GST does not promote broad-based growth.

## 6. RECOMMENDATIONS

The paper puts forward recommendations with a defence that is premised on the rationale that the goal of a tax should be to enhance national welfare, at least in the long term, and must not in any way disadvantage tax payers in the short, medium, and foreseeable future. On the basis of this axiom, the following recommendations are made.

**Recommendation 1: Retain the GST**. The GST will be more useful when PNG becomes more developed. However, it should be maintained for its potential to raise more revenue and more sustainable revenue than the existing indirect taxes because it is a broad-based tax that has the potential to raise more revenues when PNG is more developed, which is to be expected:

- minimises tax avoidance and distortions;
- avoids tax cascading, which happens when sub-national governments are permitted to impose sales taxes;
- promotes competitiveness against imported products and domestic products; and
- it is transparent and avoids the imposition of discriminatory indirect taxes or offering subsidies and tax incentives.

**Recommendation 2: Retain the GST rated at 10 per cent.** This rate is low enough but can adequately accommodate for the loss of revenues due to the abolition of the provincial sales tax, and the GST administration infrastructure in place. A higher GST rate is not needed while revenues derived from mining, petroleum, and gas sources remain strong. A lower rated GST is not justifiable because of the nation-wide GST infrastructure put in place for collecting the tax, while the Provincial sales taxes remain abolished, and the provinces need to be continually compensated.

**Recommendation 3: Change the current internal GST distribution for the Provinces from 60:40 to 60: 20: 20**. Currently, the GST revenue distribution to the provinces is patterned on the principle of the origin of derivation of the internal GST collection. The goal of the GST policy is to collect revenues for public finance, which would be partly utilised to promote growth and development. Its distribution should be aimed at objectives that enhance the achievement of this goal. The distribution based on origin of derivation of the GST collection is unfair to the least developed provinces. Implicitly, the distribution condemns them to least developed status.

The GST distribution formula, 60:20:20, should be designed to avert this situation:

- Retain 60 per cent internal GST to the Provinces. It would be politically undesirable to do otherwise
- Allocate 20 per cent to the National Government to add onto the non-inland GST collection
- Put 20 per cent in a trust fund that shall be accessed by the least developed provinces on a competitive bidding basis that is guided by a set of criteria designed to enhance income and employment generating activities that are labour-intensive. To access the fund, an entrepreneur from a least developed province should submit a well-conceived business expansion that meets the established criteria, and that will be judged by the trust fund managers. The success of this policy would depend on the design, legislation, and implementation.

Recommendation 3 takes a cue from the Australian GST distribution, which favour the least developed states. In Australia, the Commonwealth Grant Commission distributes the GST to the states based on a process known as horizontal fiscal equalisation, which is rationalized on the ability of each state to offer the same quality of service for every $1 of GST generated. It is reported by the *Weekend Australian* (May 17-18, 2014, page 16), that currently using this process Western Australia (a mining-rich state) receives $0.37 from each dollar it generates, whereas Tasmania receives $1.61 and the Northern Territory $5.30.

**Recommendation 4: IRC policies to promote disadvantaged SMEs and Grassroots Enterprises.** The GBs that register for the GST but do not submit GST returns for lack of capacity and those that cannot be lured to register voluntarily for the GST need to be assisted by private accounting firms. We suggest two means of promoting these GBs.

The objective of promoting them is to enhance GST registration and compliance. The GST collection will be enhanced, the businesses will benefit and their growth prospects enhanced. After all, this is the main purpose of the GST. Increased GST registration and compliance with respect to GST returns (a task that continues to confront the IRC) can be achieved through the following two instruments:

- **Promoting** GBs **registration and compliance of input tax claims**. The IRC should encourage freelance consultants to provide assistance by licensing them to perform these tasks, following a short course designed to impart the necessary knowledge. The SMEs and GBs can also be required to submit GST returns for the input credit claims only twice every year, instead of the current monthly requirement.
- **IRC should conduct an educational awareness program to promote the GST registration and compliance through:**

  - ➢ developing training programs for the GST officers; and
  - ➢ fully briefing the SMEs/GBs on the importance of GST registration, the benefits of the tax credit, and avoidance of penalties for non-compliance of GST requirements.

It should be recognised that GST registration and compliance are a driving force for the success of the GST. Putting instruments in place to promote them is a worthy undertaking.

**Further Study/Investigation:** There are certain aspects of the GST that need to be thoroughly investigated for informed policy decision making. Research is needed to determine:

- costs to the GST-registered businesses in preparing and submitting their input tax credit claims;
- how the GST impacts the taxation system;
- SMEs that are registered but fail to submit GST returns;
- Whether GST refunds can be corrupted or mismanaged. Currently, GST revenues fluctuate widely. For example, the 2011 and 2012 returns were respectively seven and 12 per cent of total tax revenues, which raises suspicion that all is not well with GST administration and compliance; and
- Whether the costs to the IRC of administering the GST at the GST centres are efficient.

Over the longer term, the GST should be a sustainable source of revenue, if the revenues are soundly managed to benefit the payers, including the disadvantaged payers.

## REFERENCES


Batten, A., 2010. *Foreign Aid and the Fiscal Behaviour of the Government of Papua New Guinea,* National Research Institute. Discussion Paper 114.

Duncan, R., 2002. ‘Structural Adjustment Programs: the Roles of the IMF and the World Bank’,

Paper prepared for Kumul Scholars International Conference, Asia Pacific School of Economics and Government, Canberra.

_____________, 2010. *Spotlight with NRI* Vol.4 No.1.

Independent VAT Study Group, 2000. Papua New Guinea Value Added Tax (VAT): Report of the **Independent Study Group on the Introduction of Value Added Tax in Papua New Guinea,** unpublished (located in National Research Institute Library).

King, T. and Sugden, C., 1996. *The Economy of Papua New Guinea*, AusAID International Development Issues No. 46, Canberra: National Capital Printing.

Mawuli, A., 1997. **Macroeconomic Crisis and Structural Reforms in Papua New Guinea,** National Centre for Development Studies, Canberra: The Australian National University.

Mawuli, A. and Sanida O., 2004. ‘Indirect tax policy implications’, Post-Courier, Wednesday 24 March2004.

_____________, 2004, ‘How can we form the GST’, Post-Courier, Wednesday 12 May 2004.

Millet, J., 1996. Indirect Tax Summit 1996, Institute of National Affairs, Discussion Paper No. 68.

May, R., 2001. **From Promise to Crisis: a political economy of Papua New Guinea**, ANU EPress, Canberra: The Australian National University.

Standish, B., 1999. *Papua New Guinea 1999: Crisis of Governance*, Research Paper No. 4, Canberra: Foreign Affairs, Defence and Trade Group, Parliamentary Library of Australia.