Proposed WTO Accession:

Key Issues for Tonga

Oxfam New Zealand Discussion Paper

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Executive Summary

A decade after applying to join the WTO, after long and difficult negotiations, the Tongan government is facing the decision of whether to sign up to join (“accede to”) the WTO. This paper looks at key issues in that decision, and concerns over the terms of the deal that Tonga has negotiated so far. An overall comment is that Tonga is being asked to make commitments that go well beyond those of existing WTO members at similar levels of development. It is even being asked to do more than the richest members in relation to some areas. Likely impacts include:

1. **A loss of government revenue**: In the past, tariffs and the Port and Services Tax have accounted for most of Tonga’s government revenue. The Tonga Consumption Tax (TCT) is intended to maintain government revenue as tariffs are lowered under the WTO accession deal. However there have been major problems in other countries that have introduced such systems, resulting in less revenue than anticipated. This would create a problem for Tonga, since the WTO accession deal will include a ceiling for tariffs. Tonga would not have an opportunity to use tariffs to raise additional revenue if the TCT fails to meet its income targets, a major problem when Tonga has a budget deficit and faces additional costs for public sector salaries.

2. **Costs of compliance**: It is difficult to quantify how much it will cost Tonga to put in place all the laws, regulations, systems and administrative procedures for compliance. In other countries, it has been estimated that it amounts to more than the annual expenditure on development projects.

3. **Loss of ability to promote Tongan business and new industries**: The WTO accession deal restricts Tonga from using tariffs or incentives to promote domestic business, exports, processing of raw materials and diversification of the economy. These restrictions undermine Tonga’s ability to develop using the same policies that other countries (including all members of the WTO Working Party) have used during their own development.

4. **Loss of control over vital services**: Tonga has made huge commitments in services, more far-reaching than most developing countries and more onerous than some of the rich nations. This restricts Tonga’s ability to control foreign investors, particularly in sensitive services such as education, hospitals and broadcasting, and creates pressures for further privatisation of public services.

There are strong arguments for delaying the accession deal. The issues are important for Tonga’s future and the conditions that Tonga accepts for accession would be effectively irreversible. The deal would therefore be binding on future governments, an important issue as Tonga faces reform of its constitution.

Additional time would be very useful for Tonga to evaluate the impact of the tax reforms and benefit from some of the flexibility that is likely to be built into accession negotiations in future. It also ensures that Tonga would not give away the limited bargaining power that it has in other trade negotiations, notably PACER with Australia and New Zealand and EPA with the EU.

Oxfam New Zealand is suggesting that the Government of Tonga delays its decision on accession until it has undertaken further research on the likely impacts of the accession deal and consults more widely and deeply with Tongan business and civil society.

Timing – what's the hurry?

Tonga commenced its accession negotiations 10 years ago. A first draft of its accession agreement was produced in 2003, but changes to that draft were desired by both Tonga and the various countries involved in the negotiations (the members of Tonga's "Working Party"). The changes were incorporated in a new draft agreement (called a "draft Working Party report") put out in June 2005. The new draft reflects a few concessions to Tonga but also contains some requests for increased commitments from Tonga.

There appears to be a push on for Tonga to accede to the WTO in December this year, at the Ministerial meeting in Hong Kong. In order to do this, Tonga must meet a deadline of 7 November to work through the outstanding issues and submit documents to the WTO. There would then be a final meeting of the Working Party from 14-18 November, where a final version of the Working Party report would be produced. If all the countries involved, including Tonga, agree to the contents of this report, it will then be put forward to the WTO General Council in December for acceptance by the WTO. After that, Tonga's Privy Council has a short period of time within which to ratify the accession.

Once the deal is done, it will effectively be impossible to undo it. If it turns out to have major negative implications for Tonga's economy and its people, it will be too late to make major changes. In theory, countries can withdraw from the WTO, but no-one ever has. Huge political pressure would be applied on any country proposing to do so. In addition, substantial financial penalties may be imposed if Tonga does not fully comply with the agreement it has signed up to. For example, Tonga could be sued for loss of anticipated profits by multinationals that were hoping to set up profitable service-providing businesses in the country.

There would also be major problems if Tonga completes the negotiations and then the Privy Council does not ratify the deal. Tonga would face at least two major difficulties. First, political pressure against backing out from those members of the Working Party which are also aid donors would be almost impossible to resist. Secondly, if Tonga tries to put things on hold after everything seems to be agreed, it will be in the same position that Vanuatu finds itself in now. Renegotiation of Vanuatu's package is being strenuously resisted by at least one powerful Working Party member, which if reports are to be believed is actually asking Vanuatu to make yet further concessions as the price of being allowed to restart its process.

By contrast, there is no penalty if Tonga fails to meet the 7 November deadline. Its accession process can simply continue. There is nothing in principle to prevent Tonga from delaying its response to the latest draft working party report until after it has had a chance to analyse the deal more closely, undertake research on its implications on the economy and those likely to be most affected, and consult much more widely within Tonga about the advisability of making commitments that are long term and effectively irreversible.

The Samoan government is being cautious in its negotiations, and there would be advantages in Samoa and Tonga cooperating more closely to secure better deals for both countries.

Also, in a year's time, Tonga will have a much better picture than it does now about the changes to its tax regime. If it finds that it is losing too much government revenue from the changes, or that people are suffering from the introduction of the TCT, it might decide that the best course is to modify the tax system. It will not be free to do that if it has already signed up to the WTO.

Finally, there is at least some prospect of a change of attitude to accession negotiations in the WTO as a result of the publicity given to the unfair accession process, and particularly by countries like New Zealand. Hints of such a change in the accession process are already appearing, and Oxfam intends to keep lobbying for a major rethink, towards a more development-friendly approach. Delay could be very advantageous from this perspective.

Given all this, the question must be asked “what is the hurry?” Why rush to meet this deadline, when there are so many aspects of the deal on offer which are of concern?

No choice?

The justification that is repeatedly used for Tonga to accede is that it has no choice, because it must trade to survive. People also say that, if it is good for New Zealand, then it must be good for Tonga as well.

Neither of these justifications stands up to scrutiny. It is true that trade is a vital source of income. Countries like Tonga need the ability to export their goods to other countries. Tonga’s squash crop is a prime example. Most of it currently goes to Japan, piggy-backing on NZ’s quota into that market. But the idea that joining the WTO will give Tonga better access to that market, or to others like South Korea, is probably mistaken. In all likelihood, New Zealand exporters did the deal with Tonga because their season is shorter and they couldn’t fill the orders without Tonga. Japan accepts squash from NZ because Japanese farmers can’t supply their domestic customers at that time of year. Japan is one of the most protectionist countries in the world when it comes to farm produce. Despite the fact that they are in the WTO, they have extremely high tariffs for any farm produce that would compete with their own farmers. This will not change just because Tonga has become a member of the WTO.

The suggestion that what is good for NZ will also be good for Tonga is questionable. NZ may be relatively small, but it is a major exporter on the world stage. NZ’s dairy export company Fonterra is the largest dairy exporter in the world and accounts for a major percentage of all world trade in dairy products. It also had many decades of high guaranteed prices into Britain before 1974, which enabled it to make massive investments into its farming sector, and helped it achieve a high degree of international competitiveness before it opened its agriculture sector up through removing subsidies and lowering tariffs.

Most big economies in the world need to belong to the WTO. By contrast, of the 51 Small Island Developing States (SIDS) in the world, only 24 are WTO members. Many of these are much larger than Tonga, close to big markets, or piggy-backed their way into the WTO as former colonies, getting very good terms to join (eg. Fiji and Solomon Islands). There is considerable debate amongst many of those SIDS who are not WTO members and there are good reasons to look closely at whether it is worthwhile for SIDS to join the WTO.

There are viable alternatives to joining the WTO. Tonga’s economic future will inevitably be as a niche supplier to the world economy, exporting agricultural products such as squash, fish or catering to a selective form of tourism. This will require an active government role in promoting and supporting the development of new industries to fill the niches, and to encourage more value added processing within Tonga. By restricting what the Tongan government could do to promote business, WTO accession represents a missed opportunity.

Such an active government role has been vital in the history of economic development, with active policies to promote local business having been used by both the rich and newly industrialised countries. There is deep concern within the developing countries that are currently members of the WTO that the rich countries are trying to “pull up the ladder”, as in the title of an influential book on the subject[1]. Instead of using its trade officials to implement laws and regulations that favour foreign companies, Tonga could more actively seek market niches, especially in the rapidly growing Asian countries, and work actively to strengthen the ability of local companies to supply those niches. WTO accession would severely undermine Tonga’s ability to undertake such a development strategy.

The wider trade negotiation context

Another consideration is the fact that Tonga, along with all the other Pacific Island countries, is facing the prospect of negotiating free trade deals with Australia and New Zealand, called PACER, and an Economic Partnership Agreement (EPA) with the EU. One of the main things the big economies want from the Pacific is to lock in low tariffs for their exporters. This is seen as important to them, so that they do not lose their lucrative Pacific markets to other countries, either within PICTA, or Asian countries like Malaysia and Indonesia, whose exports to Tonga are already on the increase. They also want to make sure that Tonga and other countries cannot use quarantine requirements or inconsistent customs valuation methods to favour the exports of other countries over the exports of Australia and NZ.

The reality of PACER is that Tonga already has very little bargaining power when it is up against its two big neighbours, particularly in view of the aid relationships. The things that Tonga would want out of a free trade deal, like seasonal work visas, will be hard to negotiate already. But if Tonga goes into the negotiation of PACER having already locked itself in to an obligation to lower its tariffs significantly, as well as an obligation to change its quarantine and customs systems, it will lose what little bargaining power it has with Australia and New Zealand. Similar arguments apply to the loss of bargaining power with the EU.

[1] Chang (2002) *Kicking away the ladder: Development Strategy in Historical Perspective* London, Anthem Press.

Key issues within the draft agreement

Oxfam has analysed the draft accession documents for Tonga (without having seen the latest drafts of the Goods and Services schedules), and has compared the draft with analysis of the accession packages for Vanuatu, Samoa, Vietnam, Cambodia and Nepal. A number of the key issues follow. They are not the only problems that are likely to arise as a result of the accession deal, but represent some of the most obvious ones. Further analysis of the key sectors likely to be affected would be needed for a more comprehensive report, along with further consultation with civil society and the government

Loss of ability to promote business opportunities for Tongans

Tonga currently has laws in place that use incentives to attract foreign investment that will create jobs in Tonga, replace imports, boost exports and diversify its economy. These incentives are contained in the Industrial Development Incentives Act (the IDI Act). They include criteria that depend in part on the use of local materials, import substitution and export performance. The specific criteria are whether the project:

(i) involves the processing of local resources;
(ii) substantially contributes to local added value;
(iii) is labour intensive;
(iv) has export potential;
(v) contributes to import substitution;
(vi) has a reasonable level of local participation;
(vii) would have a multiplier effect leading to the creation of ancillary enterprises;
(viii) is likely to complement other domestic manufactures

Even though these are criteria that aim to boost Tonga's development, the draft Working Party Report seeks to abolish the criteria and the IDI Act itself. In addition, a previous requirement that foreign service suppliers must have at least 25% local participation of Tongan investors is also abolished by the WTO draft accession package.

During negotiations, the Working Party members told Tonga that these provisions were not allowed under the WTO and should be abolished. Changes to the IDI have now been agreed by Tonga. It states that the IDI Act will be suspended on 1 July 2006 and subsequently repealed once customs duties have been reduced to the single rate of 15 per cent. Repealing the IDI will eliminate the benefits granted to Tongan investors under this Act.

Even without the repeal of the IDI Act, the proposed changes to the customs regime would devalue or eliminate most of the benefits to Tongan nationals, so the problem is wider than just the provisions relating to business.

This will adversely affect existing businesses that have been established under the IDI, and weakens Tonga's ability to ensure that foreign investment within Tonga is for the benefit of Tongans, rather than foreign shareholders.

If it acceded on these terms, Tonga would be prevented from instituting these measures in future, even if it is part of the policy or election platform of a future government. This prevents Tonga from using the kinds of development strategies that many other countries (including all Working Party members) have used during their own development process.

Loss of ability to protect Tonga's economy from a foreign exchange crisis

Tonga currently has laws that allow the government to restrict repatriation of profits in the short term in case of a critical shortage of foreign reserves (their target is 3-4 months of import cover). Prior approval is required for repatriation of T$50,000 and above; all capital transfers (eg. equity capital, portfolio investment); and all foreign loans. The draft Working Party report calls for this protection to be removed.

This is an unfair double standard. Other WTO members such as Malaysia instituted strong controls on financial transfers after the financial crisis of 1997, and others with strong controls during the crisis were relatively unaffected (eg. India, China). These have been regarded as prudent protection by a number of international agencies.

Removal of this provision would limit Tonga's ability to take action in situations of a shortage of foreign exchange and limit the ability to prevent a financial crisis. There are reports that Tonga is already having problems due to unauthorised foreign exchange transactions. It needs to find ways to clamp down on these, not to limit the ways in which it can regulate financial transactions.

Pressures for privatisation and deregulation of services

Services are a major part of Tonga's economy, estimated to amount to 50% of national income. Trade in services is covered by one of the WTO agreements, the General Agreement on Trade in Services (GATS). GATS is a hugely complex agreement and most developing countries (and most industrialised countries) have been very cautious about making commitments. Already, there have been cases of countries such as New Zealand and Canada not fully understanding GATS and making commitments that they had to try to change later. They were able to do so, but at the price of committing a number of other services sectors for liberalisation.

Unlike trade in goods, there are generally no tariffs on trade in services. GATS is an agreement that aims to reduce the barriers faced by foreign companies in providing services, generally in the form of restrictions on investment, preferences for Tongan service providers or government regulation.

GATS covers all four ways in which services are provided: purchased from overseas (eg. buying architectural plans), services for consumption abroad (eg. tourism), foreign investment in Tonga (eg. foreign companies establishing a bank) and people coming from overseas to deliver services in Tonga (eg. temporary immigration under work visas).

GATS recognises the rights of developing countries to make fewer commitments. The relevant Special and Differential Treatment provisions of GATS include opening fewer sectors, liberalizing fewer types of transactions, progressively extending market access in line with their development situation and attaching conditions when making access to their markets available to foreign service suppliers.[2]

It is well documented[3] that Working Party members have been disregarding these provisions and systematically demanding more services commitments from acceding countries than is the case for WTO members at a similar stage of development (WTO-plus commitments). In fact, poorer countries have typically been asked to give more than rich countries.

A raft of commitments

Tonga has undertaken commitments in nine service categories (out of eleven). By contrast, Solomon Islands has commitments in four sectors and Fiji has commitments in only one sector.

The comparison between Tonga and others is even more dramatic at the level of the individual sectors. Tonga has commitments in 26 sub-sectors (eg. air transport, hospitals and restaurants, and hospitals) out of 53, while Solomon Islands has committed 6 sub-sectors, and Fiji only 1 sub-sector. Most of the Caribbean countries have agreed to open up less than 10 sub-sectors.

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[2] Full text available at: www.wto.org/english/docs_e/legal_e/26-gats.doc

[3] Grynberg, R., V. Ognivtsev and M.A. Razzaque (2002) *Paying the Price for Joining the WTO: A Comparative Assessment of Services Sector Commitments by WTO members and Acceding Countries*, London: Commonwealth Secretariat.

The comparison with New Zealand, one of the most liberalised economies in the world, is also instructive. New Zealand has no commitments at all in one important sector — health — and only limited commitments in the education sector. Overall, it has a higher number of total commitments than the draft deal for Tonga, but many of these are in sub-sectors where there is little public or business sensitivity, such as computer consultancy or ancillary business services. There are also many exceptions attached to the more sensitive sectors, such as health care, education and audio-visual services, imposed by New Zealand in order to retain its flexibility to achieve social, cultural and economic aims.

Tonga's services sector commitments include many of those that have been rejected by many other countries, on the grounds that it may create adverse impacts. They include broadcasting, all forms of education, sewage and sanitation, financial services, hospitals, construction, as well as business and professional services such as lawyers and accountants. GATS commitments mean that Tonga cannot impose restrictions on the establishment of foreign companies and loses the power to impose certain restrictions on their operations. This means that Tonga is giving up substantial powers to regulate service sectors, whether they are imported services or delivered locally.

Will GATS increase foreign investment?

GATS is not expressly an investment agreement, but many of its most fundamental provisions relate to the conditions under which foreign capital can enter a country's services sector. There is little dispute that foreign direct investment (FDI) has the potential to contribute to sustainable development, if invested in the right way. However, the idea that FDI is always beneficial to the country involved is much more dubious, as the United Nations Conference on Trade and Development (UNCTAD) has noted: 'Not all FDI is in the best interests of host countries. Some can have an adverse effect on development.'[4]

It is important to consider that, even without any GATS commitments, there is nothing to prevent a country inviting the kind of investment that will help it to achieve its development goals. And without GATS provisions that constrain the ability of governments to regulate in certain ways, the host country can set the regulatory framework to protect and enhance its environmental, social and development needs. It is often asserted that foreign companies will only invest in a country if they know that their interests are protected by commitments such as those imposed under GATS. This is again refuted by many, including UNCTAD: 'There is no empirical evidence to link any significant increase in FDI flows to developing countries with the conclusion of GATS.'[5]

[4] As cited at p 5 of **World Development Movement and Friends of the Earth** (2003) 'Investment and the WTO — Busting the Myths', London: WDM and Friends of the Earth, available at www.foe.co.uk/resource/briefings/invesment_and_the_wto_bust.pdf
[5] *Ibid* p.8.

Privatisation of services

The terms of accession to the WTO do not directly require Tonga to privatise or prevent Tonga from maintaining public sector services or statutory corporations, but the provisions of GATS make it difficult for governments to maintain public services or state-owned entities providing services. The Working Party Report is clearly calling for privatisation.

In response, the Tonga government has undertaken that Tonga will privatise in areas where the private sector is able and willing to provide services. The nature of the GATS commitments means that Tonga is open to challenge on any public services from foreign companies that are looking to compete in those sectors.

This would affect most of Tonga’s remaining state-owned enterprises and especially those that have been or are about to be corporatised (such as Tonga Post), since they are deemed to be operating commercially and not covered by the exception under GATS for public enterprises. While Tonga has not made GATS commitments in postal services, the government has committed courier services in the draft GATS schedule. In many postal services, there is cross-subsidisation between the profitable courier business segment and the loss-making mail delivery service.

The terms of the draft accession deal will mean that Tonga will be vulnerable to challenge from foreign governments, acting on behalf of multinational investors, to open up public services for privatisation. The record of such privatisation of basic services in developing countries is mixed at best. In small economies, with natural monopolies and limited regulatory capacity, privatisation has led to higher prices and reduced access for remote and poor consumers.

It is of note that Working Party members themselves have entered specific exceptions covering a range of public services, since they maintain significant levels of publicly owned and operated services (for example, over 90% of the EU’s water distribution is supplied by the public sector). They have been very cautious in making commitments in services where public access is important (eg. education, health care, broadcasting and mail services).

Education

In the 90's some businessmen requested permission from the relevant government ministers to establish a fully private school in Tonga. They were turned down. But they used a loophole in the system and established the school anyway, under the umbrella of the Ba'hai church. They could not be prevented, because all churches in Tonga have the right to run schools.

An Iranian businessman and an Australian businessman are behind the school, called Ocean of Light. It is co-ed, primary and secondary, charges T$1,600 per year in fees and attracts the children of the wealthy and nobles. The school receives a government subsidy of $100 per child per year.

A future government of Tonga could revoke the government subsidy and place restrictions on this and any similar schools. For example, regulate to require them to accept a certain percentage of non-fee paying students from disadvantaged areas, or to pay a percentage of their fees into the state education system. With the proposed commitments in services, it might be possible to withdraw the subsidy, but other means to control the school will not be possible.

Changes to Tonga's laws and regulations

Tonga has undertaken to amend a numbers of laws to comply with the terms of WTO accession. These include:

- legislative fixes for non discriminatory price control policies for agricultural and fish products
- a new Investment Law
- a new Business Licensing Law and its regulations
- new laws addressing excise taxes, the TCT, the elimination of the Ports and Services Charges
- the elimination of Quantitative Restrictions on alcohol, tobacco and certain biscuits
- a new Customs Law for customs valuation and rules of origin
- amendments to Intellectual Property Rights laws
- Provisions for enhanced transparency of government regulations (and the Working Party has called for a right of appeal to be available to foreign companies)
- Laws protecting patents and other forms of intellectual property rights, including Amendments to IP Act 1994, Enforcement & Border Measures Bill (new), Regulations for Geographical Indications Act, Regulations for Layout-Designs Act, Copyrights Act 2002, Collective Management Regulations, and Plant Variety, Seed and Seedlings Bill

The impacts of most of these legislative changes have yet to be fully understood. Under the terms of WTO accession, Tonga would be restricted in making changes to the legislation if it was found to have damaging outcomes. This is particularly a problem for:

- Tonga's ability to attract and promote the particular forms of foreign investment that generate jobs and benefits for the economy and the Tongan people if foreign investors exploit Tonga's resources and workers without adding value
- Opportunities to grow Tongan domestic business because of inflexibility in the categories of Reserved Investment and Restricted Investment
- Maintaining adequate government revenue if the Consumption Tax does not generate enough income, or has adverse impacts on the poor
- Controlling products that create adverse health and social impacts on Tonga's people, such as alcohol and tobacco
- Effectively regulating business activities, since foreign companies are able to have the right of appeal to the Commissioner for Public Relations over a wide range of regulations that are covered under the WTO rules, and possibly to influence the enactment of new regulations under the transparency and consultation provisions

Disputes and Appeals

The Ministry has confirmed that the appeal procedures are to the Supreme Court, and if not satisfied, to the Court of Appeal. There is also provision that a complaint against a decision, recommendation or any act done by a government civil servant may be lodged with the

Commissioner for Public Complaints for investigation, in accordance with the Commissioner for Public Relations Act 2001.

Tonga has agreed that, from the date of its accession, Tonga would establish or designate tribunals or procedures for the prompt review of all administrative actions relating to the implementation of laws, regulations, judicial decisions and administrative rulings on WTO provisions. The tribunals or procedures would include actions relating to the implementation of national treatment, conformity assessment, the regulation, control, supply or promotion of a service, including the grant or denial of a licence to provide a service.

However, Tonga does not have full sovereignty over these decisions once it enters the WTO. Any law, regulation, judicial decision or administrative decision is subject to the Dispute Settlement Mechanism within the WTO. A case may be brought by any WTO member (generally instigated by a complaint from a foreign company headquartered in that country).

A WTO Dispute Settlement case requires an extremely complex and costly process for Tonga to defend itself. A judgment against Tonga would require a change in legislation or a change to the specific decision. The judgment is enforced through trade sanctions against Tonga.

The only recourse available to Tonga, other than complying, is to leave the WTO. No country has ever done this and it would be politically difficult (effectively impossible) for Tonga to do, quite apart from the possibility of financial penalties for doing so, such as being sued for loss of potential profits by foreign service companies which were planning to enter the market in Tonga.

Reductions in tariff levels and loss of flexibility

From an analysis of the negotiating documents, it seems likely that Tonga will agree to bind its tariffs at a rate of 35% (except for alcohol and tobacco products), and that they will introduce a tariff rate of 15% in two steps: 25% by 1 July 2006 and 15% by 1 January 2007. In future, Tonga will not be permitted to raise its tariffs above the level it agrees to be bound by in the final accession deal, which may be 35%.

Comparative tariff levels

Binding of Tonga's tariffs at a level below the rates applied before the changes to the tax regime would restrict Tonga's ability to provide temporary protection in order to build new industries, penalise imports that create problems for Tonga's people (other than alcohol and tobacco) or raise additional government revenue. The rate of tariff that is likely to be agreed by Tonga is low compared to other countries:

- Samoa has offered to bind its tariffs at 50% in its accession negotiations
- Vanuatu agreed an average bound tariff of 43% and a peak tariff of 75% before it withdrew its application to accede
- Nepal entered the WTO in 2003 with an average bound tariff of 44% and peak tariff of 200%
- current WTO member Least Developed Countries have an average tariff of 79% and peak tariff of 130%)

This means that Tonga is entering the WTO on worse terms than other recent entrants. Even though they are categorised as LDCs and Tonga is not, Tonga has similar income level and development indicators to a number of these countries (most notably Samoa).

It should be noted that the peak tariffs of major industrialised countries are well above this (eg. 350% for US on beef imports).

There are a number of implications from this tariff structure, including the loss of a significant source of government revenue, an adverse impact on local business and employment, and the restriction of Tonga's ability to promote the development of new industries.

Impact on Government Revenue

Tonga has historically been heavily dependent on tariffs and the Port and Services tax for the major portion of government revenue. In late 2004, the New Zealand Minister of Trade Negotiations, Jim Sutton, announced that the bilateral negotiations between New Zealand and Tonga over Tonga's accession would save New Zealand exporters NZ$6 million per year. However, the other side of the coin is that this is lost revenue for Tonga's government. Oxfam calculated that this tariff revenue loss, if applied to all countries (as it would under WTO accession) might amount to as much as one third of Tonga's annual tax revenue.

As part of its accession process, Tonga will undertake a major restructuring of its tax system. At the introduction of the new tax system, it is estimated that taxes on international trade and transactions will make up 57.9 per cent of government revenue, domestic taxes on goods and services 22.7 per cent, income and profit taxes 18.1 per cent, and property and other taxes 1 per cent. Tonga is heavily dependent on external tariffs and the Port and Services tax and it will be difficult to replace this revenue by the Consumption Tax.

Ten years ago, Vanuatu was forced by the Asian Development Bank to make similar changes to its tax system, with the excuse that this was essential for Vanuatu to be in a position to join the WTO. The price of basic commodities rose sharply in rural areas after the new consumption tax was introduced. In theory, prices should have dropped, because the consumption tax was lower than the previous import tariff in most cases. But the tax was introduced in a hurry, with no education programme about how it worked, resulting in a poor understanding of the way the tax works, particularly in rural communities. This allowed widespread abuse of the system by unscrupulous traders, who simply added 12.5 per cent to the previous retail prices, blaming the new consumption tax for the need to do so, while at the same time failing to account to the tax department for the collection.[6]

It took Vanuatu's tax base ten years to recover from the resulting loss of revenue. In that ten years, the fact that the government was struggling with a major loss of revenue loss probably had a lot to do with reported a sharp deterioration in service delivery in rural areas, although other aspects of the ADB's demands were also to blame.

This is not the only case in which a tariff liberalisation has resulted in a cut in government revenue. A recent IMF study found that less than 30% of the revenue lost from trade liberalization over the past 25 years has been recovered through other means[7]. The findings are worst for low income countries and problems with the introduction of VAT and consumption tax systems meant that they were ineffective in maintaining revenues.

Tonga's consumption tax has only been in place for a few months. It is not yet known whether the same problems will emerge as in Vanuatu, but there is some evidence that they will. People are reporting an increase in prices coinciding with the introduction of the TCT , eg chicken increasing from T$3.50 per kilo to T$4.50 per kilo, ice cream from T$59 per large tub to T$90. Prices should have gone down by about 10%, not up, since the border taxes replaced by the TCT were at 25%. In contrast to reports from people surveyed, the Government has reported a drop in the Consumer Price Index since the TCT was introduced. There needs to be further analysis done to find out what the real rise or drop has been for the average Tongan household.

A change from import tariffs to a consumption tax usually has the effect of loading more of the tax burden onto the poor. While there have been no specific studies on the impacts of the TCT in Tonga, the effect is likely to be similar.

The government is unlikely to have a clear idea of the effect of the tax changes on its revenue until the system has been in place for some time. If it proceeds with WTO accession before it has this information, its options for changing the system back will be limited, since the deal includes a promise to abolish the 25% taxes that have already been taken away, as well as a promise to reduce all tariffs to a low level, probably no more than 35%.

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[6] Lennon, S (2005), Make Extortion History, Oxfam International
[7] Baunsgaard and Keen (2005), *Trade Revenue and Trade Liberalisation* IMF Working Paper WP/05/112.

The current fiscal context for Tonga also needs to be borne in mind. Tonga ran a fiscal deficit last year, and needs to find tens of millions of dollars to fund the increases in public service wages. A shock to its revenue base would compound Tonga's fiscal problems.

Adverse impacts on Tonga's businesses and employment

It is likely that the costs of domestic products will rise, relative to imports. This will worsen Tonga's trade deficit and have an adverse impact on local producers, many of whom will find it difficult to compete with imports. It should also be noted that these changes are being introduced in a short period of time, making it difficult for local businesses to be able to adjust to increased competition from imports.

The impact will be severe on those farmers, fishermen and the informal sector who previously had exemptions from sales taxes. This exemption has included local agriculture, livestock and fisheries products sold at local markets and farm gates by individual sellers; and goods sold by street vendors such as handicrafts, woodcarvings, clothing and peanuts. Most of them will be exempt from the TCT since they have turnover below T$100,000, but will face competition from imported foods coming into Tonga at far lower tariff rates.

The binding of tariffs at these low rates also represents a problem in Tonga being able to defend local business from unfair business practices used by exporters in order to increase their sales or drive local companies out of business. This is a major problem in other countries when multinationals are able to cross subsidise their exports to gain market dominance and then raise their prices once local competitors have closed down. It is also a problem when exporters receive large subsidies from their governments (such as the agricultural subsidies provided to farmers in the USA and the EU, both members of the Working Party).

Tonga has no specific legislation providing for the imposition of anti-dumping, countervailing duty, or safeguard measures, and has no plans to introduce such legislation. Tonga has informed the WTO Working party that the government does not intend to use tariff flexibility to address unfair or excessive imports.
As a result, there is a risk that some businesses and small producers will not be able to compete with imports, with a consequent loss of sales and income, foreign exchange and jobs.

Loss of flexibility to promote new industries

All of the industrialised countries and the newly industrialised countries (such as the Asian "tiger economies" like South Korea, Taiwan and Malaysia) have used import tariffs as a means to provide local producers with some degree of protection for a limited period during which the local industry can establish and become internationally competitive. By binding its tariffs at a relatively low rate, Tonga will lose the right to promote its own industries.

The impact is particularly important where Tonga has a basis to be able to compete internationally, such as in the processing of its raw materials. Tonga is already at an extreme disadvantage, being a long distance from major markets, with undeveloped infrastructure and high transport costs. Without the ability to use tariffs to establish 'infant industries', Tonga will face even greater difficulties in being able to develop its local economy, earn foreign exchange and create jobs for its youth.

Compliance Costs

Tonga has already undertaken many major reforms to its laws and practices to comply with WTO requirements, but a lot more are needed. For the benefit of foreign companies, it is promising major reforms in areas of little or no benefit to ordinary Tongans, such as intellectual property rights, the customs valuation system and quarantine regulations for imports into Tonga. It is also promising to establish tribunals and procedures for other WTO members to use within Tonga.

There are repeated statements in the report itself that Tonga will need help to undertake these reforms. The actual costs are unknown, but could be enormous. One World Bank report stated that reforms to intellectual property rights, customs and quarantine alone can cost a year’s development budget even in the more advanced developing countries. For less advanced countries, the relative costs are even higher.

Also, even if Tonga does get financial and technical assistance with the reforms, that money and help is likely to be part of the overall aid allocation, diverted from other development priorities that are funded by the donor countries. Also, any staff and other resources Tonga itself puts in to these reforms mean there is less funding for other areas of Tonga’s economy. More information is needed on the necessary compliance costs before Tonga locks itself in to the obligation to spend money and resources on compliance with regulations that provide few, if any benefits for Tonga.

Implementation Issues

Tonga is required to implement the agreements on Customs Valuation and Trade Related Intellectual Property Rights (TRIPs) by 1 January 2007, and all other agreements immediately. This is far shorter than other acceding countries, such as:

- 13 year transition period on TRIPs pharmaceuticals for Cambodia and Nepal
- 5 year transition period for the Agreement on Sanitary and Phytosanitary Measures (SPS) for Cambodia
- 3 years for the Agreement on Technical Barriers to Trade (TBT) for Cambodia and Nepal

Handing power over Tongan laws to foreigners

Tonga has a long way to go before its border controls on imports (including quarantine) are WTO compliant. It is being asked to promise not to put any new measures in place until it is fully compliant. This could take several years. If in the meantime Tonga sees a need to introduce new kinds of quarantine restrictions to cope with a new disease, like bird flu for example, it may not be able to do so without breaching WTO obligations. This needs to be carefully looked at before the WTO commitments are made.

The process by which laws are passed in Tonga gives ordinary Tongans little chance to comment or be consulted before a law is passed that could have a major effect on their lives. This is something that could change with constitutional reform.

By contrast, the draft accession agreement requires Tonga to put in place a process that effectively allows foreign corporations to be consulted before any new law “relating to trade” takes effect. The requirement is for Tonga to publish all such laws on a website that can be accessed by foreign governments and corporations. In theory, it can also be accessed by NGOs in the capital and villagers in the outer islands, but even if they do have the capacity to analyse the proposed law, they do not possess the kind of lobbying power that, say, the Australian government would have if they considered the law would disadvantage an Australian company.

This provision is not to be found in the WTO obligations of any of the Working Party members. In fact, it may be the first time that any country’s deal includes this requirement. It is still in brackets in the draft, meaning that the government has not yet agreed to it. But the fact that it is in there at all is an indication of the pressure Tonga is under to give away its rights as a sovereign nation.

Another aspect of the draft deal that takes power away from Tongan institutions is a provision that says that action must be taken about any breaches of WTO obligations occurring within Tonga, without the need for the complaining party to go to court. This means that a foreign corporation can complain of a breach and the authorities have to take action without receiving a court order. Normally, only a court can say whether a law has been breached, but this provision takes that power away and effectively hands it over to foreign complainants.

Approval of the WTO Accession Package

The WTO Accession agreements will be submitted by the Minister for Labour, Commerce and Industries to the Privy Council for ratification. It appears that no further consultation with MPs or the public is required (or anticipated by the Ministry).

This means that there is no process for ratification of the Accession Package by Tonga’s Parliament, or provisions for wider consultation with civil society or members of the public on the final package.