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INFORMATION PAPER NO. 3: PUBLIC FINANCE MANAGEMENT

Purpose and Summary

Purpose

This paper provides an update of progress made on public finance management (PFM) and revenue administration reforms in Pacific Island countries (PICs), since the last FEMM held in May 2019.

Summary of Issues

- i. The Public Expenditure and Financial Accountability (PEFA) framework has underpinned PFM reforms in the Pacific since the 2010 FEMM endorsed the *PFM Roadmap for Forum Island Countries*. The lead role of PFTAC in the execution of this strategy over the past decade is subject to analysis and review by the IMF's Fiscal Affairs Department (FAD). The review is nearing a conclusion and will be documented in a published Working Paper, following wide consultation.
- ii. Enhancements to the PEFA methodology have been piloted in the Pacific in the past year by PFTAC and other partners including an agile assessment methodology, a gender responsive PFM module, and ongoing development of a climate change PFM module.
- iii. Issues addressed through PFTAC organised seminars have included the effective management of fishing revenues for fish rich PICs, and a PFM climate change resilience event bringing together small island states of the Pacific, Caribbean, and Indian Ocean regions. Climate Change Policy Assessments (CCPA) were delivered jointly between the IMF and World Bank with PFTAC inputs in the Federated States of Micronesia and Tonga.
- iv. Revenue mobilisation Capacity Development (CD) efforts of PFTAC remained at an elevated level given the provision of additional Australian financing, with intending PACER Plus countries given specific attention to ensure possible trade tax losses are offset with new or improved tax instruments and strengthened administrative capacity and practices around appropriate legal frameworks that maximize voluntary taxpayer compliance.

- v. COVID-19 developments impacted PFTAC operations in the final months of the IMF fiscal and reporting year between May 1, 2019 and April 30, 2020. Support to member countries continued through a pivot to remote CD delivery following confirmation of the ongoing relevancy and priority of the issues. Workplans, topics, and support modalities are expected to continue to evolve as the impact of COVID-19 unfolds, both from the perspective of the public health response and the ensuing economic dislocation that has eventuated. Since the pandemic outbreak, the resources of the IMF have been in high demand, with emergency financing provided to over 50 countries, debt relief grants to 29 countries, and a wide range of technical guidance notes available to help institutional responses to COVID-19 pressures.

A. Overview/Summary

Fiscal policy and administration are of crucial importance to PICs from both the revenue raising and budgeting/spending perspectives. PFTAC leadership on fiscal matters draws on the knowledge and expertise of FAD that oversees or backstops the Revenue and PFM programs of PFTAC. These have grown from about half of PFTAC's outputs and resources to two thirds in the past fiscal year, primarily from an extensive scaling-up of the revenue program.

2. On PFM, the role of PFTAC is more catalytic and collaborative to ensure the more expansive PFM resources provided by several bilateral and multilateral development partners are aligned to the best interests and priorities of the PICs, and are reflective of international good practice as guided by PEFA and other appropriate standards. For revenue support where there are fewer development partner resources, PFTAC delivers a larger and more comprehensive program that is leveraged and reflective of the region's priorities through the partnership of the Pacific Islands Tax Administrators Association (PITAA) and the joint advocacy and support for application of best Tax Administration Diagnostic Assessment Tool (TADAT) defined practices.

3. As mandated by the PFTAC Phase V Program Document, an external evaluation of PFTAC performance at the midpoint of the fifth phase of operations was launched in FY2020 and is due to be completed by December 2020.

B. Discussion

(i) Public Financial Management

4. In FY2020, the PFM program is projected to have delivered twenty-four (24) missions or activities totalling four hundred and twenty-six (426) Technical Assistance (TA) days; and, conducted or contributed to four regional workshops on PFM related topics. Prior to the late postponement of missions in March and April 2020 due to COVID-19 travel restrictions, the projected outturn was four hundred and seventy (470) TA days – slightly more than the FY2019 outturn, and twenty-seven (27) missions. More than one third of the missions delivered in terms of TA days, were led by the two Suva-based PFM advisors.

5. The major users of PFM TA during the year were Fiji, Tonga, Papua New Guinea, and Samoa. The key topics of assistance continued to be assessments under the PEFA framework; improving controls and developing internal audit processes; and, improving financial reporting.

6. The updated PEFA framework has been used across the region since 2016. Multi-phase assessments are now required and cover: (1) a review of the progress achieved since the last PEFA, including under the previous framework; (2) completion of an assessment under the new framework, and (3) inclusion of both assessments in the report. This requires additional assessment effort and lengthens the report. This transitional approach was followed with the Papua New Guinea, Fiji, and Tonga assessments during FY2020.
7. The Tonga PEFA assessment comprised two new innovative aspects, namely a new ‘Agile’ reporting approach and format, and pilot usage of a Gender Responsive Budgeting (GRB) module, which has been subsequently retitled a ‘Gender Responsive PFM’ module. Staff from the PEFA secretariat complemented PFTAC resources in the successful application of these innovations. The Fiji and Tonga assessments and the Tongan GRB are finalised, and all documents have received the PEFA compliance check. Both the Fiji and Tonga assessment reports have been published.
8. A GRB assessment is similarly being completed in Fiji with ADB support. In a peer-sharing approach facilitated by PFTAC, a Fiji official participated in the Tonga mission and has been very effectively applying these learnings to the Fijian context. The Papua New Guinea PEFA draft report has been issued and will be finalised shortly.
9. After the finalisation of each PEFA assessment, PFTAC missions have supported the update of PFM reform plans in Fiji, Samoa, and Tonga. These missions have piloted the application of Volume IV of the recently updated PEFA Handbook. Support to update the Fiji reform plan has benefited from the participation of PEFA Secretariat staff.
10. Improvements in internal audit practices are being observed across the region. While initial efforts focused on the establishment of audit committees, implementation of audit charters and related reporting, recent work has turned to updating planning and audit practices to be consistently risk based. This includes establishing risk-based audit of systems such as procurement, payroll, and budget.
11. Financial reporting is being enhanced on multiple fronts. Improvements to reporting on financial and non-financial assets continue. It remains problematic in several countries where auditors-general are qualifying areas of concern. During recent missions, PFTAC assisted in the review of issues raised in auditor general management letters to help identify solutions and responses.
12. In conjunction with the ADB, the Pacific Islands Forum Fishing Agency (FFA), the Parties to the Nauru Agreement Office (PNAO) and the SPC, PFTAC organised a fishing revenue workshop in Honiara to enhance understanding of sustaining the viability of the sector, techniques to estimate revenue and improve fiscal management, and opportunities to improve financial transparency of the fisheries.
13. For the Pacific, Climate Change is a preeminent, if not existential topic and as such is increasingly interwoven into most facets of IMF surveillance and CD. Examples include the Climate Change Policy Assessment (CCPA) undertaken in Tonga in February 2020 as well as in FSM in mid-2019, and the joint Pacific/Caribbean conference on PFM and Climate Resilience in Washington in December 2019. Securing easier and wider access to climate change financing led to the May 2019 FEMM to request PIFS to work with PFTAC and other stakeholders to explore PFM options to reflect the challenges of small island states in the Pacific to reach the PFM standards sought by climate

change finance providers. To this end, PFTAC is assisting a Working Group to explore a PEFA Climate Change module that the PEFA Secretariat received approval to develop and prototype during their December 2019 PEFA Steering Committee meeting.

14. The regional PFM reform strategy endorsed at the 2010 FEMM focused on three broad objectives: (i) PICs undertaking PEFA assessments every three years; (ii) practical, action plans derived from the assessments were to be used as the basis for delivering CD; and (iii) be supported from dedicated regional resources and development partners, coordinated by PFTAC. Following a decade of activity, a review of the strategy has been undertaken by FAD to:

- examine whether the strategy and policies it mandates have achieved their basic objectives and have resulted in an improvement in PFM performance of PICs;
- examine whether the tools and modalities were adapted to the needs and capacities of PICs and were sufficiently focused on their strategic reform priorities;
- assess the modalities and effectiveness of coordination between PFTAC and other development partners working on PFM issues; and
- consider the progress made toward achievement of the PFM reform objectives outlined in documents relating to Phase III (FY2009-FY2011), Phase IV (FY2012-FY2016), and Phase V (FY2017-FY2022) of the PFTAC program.

15. A draft report is expected to be circulated to stakeholders in mid-2020 leading to the publication of Working Paper later in 2020.

(ii) *Revenue Administration*

16. PFTAC supports member countries to strengthen their tax administration capacity, mobilise tax revenue, improve taxpayer compliance, and promote the role and contribution of citizens as taxpayers towards fiscal sustainability. The Revenue Administration Program focuses on two key objectives: (1) strengthened revenue administration management and governance arrangements; and (2) strong core tax administration functions that include an accurate taxpayer base, quality taxpayer services that support voluntary compliance, and improvements to filing, payment, audit, and taxpayer education; that are supported by fit-for-purpose legal frameworks. The program is delivered by a resident tax administration advisor with peripatetic support from his predecessor and from an extensive pool of international tax experts. Further resources are provided from the IMF's Legal Department to draft new or revised tax legislation to support the revenue program objectives, as well as tax policy expertise from FAD to review and provide advice on tax policy options.

17. The FY2020 Revenue program is projected to have delivered fifty-four (54) missions or activities (totalling eight hundred and twenty four (824) TA days) including six regional workshops. Prior to the late postponement of missions in March and April due to COVID-19 travel restrictions, the Revenue program was on track to its largest outturn in PFTAC history, comprising sixty-six (66) missions utilising nine-hundred and eighty-one (981) TA field days. Given its large scale, most Revenue program CD is delivered by short-term experts (STX) and some HQ staff-led missions with the single resident advisor managing and overseeing the extensive program.

18. The major beneficiaries of Revenue CD were Cook Islands, Fiji, Solomon Islands, and Tonga. Key areas of focus and support included facilitating improvements to tax administration organisational arrangements and introduction of function-based structures; developing and implementing risk-based compliance improvement strategies; elevating the importance and improving the effectiveness of taxpayer services; strengthening the compliance and management of the large taxpayer segment; facilitating improvements to the management of tax return filing and tax arrears management; strengthening tax audit capabilities; and modernising tax legislation such as income tax, VAT, and tax administration statutes. Tax administrations in the region also benefitted from a series of six training events, which included risk management and data analysis, followed by four workshops that covered; (a) managing a modern tax administration; (b) taxpayer services; (c) tax arrears and return filing; and (d) taxpayer audit. A sub-regional workshop was also held for the three northern countries to develop capacity for the audit of Gross Revenue Tax.

19. Extra funding from Australia enabled the extensive scaling-up of the revenue program to better respond to unmet demand for CD for the region. The scaling-up of the revenue program started in mid-FY2019 and continued throughout FY2020. It extended PFTAC's provision of tax policy advice, tax legislation drafting, and extensive tax administration CD with a significant proportion of the expansion directed to six countries (Cook Islands, Nauru, Solomon Islands, Tonga, Tuvalu, and Vanuatu) that intend to be or are signatories to the PACER Plus trade agreement and who face likely losses of revenue from trade taxes under the trade agreement. These countries also received assistance with managing tax debt and return filing, strengthening the audit function, improving taxpayer services, moving to more effective functional structures, developing modernisation plans, compliance improvement strategies, and renewal or drafting of new tax legislation and regulations.

20. The scaling-up is not a short-term undertaking, it is the start or in some cases the continuation of multi-year efforts with longer horizons. A comparison between the first half of FY2020 after the up-scaling and the corresponding six months of FY2019 before the scaling-up, shows the impact of the expansion. In the first six months of FY2020, seventy- nine (79) percent more missions and one hundred and thirty-six (136) percent more TA days were delivered compared to the corresponding six months of FY2019 before the expansion started.

C. Next Steps

21. With funding mostly secure, the fifth phase of PFTAC operations is expected to conclude in April 2022. From early 2021, consultations and inputs from all existing and potential stakeholders will be solicited to develop a strategic framework and priorities for an expected Sixth Phase of PFTAC from May 2022 for a further five years. Several important inputs will contribute to this exercise, including the external mid-term evaluation of PFTAC now underway, the FAD review of the decade long PFM Roadmap Strategy underpinned by the PEFA framework that is wrapping up, and of critical importance, direction from the 2021 FEMM, and particularly in the economic context of a post-COVID world, assuming by then that the pandemic has been brought under control. A Phase VI Program Document will be the product of this exercise and must be ready by mid-2021 to enable fund-raising to move forward to guarantee the sustainability of PFTAC operations to meet the needs of the PIC membership.