Before sunset we sat in a circle to drink kava. My friend Tim passed around some smol kakai to wash away the taste. Gathered for a fundraiser to help a friend pay her daughter's school fees, we chatted as group of about eight kids played nearby. Who belonged to which parent? Later, a plate of chicken legs and island cabbage followed – for everyone.

It's a scene familiar to most ni-Vans and to anyone who's lived in Vanuatu for a while, but the first time foreigners visit an island village they're usually gobsmacked by the sense of community. Off the boat from man-eat-man Australia, Europe or the United States, most can't quite believe that sharing is a way of life and that no-one goes hungry when there's enough food. It's become a cliché to ask: "What? No homeless people or beggars?"

The nation's founding Prime Minister Father Walter Lini perhaps said it best when he underlined the importance of "compassion and mutuality," remarking that in traditional society "the individual was not to consider himself or his private interests taking precedence over the general interests of the community."

Paradoxically, government policy doesn't reflect this traditional egalitarianism. The tax system relies almost entirely on consumer taxes, which fall harder on the poor than the rich. With no income tax, capital gains or inheritance dues, the state has to collect most of its revenues from value-added tax (VAT) and import duties.

Most consumer goods are subject to VAT of 12.5%, which businesses add to prices. The tariffs paid by importers at the border are similarly passed on to the customer.

Because the basic essentials – school fees, soap, fuel – take up a much bigger chunk of a poor person's weekly budget (the basic needs poverty line is currently considered to be about 1,800 vatu), and there are aren't many other taxes, the government effectively takes more from the worst-off than from the rich. The result in Vanuatu has been persistent levels of inequality. Economists call this type of system 'regressive'.

Direct taxes like income tax are fairer because they help with redistribution. The more you earn, the more your income you pay. A minimum threshold can be set so as to exclude low-income earners. In Fiji, no-one pays tax on any amount they earn up to F$16,000 (861,000 vatu).

Revenues generated from this fairer system can then be spent on goods and services like bridges, roads, housing, schools and hospitals. They benefit everyone, but especially the poor.

Vanuatu's community spirit is an achievement to be celebrated, and something which puts the country ahead of countries where social bonds have eroded. Why not build a revenue system consistent with this traditional sense of fairness?

The taxman cometh

The government, sensibly, is considering exactly that option. In an attempt to make the system more progressive and to broaden the tax base, the Department of Customs and Inland Revenue is for the first time considering the option of income, corporate and capital gains taxes.

Trade deals mean that the state can no longer rely on import duties as much as it once did. The possible conclusion of the Pacer Plus agreement with Australia and New Zealand this year will herald a schedule of tariff cuts that have much more serious implications than any other agreement, including the World Trade Organisation and the Melanesian Spearhead Group.

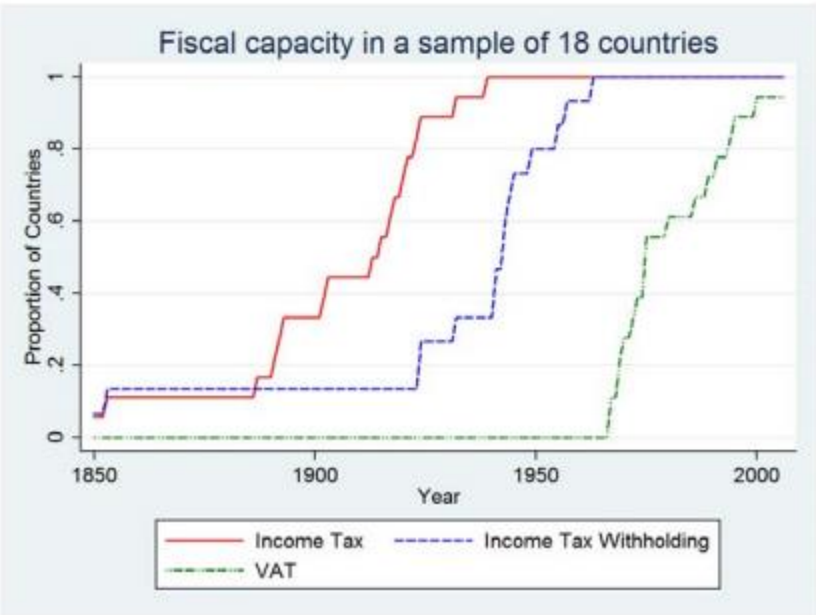
More people are moving to Port Vila in search of work, the population is growing and subsistence can no longer provide such a good safety net, the government will increasingly have to support the less-advantaged. [table of government revenues?]

Average income per head has more than doubled in the last 15 years and the country is scheduled to graduate from least developed status in 2020. This economic success is no use if it doesn't benefit most people. And as the economy keeps growing, overseas aid donors aren't likely to feel so generous. If the government doesn't want to borrow more, it'll have to find its own money elsewhere – something which will also give it more independence from foreign influence.

Put like this, the need for income tax isn't just fairer, it's vital. Across the world, development and tax are closely linked.

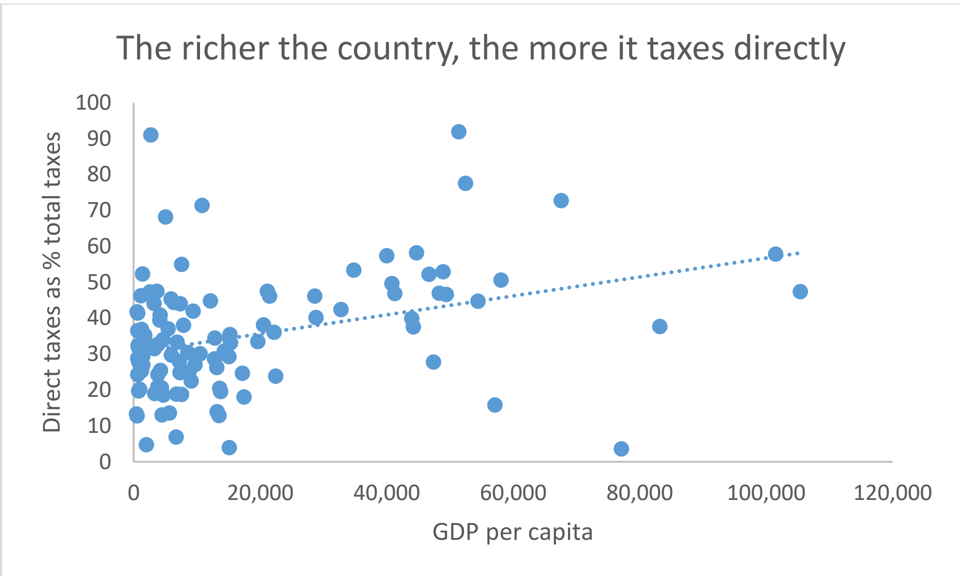
In a classic 1963 paper the economist Nicholas Kaldor wrote that: "It is shortage of resources, and not inadequate incentives, which limits the pace of economic development. Indeed the importance of public revenue from the point of view of accelerated economic development could hardly be exaggerated."

In the most prosperous countries, tax revenues make up a big chunk of annual economic output. Tax revenues are as high as 60% of GDP in some cases, as in Mauritius. For the OECD club of rich nations the average is 34.4%. In Vanuatu, it's only 17%. The most successful economies use government to mobilise funds for development – taxing those who could afford it and spending the money on the essentials of development. What's more, countries normally rely less on trade taxes and make increasing use of direct taxation. Over the last century more and more rich countries imposed an income tax, followed by VAT.

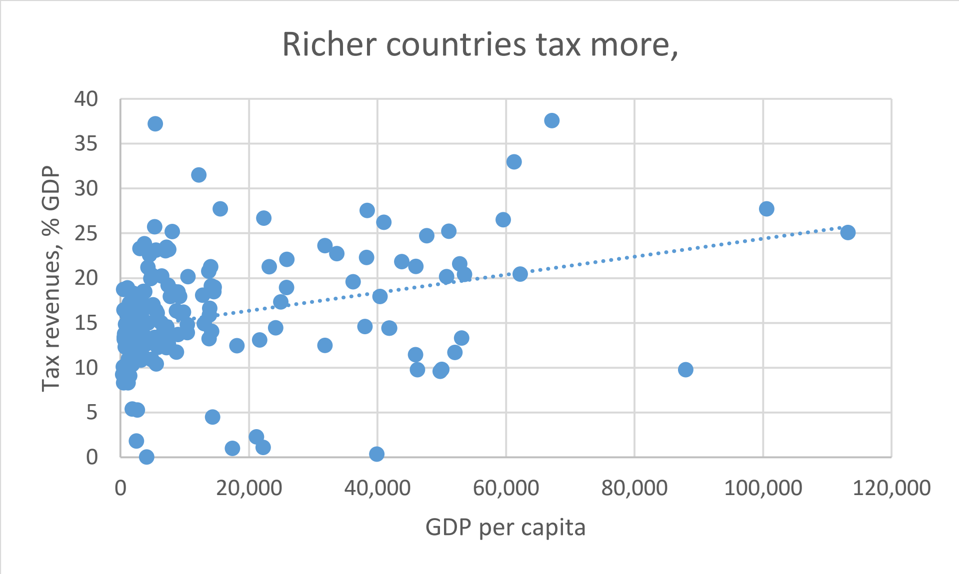


Source: Beasley et al. (2013) 'Taxation and development'
http://econ.lse.ac.uk/staff/tbesley/papers/TaxationAndDevelopment.pdf

The countries in the sample are Argentina, Australia, Brazil, Canada, Chile, Colombia, Denmark, Finland, Ireland, Japan, Mexico, Netherlands, New Zealand, Norway, Sweden, Switzerland, United Kingdom, and the United States.



Data source: World Bank. Author's calculations based on 107 countries for which data is available.



Data source: World Bank. Author's calculations based on 107 countries for which data is available.

Unless savings are either reprocessed through the financial system or income is partially taxed and then spent by government, spare cash sits idle in bank accounts – or worse, leaves the country – rather than being channelled into useful areas like infrastructure, health or education spending.

An over-reliance on consumer tax is risky. In a recession, spending falls quickly, reducing consumption tax revenues and creating a double-whammy for government, which has to compensate by borrowing more. Business profits tend to be more stable than consumer spending.

Seen like this, taxation is just a way of diversifying revenue sources and making sure that wealth is recycled into productive investment rather than sitting in the pockets of the rich.

Never mind what's right for Vanuatu's specific circumstances; there's been a recent worldwide re-evaluation of the importance of taxation for economic growth. The poverty that resulted from the shift away from redistribution from the 1980s onwards reduced aggregate demand, meaning that workers couldn't afford the things that companies made. Economic growth slowed.

If more of the population are poor it's bad for the economy as a whole because the less wealthy spend a higher proportion of their income than the rich. Inequality is therefore a major explanation for the global economic crisis of 2008 and the stagnation afterwards. Many voters are again putting their faith in governments to stimulate growth and to generate funds for spending and investment.

Treasure islands

Why doesn't government policy match traditional communal values? In brief: colonial powers and government could get away with it. The traditional subsistence lifestyle provided a buffer against extreme deprivation.

When the French and Brits left in the 1970s they made Vanuatu a tax haven like many of their other island colonies, something which handily served allowed financiers to hide their cash from the UK taxman.

For a while, the tax haven seemed a welcome source of prosperity. With little manufacturing and copra providing the limited income from exports, it seemed important to win business and investment however possible. At its peak the financial centre was estimated to be worth up to a fifth of the economy.

But it never benefited most ni-Vanuatu people. And as rich-country tax collectors hadn't anticipated globalisation, they grew anxious as their funds leaked out into secrecy jurisdictions like Vanuatu. A recent estimate suggested that banks located in tax havens cost the US taxpayer up to $100 billion a year. This explains the push by the Organisation for Economic Cooperation and Development – the club of rich countries -- to force tax havens to open up their books. As the Panama papers recently showed, European and American governments, together with powerful interest groups, will keep trying to shut down the havens.

This isn't just heavy-handed foreign intrusiveness; tax havens are bad for the world because they facilitate a race to the bottom whereby governments outdo each other by lowering levies to attract investment. Letting foreigners (and locals) hide their cash in Vila-based banks harmed the country's reputation and attracted dodgy businesses.

Contrary to the view that zero tax is necessary in order to attract business, Vanuatu's economic upturn of the last 15 years or so coincided with a decline in the financial centre to half its size during the glory days. The latest boom was built on tourism and construction, which depended on the country's beauty rather than its tax breaks. There's been no related decline in investment now that Vanuatu's financial centre is fully transparent – in fact the opposite, as investors begin to trust the country as a solid place to do business.

Instead of simply looking for the cheapest deal, most businesses are happy to pay their way. International corporate surveys suggest that a predictable business environment and decent services are more popular than a free ride. Despite some squealing, the best way of attracting business is to fund decent public services and infrastructure, which need a stable and broad revenue base.

A more realistic worry about income and corporate tax is that it'd be technically too difficult and that companies wouldn't report their profits truthfully. But people said the same thing when VAT was introduced back in 1998, and the system now works well. Country after country has dramatically raised its revenue-generating abilities. The Rwandan Revenue Authority has almost doubled its domestic revenues since 1998. If a landlocked, post-genocidal African state can do it, then surely Vanuatu can, with its experienced tax collectors, geographical concentration and small corporate sector?

Professor Jeffrey Sachs of Colombia University describes taxation as "the price we pay for a civilised society". Vanuatu already has a civilised traditional society – one that should be the envy of the world. As the economy progresses and donors move out, the government is rightly looking at ways of preserving the national sense of fairness. Those eight kids I encountered at the fundraiser should have the same opportunities as the richest Port Vila expat.

The Sustainable Development Goals adopted by the United Nations last year declared that 'no-one should be left behind.' Ni-Vanuatu people figured out centuries ago that no-one should be left behind – and they should keep putting the idea into practice.