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# The New Caledonian Economy Beyond Nickel

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New Caledonia enjoyed a strong economic growth between the 1960's and 2010. Nowadays, the average income per inhabitant is quite high. However, this prosperity largely relies upon the mining of nickel and transfer payments from mainland France. The New Caledonian economy suffers from a lack of productivity gains, insufficient competitiveness and strong income inequalities. This *Note* offers solutions to try to tackle these issues. Although their implementation relies upon New Caledonian authorities, mainland France could contribute by adapting its transfer payments according to the hereby-redefined goals.

Since 2011, economic growth has slowed down due to the fall in nickel prices and the loss of impetus of an economic model lacking productivity gains. The extractive sector developed relatively autonomously with regards to the rest of the economy, absorbing most of the technical capabilities. Apart from nickel, few export activities managed to develop, particularly because of high costs. This *Note* proposes the creation of a sovereign fund to capitalise on the income of nickel extraction to smooth the effects of nickel prices on public budgets and investments. The governance of the fund shall be independent from the political power, a condition required for allowing a partial reallocation of mainland France transfer payments to the fund.

The narrowness of the local market and the geographic remoteness do not favour competition. In 2013 and 2014, two countries' laws set up control rules for concentration operations and decided the establishment of a local administrative competition authority trusted with their enforcement. However, this authority does not function yet. It is important to make it operational quickly, possibly with a technical assistance from mainland France. To strengthen competition, it would also be desirable to pursue the efforts to transfer custom duties to the new general tax on consumption (by progressively unifying its different rates), and to lower the corporate tax level to attract foreign companies –a reform that could be offset by a rising of property taxes. The lack of competitiveness also comes from an insufficient qualification of the work force. The *Note* recommends accentuating the efforts on formation, especially by strengthening the technical and higher education offer on the island while supporting temporarily the welcoming of external competencies. Regarding primary and secondary education, financial incentives for teachers in the least favoured areas shall be increased. Finally, New Caledonia suffers from deep social inequalities that however are difficult to assess precisely due to a lack of statistics. The *Note* suggests broadening the income tax base in order to finance incentivising social transfers such as negative taxes or income supplements for the lowest salaries.

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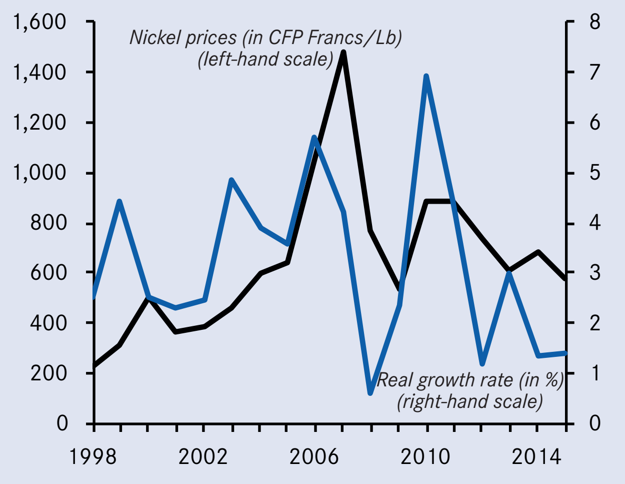
## Introduction

The New Caledonian economic prosperity remains an exception among the French overseas territories. During the 50 "Golden years" lasting from 1960 to 2010, its gross domestic product (GDP) rose, on average, by 3,9% per year in real terms. In 2015, GDP amounted about 8 bn euros (956 bn CFP francs). The average income per inhabitant is therefore comparable to the one in mainland France and largely superior to overseas departments. New Caledonia also stands the comparison with other nearby territories in the Pacific, with a nominal GDP per inhabitant comparable to the New Zealand one, considerably superior to the one of the other islander Pacific States, but almost a half lower than the Australian one.[1]

However, a major part of this relative prosperity relies on nickel mining –a non-renewable natural resource whose prices have decreased strongly since 2011– and the transfer payments from mainland France. The rest of the economy suffers from the Caledonian islander location (the inner market is limited), institutional uncertainty (referendum of 2018), which favours a "wait-and-see" attitude of the economic actors, and a weak competitiveness of the economy, with an incipient competition law, a limited goods and people mobility due to structural reasons and a protectionist tax system. The poor internal profitability of many investments has been compensated and maintained by large tax exemptions and tariff protections which, added to the narrowness of the market, favoured the appearance of windfall rents. These various elements contradict the development of innovation and exportation oriented strategies, letting nickel –strongly cyclical and unsustainable in the long term– being the only source of exports. Finally, strong income and access to education inequalities handicap future growth while the country benefits from remarkable natural resources (climate, biodiversity, ore, etc.). The concentration of wealth also limits consumption while favouring savings mainly invested abroad. Each of these handicaps has to be carefully considered. On these various issues, mainland France is not a decision-maker (see Box 1), but it can contribute to a new growth strategy by adapting its transfer payments according to redefined goals.

**1. A growth reliant upon the nickel industry**




*Source*: ISEE.

## Pros and cons of an economy based on mineral extraction

### Macroeconomic trends: a breathless growth

From 1998 to 2011, the New Caledonian real GDP grew by 3.6%on average, for a population growing about 1.9% per year. This relatively satisfying average hides a major instability due to the nickel price fluctuations (Graph 1) and to the variations of the extraction rates, particularly because of the noticeable technological issues encountered over the last few years. Since 2012, New Caledonia has also suffered from a drop in investments due to the end of the construction work of metallurgical plants and to the progressive ending of big public building sites. Consumption has also strongly slowed down since 2011.

The composting of growth since 2011 also reveals the breathlessness of the historical development model. Demand has been artificially maintained by major external transfer payments (mainland France grants, and foreign direct investments in the nickel sector) and by growing public spending (in current spending as well as in investment). Activity developed through mobilising always more capital and work, but without a real competitiveness imperative due to the strong protection of the internal market. Between 1995 and 2010, employment in the private sector as well as activity grew at about 3.6% per year: the average labour productivity has stagnated. In the meantime, the rise in incomes supported a rise in the unit labour cost and a worsening of competitiveness.[2]

**Assessment 1.** Economic growth has slowed down since 2011 because of a fall in nickel prices and the breathlessness of an economic model lacking productivity gains.

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[1] However, this comparison does not take into account differences in the cost of living between countries due to the lack of data on relative price levels for New Caledonia.

[2] See Gorohouna S., S. Rey and C. Ris (2016): *L'évolution de la formation et de la productivité du travail en Nouvelle-Calédonie*, Conférence AFD 'La productivité comme relais de la croissance calédonienne ?', Noumea, August.

## 1. The institutional framework of New Caledonia

New Caledonia is a unique model of French overseas countries.[a] As a *sui generis* collectivity, it enjoys its own institutions and broad competences. A referendum on its accession to full sovereignty is expected in the second half of 2018.

### The status of New Caledonia[b]

The 1988 Matignon Accord created three provinces (South Province, Northern Province and Loyauté Islands Province) that share geographical power, while the 1998 Noumea Accord changes the status of the territory and establishes a collegial government. The specificity of this status is specified in the Constitutional Law (no 98-610) of 20 July 1998 on New Caledonia and the Organic Law of 19 March 1999, which details the procedures for the transfer of powers. New Caledonia thus enjoys great autonomy, with the recognition of the Kanak people, of a local citizenship, and the voting by the Congress of "laws of the country"[c] which are legislative acts equal to the French national law and the control of which falls directly under the jurisdiction of the French Constitutional Court. The Organic Law also sets out the terms of the referendum in which New Caledonia will be called upon to decide on its attainment of full sovereignty. Finally, the country has 33 municipalities whose acts are subject to ex post control.

### The institutions

New Caledonia has a Congress, a collegial government, a customary Senate (second chamber on customary status, land, identity and customary councils), and one advisory Economic, Social and Environmental Council.

Each of the three provinces has a common law jurisdiction. It is administered freely by an assembly elected for five years by direct universal suffrage within the framework of the province. These elections also appoint representatives to the Congress of New Caledonia. The southern province, the most populous, benefits from almost 3/5th of the 54 seats of the Congress.

The Congress is responsible for affairs common to the whole country and elects a collegiate government of 5 to 11 members, including a president who directs the administration, appoints public offices, and represents New Caledonia.

### The organization of competences

Since the mid-1980s, New Caledonia has benefited from a progressive transfer of State competences, including labor law, taxation, foreign trade, regulation of natural resources, repression of fraud, regulation of prices, rules In the field of health protection, a movement which has been accelerated by successive political agreements with civil law, commercial law, primary and secondary education, etc.[d] Following the Noumea Agreement, the French State remains competent only in matters of defense, justice, police, currency and external relations. With regard to external relations, however, New Caledonia is associated with France, for example, with a diplomatic representation in New Zealand or participation in the Pacific Islands Forum.

[a] Since the constitutional revision of 20 July 1998, the status of New Caledonia has ceased to be that of overseas territory, or that of local authority, but a specific status defined by Title XIII. The 2003 constitutional revision confirms that it is governed by Title XIII as a *sui generis* collectivity.

[b] See Chauchat M. (2011): *Les institutions en Nouvelle-Calédonie*, CDP-NC SCEREN, Coll. Université.

[c] Organic Law no 99-209 of 19 March 1999 defines the areas on which the "laws of the country" are competent.

[d] The division of powers is detailed in the annual report for 2015 of the Institut d'Émission d'Outre-mer.

## An economy insufficiently oriented towards exportation

New Caledonia represents the second biggest nickel stock in the world (11%) after Australia (23%). The share of nickel in GDP varies according to years and prices.[3] It reached 17% in 2007 and fell to 5% in 2009 before rising again due to the opening of two new plants. In 2011, the share of nickel within the economy (mine and metallurgy) was of 7.2% (Graph 2). The remaining industry only counted for 5.5% of GDP, and commercial services for 30%. In total, 70% of commercial activities were "sheltered" from international competition (non-tradable sector).

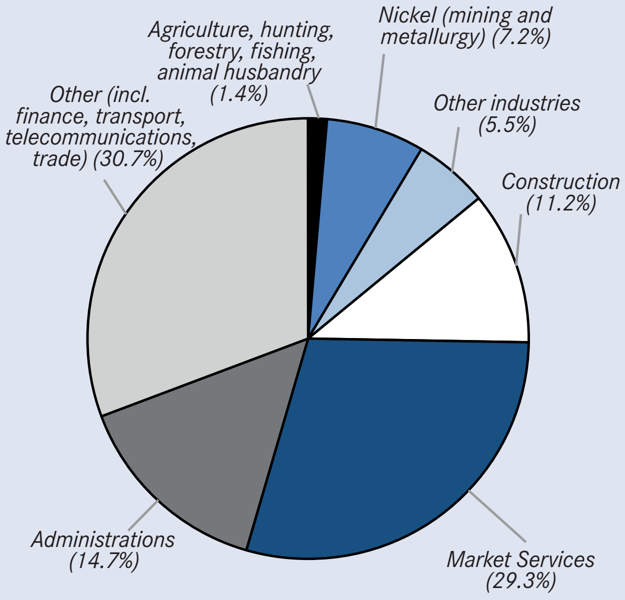
The nickel sector represents almost 14% of employment in New-Caledonia including one half of direct employment (nickel extraction and metallurgy plants), and the other half in subcontracting and ordering, construction, transportation and trade services.[4] This sector makes the biggest part of exportations, twice less important than the country's imports.

Similarly to all economies whose development relies on natural resources, New Caledonia is exposed to two classical risks: the "resource curse" and the "Dutch disease" (Box 2). If we cannot see major political dysfunctions due to the abundance of ore, the "resource curse" is not absent since the

[3] Wasmer E. and Q. David (with C. Carbonnier) (2012): *La situation économique de la Nouvelle-Calédonie : et si la prospérité n'était pas éternelle ?*, Rapport adressé au Président du Congrès de la Nouvelle-Calédonie.

[4] Comptes Économiques Rapides de l'Outre-Mer (CEROM) (2015): *L'impact du nickel en Nouvelle-Calédonie : deux emplois privés sur dix liés au secteur nickel en 2012*.

**2. Share of the sectors in the 2011 GDP**



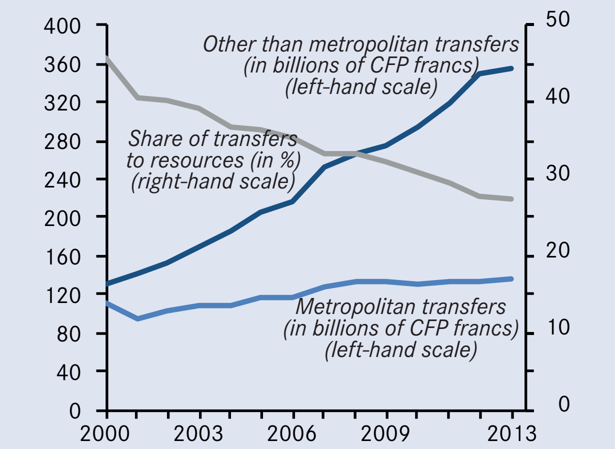

*Source*: ISEE.

extractive sector is developing rather autonomously from the rest of the economy, without pulling up productivity. The "Dutch disease" is also visible. On the one hand, the nickel sector seems to absorb most of the technical capabilities. Even if technology and the qualifications developed by the nickel industry have a positive effect on other sectors, capabilities lack to modernize production lines in other sectors (cold chain, infrastructures, etc.). On the other hand, the very high price level, associated with the fixed exchange rate relative to the euro, damages the competitiveness of other exporting sectors. A poor development of the tourism sector could be at least partly a consequence of this phenomenon. Only the services sectors that are protected from competitiveness benefit from the mining rent.

To the two classical syndromes of economies based on natural resources a specific Caledonian effect is to be added due to mainland France transfer payments and the incomes of civil servants based on the island. The French State commitment permits in favor of New Caledonia, which cover the salary of State civil servants (about 25% of the public sector employees), other functioning costs related to State functions as well as endowments and subsidies to territorial collectivities, represent a decreasing part of the New Caledonian budget: between 2000 and 2013, their share fell from 45 to 27% (Graph 3). Until recently, this decrease was due to the expansion of receipts other than those from transfer payments, which have tripled over this period, and not to an absolute drop in mainland France transfers. Over the last few years, transfer payments from mainland France have stagnated. However, at about 13% of the Caledonian GDP, they almost represent twice the share of nickel in the economy in 2011.

The pay of Caledonian civil servants matches the mainland France index point treatment, increased by the maximum residency compensation (the one applied in Paris) and multiplied by 1.73 (Noumea and its suburbs) or 1.94 (the rest of the territory). This indexing mechanism contributes to holding prices up in the country and reducing the exports' competitiveness, may they be in the "off-nickel" industry or services. To the "Dutch syndrome", a type of "French syndrome" seems to be added based on the indexing mechanisms of civil servants' wages.

**3. Fiscal resources and share of mainland France transfer payments**




*Source*: ISEE, comptes du secteur public de Nouvelle-Calédonie.

**Assessment 2.** The Caledonian economy both suffers from a "Dutch disease" (due to nickel mining) and a "French disease" (due to transfer payments from mainland France and the civil servants' indexing mechanism).

## The necessary creation of a sovereign fund

Countries whose economy relies in majority upon non-renewable resources (Norway, Ghana, Nigeria...) often tried to master the above-mentioned risks implementing a sovereign fund to accumulate financial assets according to three goals:

- Compensate the progressive depletion of natural resources to leave an equal amount of wealth to the next generations,
- Smooth the impact of price variations on public budgets by increasing transfer payments during high-price periods and decreasing them during low-price periods,
- Invest in the diversification of the economy, through infrastructures to develop tourism for example.

In New Caledonia, the idea of a fund for the future generations is getting more and more popular. The Technical group

## 2. The resource curse and the "Dutch disease"

Although the existence of mineral resources is an opportunity for a territory, economic history teaches that it is often poorly managed and can even lead to the so-called "resource curse".[a] The exploitation of natural resources is often accompanied by considerable socio-economic inequalities between those holding the shares of the mining rent and the rest of the population. The associated tensions can sometimes go as far as civil war for control and appropriation of resources.

The sources of these problems are fairly well understood. First, natural resources must not be produced, but simply extracted. The exploitation of resources can thus be done independently of other economic activities, without externalities in the productive sector and involving only a small fraction of the labor force. A similar reasoning applies to the links between the existence of natural resources and the governance of a country.

Second, as these resources are generally non-renewable, they must be considered as an asset that produces dividends, which will disappear in the more on less near future, unlike a permanent income. In terms of sound asset management, the wealth derived from the extraction of a resource should not be used to finance current expenditures, but should be saved or used to finance investments.

Third, the discrepancy between the value of the extracted resource and its cost of extraction generates an economic rent that provokes covetousness. The economic actors seek the rent rather than invest for the future. Different social or ethnic groups may clash, sometimes leading to coups d'état or civil wars.

Finally, natural resources can hamper the development of a modern tax system. To the extent that it is a shareholder, the State has no (or less) need to raise taxes. From then on, governing consists essentially in distributing wealth through subsidies, and benefits.

The "Dutch disease" is also linked to the exploitation of natural resources. It is a purely macroeconomic mechanism, present both in developing economies and in advanced economies such as the Netherlands when natural gas was discovered in the North Sea in the 1970s. At that time, the introduction of gas coincided with a decline in manufacturing. The natural resource sector is attracting an increasing share of skilled workers through wage increases, with two consequences: other sectors are struggling to grow due to wage competition and skill shortages; and the increase in purchasing power associated with the exploitation of the resource increases the demand for non-tradable goods (services in particular), which become expensive and contribute to reinforce the competitiveness deficit of the tradable sectors.

[a] See Auty R.M. (1993): *Sustaining Development in Mineral Economies: The Resource Curse Thesis*, Routledge; Frankel J. (2010): "The Natural Ressource Curse: A Survey", *NBER Working Paper*, no 15836, March; Macartan H., J. Sachs and J. Stiglitz (2007): *Escaping the Resource Curse*, Columbia University Press.

of Presidents and Signatories validated its principle and asked for further research works.[5] Box 3 sums up the foreign experiences regarding sovereign funds. The two key questions to solve are: the nature of the resources given to the fund, and its governance.

In New Caledonia, the question of resources is a complex one since only one of its three metallurgical plants is public (the new Northern plant),[6] while the "tax stability pact" granted to new plants forbids to get resources through taxation. Three financing solutions we shall present briefly can be considered.

The first one consists in abounding the sovereign fund from New Caledonia's general budget, what the *Institut d'*émission *d'Outre-mer* already recommended in 2012. With a strict budget discipline (no payment or withdrawal in cases of budget deficit), the accumulation of fiscal surpluses between 2006 and 2009 would have reached 4.5% of GDP, a small number in comparison with the Chilean or Norwegian orders of magnitude. If the government had been allowed to make a withdrawal in 2009 to fill its deficit, the accumulation would have fallen to only 2.3% of GDP.[7]

Another solution would consist into supplying the fund with a new mandatory direct tax on extractive activities. Upstream, it could be a direct tax on property (poorly developed in New Caledonia), or on the sales of ore to metallurgical companies. Downstream, it could be a tax on nickel exports.

Finally, mainland France transfer payments could be partially re-allocated to the fund, provided a strong and transparent governance is guaranteed. At the same time, the income indexation mechanism for civil servants would progressively disappear, by not applying it to new affectations in New Caledonia for example, while keeping exceptions to strengthen teaching capacities in some disadvantaged areas (see *infra*). Such a reallocation of mainland France transfer raises the issue of the durability of agreements, which might reinforce the *statu quo*. Therefore, a yearly payment to the fund

[5] *Cf.* Relevé de conclusions du Groupe de travail des Présidents et des signataires sur le nickel du 20 février 2017.

[6] There are three metallurgical plants in New Caledonia: the oldest (created in 1880) is the SLN, whose main shareholder is ERAMET, and the two most recent are: VALE-NC (in the South, whose main shareholder is Brazilian Vale) and Koniambo Nickel SAS (in the North, whose principal shareholder is the Southern Pacific Mining Company, a subsidiary of Sofinor, a mixed economy company in the Northern Province).

[7] See Baude J. (2012): "Étude sur la création d'un fonds souverain en Nouvelle-Calédonie", *Document de Travail de l'Institut d'Émission d'Outre-Mer (IEOM)*, May.



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## 3. Sovereign funds best practices

Among the 58 existing sovereign wealth funds, 34 have been set up since 2000. The Norwegian (1990) and Saudi (1952, 1971) funds largely mitigated the effects of the Dutch disease, while the Chilean fund (2006) succeeded in maintaining stable government spending despite high volatility in copper prices. Other funds, such as those in Timor-Leste, Ghana or North Dakota, have helped to smooth consumption over time and save for future generations.

In order to enable a fund to achieve its objectives, it is essential to define the nature of the resource it contains, as well as specific governance rules that are able to withstand the pressures of the executive, often tempted to use revenues of the fund for political purposes:[a]

- Define one or more clear objectives to which the fund must respond. These can be saving for future generations; the stabilization of public expenditure; investments for the future or a precautionary motive; the protection of income against mismanagement or corruption. For example, in 2011, Ghana established an “inheritance” and a “stabilization” fund, each with a single objective;
- Establish budgetary rules regarding the nature and use of the resources paid to the fund, in line with the objectives set. Income paid to the fund may come directly from the exploitation of resources (where the State is a shareholder), from a tax on operating income (in the case of private companies), or from a share of general budget revenue. The fiscal rule allows a countercyclical policy to be implemented. In Norway, for example, the non-oil structural public deficit cannot exceed 4% of GDP: therefore, an increase in oil price revenues will be saved. For its part, Alaska limits the share of the budget that can be financed by oil revenues;
- Define the rules regarding the nature of investments that may be made by the fund. For example, the Norwegian sovereign wealth fund is subject to investment rules according to strict ethical and environmental standards;
- Clearly establish a separation of powers between the government, the fund manager and all management units, with regular monitoring of ethical standards and possible conflicts of interest. The Norwegian and Texan funds have established internal control mechanisms including regular internal audits, ethical charters for employees, an evaluation of directors, and independent controls at all levels of the fund’s governance;
- Ensure the transparency of the fund through the regular publication of key information and performance evaluations. Funds in Alaska, Texas, Chile and Norway can be cited as models of transparency: they publish the amounts of their deposits and withdrawals, the type of investments (type, location, currency, returns) and communicate on the fund’s major activities and on the composition of the Executive Board;
- Establishing an independent supervisory authority, ensuring compliance with the fund’s governance rules. This was done by the Ghana, Alberta and North Dakota Funds.

[a] The Natural Resource Governance Institute (NRGI) and the Columbia Center on Sustainable Investment (CCSI) identified six key elements for good governance of SWFs, see NRGI and CCSI (2014): *The Natural Resource Fund Project*, //www.resourcegovernance.org/natural-resource-funds

could seem less “safe” than indexation which is automatically renewable by nature. On the contrary, an allocation in capital (corresponding to the present value of the future transfers’ decrease) implies a budgetary risk for mainland France: once the effective payment is delivered, the risk is to have a strong pressure to go back to the indexing. It would be necessary to secure this transaction with an agreement explicitly planning the progressive ending of indexing with no possible return.

Another thorny issue has to do with the fund’s governance. To follow best practices (Box 3), the fund’s only goal should be to prepare the future of New Caledonia after nickel. This could pass through financial placements outside the country or within interior production capabilities. In a very regulated action, the Caledonian government could use the fund in times of recession, but with the symmetrical commitment to filling the fund in upper cycle phases. Such rule, countercyclical by nature, is not contradictory with the goal of accumulating assets over time. But it requires a governance independent from political power, in order not to endanger long-term objectives.

**Recommendation 1**. Implement a sovereign fund with a governance independent from the political power and strict budget rules. Progressively redirect part of the metropolitan transfer payments to the fund.

Even though the nickel international market is in an unfavourable phase, we still think it is time to create such a fund. The budget rule will have the virtue of filling the fund according to nickel cycles and to reduce the risks of pro-cyclical investments in the future, risk which have not been totally avoided (in the past). The abound to the sovereign fund will imply almost mechanically, at least at first, a decrease of public resources which might have to be temporarily compensated by a rise of public debt not to decrease investment, in human capital in particular. The difference between interest rates on investments managed by the fund and those on public debt make the operation profitable from a strictly financial perspective.

## The poor competitiveness of the Caledonian economy

New Caledonia also suffers from a lack of competition and international openness. In 2014, total exports are estimated at 19% of the GDP while imports would have represented 41% of GDP (ISEE). An important penetration of imported goods is unavoidable for a small island economy. Border protections only preserve rents and do not encourage improving productivity. The risk is then to get enclosed into an uncoupling economic spiral. On the contrary, the advantages attached to opening are even greater when an economy is small. New Caledonia shall open progressively with a clear and credible display to all economic agents. A small island economy can enjoy both trade openness and high salaries as the example of Iceland shows it.

### Competition law

The Caledonian market is not only very limited (268.767 inhabitants in 2014), but also marked, especially in rural and tribal areas, by the practice of self-consumption:[8] it only offers room for few viable operators, which does not allow for strong competition to emerge. Despite the relative closeness of larger markets (Australia and New-Zealand), custom barriers, administrative import authorizations and quantitative restrictions on imports (quotas) slow the development of competition down.[9] As a result, markets are highly concentrated and they are favourable to situations of collusion. As noted by the French competition authority, we can observe two types of monopolies or oligopolies: on the one hand those related to the narrowness of the market (retail distribution,[10] air transport…), and on the other hand those linked to communication networks (freight, harbours, wholesalers and importers…). This contributes to the poor productivity of the Caledonian economy and the very high level of prices, even despite the administrative controls on prices and margins which do prove poorly efficient.

Prices in New Caledonia are higher than in mainland France: in 2010, the gap was of 34%. Much higher than the one observed in overseas departments,[11] this gap stabilized since the beginning of the years 2000 thanks to a similar inflation (or even lower) as the French one.

Following reports of the French competition authority, a country law on competition has been voted in 2013. It sets up rules to control business concentration operations and the extension of retailers, with investigation and sanction powers. Complementary to this, the April 2014 country law created a local administrative authority for competition in charge of implementing the antitrust law. At the beginning of 2017 however, this competition authority is still not settled.[12]

The price-competitiveness aspect of the 2016 “competition, competitiveness and price law”, which aims at shifting several taxes (namely on imports) into a general tax on consumption (TGC, Box 4), shows how useful the settlement of a competition authority would be. For the suppression of import taxes to benefit consumers, article 19 of this law forecasts a freezing of business profit margins during the 18 first months of the implementation of the general tax on consumption. The article also plans the signature of competitiveness agreements in the four sectors which represent the main spending for Caledonian households (housing, food, products of general consumption and automobile) before April 1, 2017.

The principle of a margin control, even if limited in time, is problematic. Generally speaking, intervening on prices leads to several well-known perverse effects (rationing, shortage, quality loss). Apart from the fact that they are difficult to implement, margin controls have the disadvantage of removing any incentive to lower production costs. To limit the increase in prices, mainland France competition authority recommended, in 2012, that competition shall be strengthened in distribution (control of business concentrations, predictable and transparent controls of areas’ openings, structural injunctions measures). To do so, it is important to make the New Caledonian competition authority operational as soon as possible with broad competences and a real independence. During the transition period, a control of margins and imported goods which are not transformed in New Caledonia, could be implemented to ensure that the decrease in tax pressure effectively translates into lower after-taxprices for consumers.

**Recommendation 2.** Make the competition authority rapidly effective, with a potential (technical) support from mainland France to correct and sanction anti-competitive behaviours.

The New Caledonian competition authority shall give a specific care to network activities (telecommunications, maritime and air transport…) which play a key role to connect New Caledonia with the world, and therefore for the devel-

[8] Decruyenaere T. and P.Sauze (rep.) (2012): *Mécanismes d’importation et de redistribution des produits de grande consommation en Nouvelle-Calédonie*, Rapport de l’Autorité de la concurrence.

[9] In addition, there is very little competition between the five stevedoring companies in the port of Noumea. The Competition Authority (2012, *op. cit*, p. 30) notes that “the price of landing in New Caledonia is thus between two and three times higher than the price at La Réunion, which could itself follow an agreement between the differents companies”.

[10] In the Grand Noumea area, which accounts for 90% of the sales of supermarkets, two operators own more than 80% of retail space (ADLC, 2012).

[11] See Comptes Économiques Rapides de l’Outre-Mer (CEROM) (2012): *Comparaisons des prix entre la Nouvelle-Calédonie et la métropole*.

[12] Seemingly overly strict constraints regarding the appointment of members have been relaxed by the April 2016 Act, which should facilitate appointments.

## 4. The 2016 tax reform

In September 2016, the New Caledonian Congress passed the country's general consumption tax (GCT) and competitiveness law, launching a fundamental tax reform. The objective is to increase the neutrality and transparency of the New Caledonian tax landscape without reducing its tax revenues, while the price-competitiveness component (Article 19) aims to reduce prices for consumers.

### The general consumption tax

The TGC, which is part of the calendar of tax reforms of the shared agenda, is a value added tax that will replace a set of customs duties and taxes applied to consumer prices of goods and services.[a]

The TGC will have three rates and exemptions. The distribution of goods between the different TGC rates is aligned with current taxation on imports. The reduced rate is 3% for all basic necessities, services to the person and industry. The normal rate of 11% will apply to a portion of food, shelter, clothing and fuel. The upper rate is fixed at 22% for the automobile, the equipment of the house, or tobacco.[b]

The basic necessities, exempted today from the import tax, as well as the health and education sectors (nurseries, retirement homes, residential leases, etc.) will be exempted from TGC. Goods produced or processed locally will also benefit from the reduced rate in order to maintain local competitiveness.

A TGC clearance will be implemented for a period of 15 months beginning in April 1, 2017, to allow companies to comply. This period will see the application of lower rates (a reduced rate of 0.25%, a specific rate of 0.35%, a standard rate of 0.5% and a rate of more than 1%), superimposed on taxation already in place. The TGC will come into effect with its actual rates on July 1, 2018.

[a] The TGC will replace the general import tax (TGI), the basic import tax (BIT), the toll tax (TP), the air cargo tax (TFA), the solidarity tax on (TSS), the tax on hotel accommodation (TNH) and the proportional tax on the license, with a total annual return estimated at 51 billion Francs (427 million Euros), *cf*. Government of New Caledonia.

[b] While metropolitan VAT at 20% covers 77% of French consumption, the higher rate of the TGC will only concern 15% of consumption in New Caledonia.

opment of competitive lines of business. In some cases, the network activity is a natural monopoly that has to be regulated. In some others, it is about ensuring the effective conditions of competition. Excessively high prices play the double detrimental role of import and export custom duties. As an example, airfares available on line for a Sydney-Noumea trip (1971 km as the crow flies) are 50% more expensive than the Sydney-Port-Vila flight, which happens to be longer (2 473 km as the crow flies), while this difference cannot be justified by a bigger population cluster in the second case. Indeed, air traffic at the Noumea-La-Toutouta airport has been stagnating since 2011 (less than 500.000 passengers). This type of offer deficiency slows down tourism and more globally outward exchanges.

### Pursuing the fiscal reform

To improve the business climate, the Caledonian government initiated an administrative simplification process (dematerialisation, one-step shops). Incentive measures to favour innovation have also been considered, while there is no fiscal advantage such as tax deductions for research and development ("*crédit d'impot recherche*").

Aware of the limits of their market, Caledonian companies try to pool their means together to reach a critical size for exports. As an example, the group *Avenir Export* (Avex), created by the Caledonian Federation of Industries (FINC), is the first French transversal cluster. Dedicated to the operational development of exports, it is open to all companies whose activity is connected to exports. However, these initiatives will probably not be enough and the tax lever might have to be enlisted.

New Caledonia has a 30% level of corporate income tax (CIT),[13] identical to the Australian one and comparable to New-Zealand (28%). A reduced level of 15% is applied to SMEs under certain conditions. But New Caledonia has to compensate its small size and geographic isolation: to attract foreign direct investments, a lower tax level than Australia or New-Zealand shall be displayed.[14] The loss of fiscal receipts could be compensated by higher taxation of property whose incomes are nowadays considerably exonerated (see *infra*).

This shift should be progressive. Today, a high rate of CIT is justified since it applies to the rent artificially sustained by the lack of competition and international openness. As tariffs decline and competition increases, particularly in distribution, the rent part of profit will decrease and CIT will become more harmful by affecting the part related to entrepreneurial quality. The shift towards property tax will then allows capturing a part of the land rent. More than half of the land (56%) belongs to communities (New Caledonia, municipalities, provinces) and 27% are customary lands (mainly in the Loyalty Islands province). The proposal only applies to private land (16%) and de facto mainly in urban or constructible areas where prices significantly increased over the last decade. We propose to

[13] The rate is 35% for the mining or metallurgical sector.

[14] Several empirical studies show the importance of geographical factors (size and centrality) for the attraction of foreign direct investment. The geographic economy confirms that a central country can impose higher CIT rates than a peripheral one. See for instance, Andersson F. and R. Forslid (2003): "Tax Competition and Economic Geography", *Journal of Public Economic Theory*, no 5, pp. 279-304.

amplify the already initiated movement: the share of the property tax in the tax revenues of New Caledonia rose from 0.86 to 1.41% from 2007 to 2014.

The gradual replacement of customs duties by an indirect taxation on value added, not directly protectionist, is very positive (see above). In the medium term, consideration should be given to moving beyond, focusing on the convergence of the different tax rates.

**Recommendation 3.** Pursue the tax reform by gradually unifying the general tax rates for consumption. Consider a reduction in the standard CIT offset by higher property taxes, especially in urban areas.

## Investing in education and training

Labor productivity did not increase between 1995 and 2010. In addition to the low competitive pressure, education lags could have played an important role. The proportion of higher education graduates has increased for younger generations, but it remains by 16 percentage points (pp) lower than the OECD average and by 13 pp lower than in New Zealand. The gap with the latter tends to increase (Table 1). In addition, there are large disparities between the three provinces, due in part to the unequal distribution of educational facilities. Unemployment rates speak for themselves: 11% in the South Province, 24% in the North and 34% in the Islands (ISEE).[15]

**1. Share of graduates of tertiary education**
% of age group

| | 25-34 years | 55-64 years |
|---|---|---|
| OCDE Average | 42.1 | 26.0 |
| Australia | 48.5 | 33.9 |
| New Zealand | 39.1 | 27.5 |
| New Caledonia | 26.3 | 17.3 |

*Sources*: RP 2014 ISEE and OECD 2015.

Improving the level of education is an imperative to ensure a proper match between skills and jobs. Nearly two out of five jobs in the industry require a bachelor's degree or higher. Nearly half of the jobs in the commercial tertiary sector (including trade) are filled by graduates of higher education and this proportion rises to 65% in non-market services (public administration, education, health, etc.). Only the sectors of agriculture, construction and personal services still offer large outlets for those without a diploma or only with a high school certificate.

In addition to investing in education infrastructure and quality of teachers, improving the qualification of the workforce also requires better adaptation of training systems to business needs. Apprenticeship, in particular, today affects less than 2% of people aged 16-25 years. A special effort could be made in research and training in certain occupations, such as those related to land and marine biodiversity that should offer interesting opportunities in New Caledonia. Strengthening public efforts in higher education is however not enough. The young Caledonians must first be brought up to this level of education. While great progress has been made in terms of illiteracy (Table 2), the rate of people aged 16-24 years in big trouble to read or write in 2013 is twice as high as in mainland France. The rate of individuals with calculation difficulties is even higher and seems to have increased for the younger generations.

**2. Illiteracy and numeracy difficulties in New Caledonia**, in %

| | Reading and writing | | Calculation |
|---|---|---|---|
| | New Caledonia | Mainland France | |
| 16-24 years | 8 | 4 | 37 |
| 25-34 years | 16 | 5,5 | 37 |
| 35-44 years | 16 | 7,5 | 33 |
| 45-54 years | 24 | 7,5 | 40 |
| 55-64 years | 41 | 12 | 47 |

*Reading*: Share of people with serious or severe difficulties (in %), 2013.

*Sources*: ISEE, *Enquête Information et vie quotidienne (IVQ) 2013* and INSEE, *Enquête IVQ* 2011.

The aim is therefore to improve the quantity and quality of pedagogical support, especially in less-favored areas. In a context of gradual attrition of the indexation of civil servants' salaries (see above), it may be wise to retain a form of indexation for teachers working in the areas requiring the largest share of educational efforts.

In order to increase access to higher education, the strengthening and development of positive discrimination schemes (such as *Cadres d'avenir*, excellency boarding schools and tutors, continuing education support schemes, etc.) would reduce the impact of socio-economic and cultural factors on individual paths. The development of know-how and, in particular through apprenticeships, must also be supported.

In order to strengthen skills in training and mentoring, New Caledonia could draw inspiration from the French system for welcoming foreign talent (the "*passport talent*"), which offers a long-stay visa, for example to entrepreneurs, whereas existing schemes are only open to those who have a job contract.

[15] The unemployed, as defined in the census, are persons (aged 15 or older) who have explicitly stated that they are seeking employment, whether or not they are registered with an employment search organization.

External net migration is low in New Caledonia. At the 2014 census, 18,574 non-natives lived in New Caledonia while they were not present on the territory in 2009, or nearly 7% of the population. However, the ISEE estimates that about one-third of arrivals are offset by non-native departures, not including the negative migration balance of natives. We do not advocate a general migration openness that could jeopardize some sensitive demographic balances but a targeted immigration policy according to future needs of rare skills that could not be filled by the human resources of the Archipelago.

**Recommendation 4.** Strengthen the provision of higher education and technical education in the island, while facilitating the entry of skills of external trainers. At the primary and secondary levels, increase financial incentives for teachers in disadvantaged areas.

Is this training effort to be financed by taxation or debt? Despite a marked increase since 2009, public debt remains low: at 8% of GDP in 2014 (excluding off-balance sheet commitments). Like mainland local juridictions, New Caledonia has to balance the operating section of its budget, and benefits from large transfer payments (see above). Financing a specific investment policy in human capital by public debt would mean changing the budgetary framework. Beyond the legal difficulties associated with the necessary modification of the statutory organic law, a strategy consisting in partly financing the training effort through debt, combined with a policy of activating competition, could prove to be sustainable insofar as it would enhance potential growth, thus the ability to repay in the future. However, this strategy can only be envisaged in addition to maintaining transfer payments from mainland France, which can be reoriented as indicated above.

## Socio-economic inequities

The Neo-Caledonian society is shaped by strong inequalities, whether social, geographical or ethnic. Unfortunately, the latest data available on this subject dates back to 2008.[16] Therefore, it is very complicated to pilot policies to combat poverty and redistribute wealth if the New Caledonian Congress does not have access to more recent data on the issue.[17]

**Recommendation 5.** Establish a system for collecting income data (survey or exploitation of administrative data) in order to construct annual and spatial series of income inequalities.

The 2008 statistics reveal a high level of inequality: in 2008, the lowest 10% had a standard of living 7.9 times lower than the wealthiest 10%; the Gini coefficient of disposable income was 0.42; the poverty rate 17%.[18] These indicators are much higher than for mainland France or Australia (Table 3). Since 1991, the average standard of living has increased considerably but the poverty rate has not declined while inequality has increased.

### 3. Inequalities and poverty in New Caledonia

| | Inter-deciles ratio (D9/D1) | Poverty rate[a] (in %) | Gini Coefficient |
|---|---|---|---|
| Loyauté Islands | 9.3 | 52 | 0.52 |
| Northern Province | 7 | 35 | 0.46 |
| Southern Province | 6.4 | 9 | 0.38 |
| New Caledonia | 7.9 | 17 | 0.42 |
| France | 3.6 | 8 | 0.29 |
| Australia | | | 0.34 |
| Fidji | | 35 | 0.43 |

*Note* : [a] Poverty line at 50% of the median standard of living, i.e. 72 000 CFP Francs (603 Euros) per month per unit of consumption..

*Sources*: Enquête BCM 2008 ISEE for New Caledonia, OECD and World Bank.

Moreover, territorial differences are strong: the poverty rate reaches 52% in the Loyauté Islands, against 9% in the South province. Nevertheless, poverty has increased most in urban areas (particularly Greater Noumea) since 1991. Labor market characteristics, with large geographical and ethnic disparities, are the main explanatory factor for differences in income and poverty levels. By 2014, the employment rate was 65% in the Southern Province, 52% in the Northern Province and 40% in the Loyauté Islands. In New Caledonia, this rate is 70% among non-Kanak and 49% among Kanak. This is linked to access to and level of diploma: 21% of the population is without a diploma in the southern province, compared with

[16] The Household Consumption Budget (BCM) survey, carried out by the ISEE in 2008, was conducted among 3,700 households representative of all households in the Loyauté Islands, North and South Provinces, covering all housing zones (rural, tribal, or urban). The collection took place over a year between April 2007 and March 2008. The previous survey of the same type took place in 1991.

[17] Article 146 of the *Loi égalité réelle des outre-mer* (loi no 2017-256) makes provisions for the improvement of statistics and data collection in New Caledonia.

[18] The poverty rate is calculated according to the local poverty line (50% of the median standard of living), the only data available for New Caledonia.

40% in the North and the Islands; 28% of non-Kanak are graduates of higher education, compared to 5% of Kanak.[19]

Inequalities are also high among employed people. In 2010, one in five jobs was paid less than two-thirds of the median wage (equivalent to 136,000 CFP Francs net in 2010), with a much higher frequency in agriculture and domestic employment, hotel and catering industries where part-time jobs are widespread.[20] By way of comparison, the guaranteed minimum wage (SMG) was 7.54 Euros in gross hour terms in 2015 (about 78.5% of the mainland SMIC).[21] These low wages are to be compared with the very high prices in New Caledonia (see above). With a minimum wage equal to 78.5% of the French level and 34% higher prices, the purchasing power (before transfers) of employees at the minimum wage is around 59% of the metropolitan level (50% for Agricultural workers).

Finally, inequalities are linked to networks of sociability and the remoteness of certain populations from the employment areas, given the difficulties of transport.

It is essential both to tackle inequalities in opportunities (by pursuing the policy of geographical and ethnic rebalancing implemented since 1988) and to correct existing inequalities through redistributive policies, in particular through taxation.

New Caledonia does not possess an actual Social Security net: the unemployment benefit is minimalistic and there is no social minimum comparable with the *revenu de solidarité active*. The minimum-old-age pension, created in 2012, supplements the income of seniors by a gross amount of 88,034 gross CFP Francs per month (737 Euros) for a single person. Taxation itself is generally poorly redistributive. The ratio between indirect (generally regressive) and direct (potentially progressive) taxes, excluding social contributions, is 1.5 in New Caledonia (see Graph 4), compared with 1.17 in France (see Eurostat). Direct taxes are often inequitable: new nickel factories are exempt from CIT, while personal income taxes (PIT) contain large niches.[22] Income from securities is taxed separately at 18%.

The 2016 tax reform does not fundamentally change the structure of tax revenues since the income tax revenue should be kept constant. This reform is officially intended to alleviate the middle class tax burden (deciles 4 to 8 of the income distribution). In New Caledonia, this corresponds to the households whose reported income is between 150,000 and 500,000 CFP Francs per month (1,257 and 4,190 Euros). Some of the better-off households will see their taxation increase owing to the ceiling of the family quotient. However, the reform introduces new tax niches with the extension of deductible expenses, such as the salaries of home helpers, housekeepers, childcare expenses, and isolation and security expenses for housing.

On the contrary, the introduction of a more progressive combined tax-transfer system would require an extension of the tax base in order to finance social minima. As in mainland France, every tax niche should be subjected to a cost-effectiveness analysis based on an independent evaluation. Tax niches whose economic and social efficiency is not demonstrated should disappear and the remaining ones be capped. Property income would be reintroduced into the tax base, while the rate applied to income from movable capital could be increased.

**Recommendation 6.** Expand the income tax base to finance social transfers such as negative taxes or income supplements on low wages.

## Conclusion

New Caledonia benefits from a rich subsoil and the support of a large developed economy that have enabled it to achieve a high level of development. It is now a matter of transforming these transitional assets into long-term growth factors in a long-term vision preparing for the post-nickel era, in particular by setting up a sovereign wealth fund. The comparative advantages of New Caledonia (biodiversity, climate, sea economy, quality tourism) are not sufficiently valued. Increased technical and general skills supported by increased investment in human capital, changes in the tax system towards a better balance between efficiency and redistribution and the activation of competition policies would make it possible to put in place a genuine strategy favoring exports.

These new directions could be encouraged by the maintenance of mainland France transfer payments, which could be progressively reallocated without forbidding the use of debt to finance the upgrading of skills.

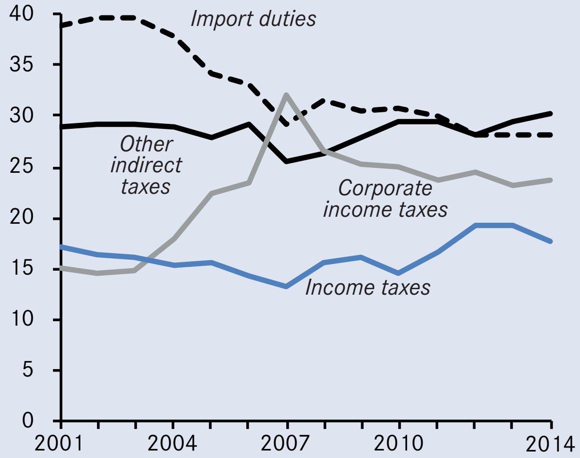
[19] Ris C. (2014): "Les inégalités ethniques dans l'accès à l'emploi en Nouvelle-Calédonie", *Économie et Statistique*, no 464-465-466.

[20] Frappier J. (2013): "Les salaires entre 2007 et 2010", *Synthèse ISEE*, no 26, July.

[21] It should be noted that employees in the Caledonian agricultural sector are covered by the SMAG (guaranteed minimum agricultural wage), which corresponds legally to 85% of the SMG.

[22] In particular, the exemption from land income is 100%, for 10 years, when the buildings are new and located in municipalities other than Noumea, Dumbea and Mont-Dore, and 50% in these latter cases, *cf*. Lieb J-P. (2012): *Propositions de réformes de la fiscalité directe de Nouvelle-Calédonie*, Rapport d'inspection, June.

**4. Breakdown of tax levies between types of taxes**
as % of tax revenue excluding social contributions




*Source*: ISEE, comptes du secteur public de Nouvelle-Calédonie.

***In memory of Edgard Pisani and Michel Rocard***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