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STUDY OF HARMONIZATION OF INDUSTRIAL INCENTIVES
IN THE SOUTH PACIFIC REGION

Terminal report*

Prepared for the South Pacific Bureau
for Economic Co-operation
by the United Nations Industrial Development Organization,
acting as executing agency for the United Nations Development Programme

Based on the work of William Dennis Rose,
senior economic adviser

United Nations Industrial Development Organization
Vienna

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## CONTENTS

### Chapter One - Introduction

### Chapter Two - The Present System of Incentives

<table>
<thead>
<tr>
<th>Topic</th>
<th>Paras</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td>2.1 - 2.2</td>
</tr>
<tr>
<td>Income tax - companies</td>
<td>2.3 - 2.6</td>
</tr>
<tr>
<td>Tax holidays</td>
<td>2.7 - 2.10</td>
</tr>
<tr>
<td>Accelerated depreciation and investment allowances</td>
<td>2.11 - 2.12</td>
</tr>
<tr>
<td>Accelerated depreciation</td>
<td>2.13 - 2.21</td>
</tr>
<tr>
<td>Investment allowances</td>
<td>2.22 - 2.25</td>
</tr>
<tr>
<td>Export incentives</td>
<td>2.26 - 2.27</td>
</tr>
<tr>
<td>Other company tax concessions</td>
<td>2.28</td>
</tr>
<tr>
<td>Carry forward of losses</td>
<td>2.29 - 2.31</td>
</tr>
<tr>
<td>Training and recruitment</td>
<td>2.32 - 2.35</td>
</tr>
<tr>
<td>Other income tax matters</td>
<td>2.36</td>
</tr>
<tr>
<td>Tax on interest and dividends</td>
<td>2.37 - 2.43</td>
</tr>
<tr>
<td>Tax on individual incomes</td>
<td>2.44 - 2.45</td>
</tr>
<tr>
<td>Double taxation</td>
<td>2.46 - 2.55</td>
</tr>
<tr>
<td>Customs duty, exchange control and protection</td>
<td>2.56</td>
</tr>
<tr>
<td>The tariff</td>
<td>2.57 - 2.60</td>
</tr>
<tr>
<td>Relief from customs duty</td>
<td>2.61 - 2.68</td>
</tr>
<tr>
<td>Exchange control</td>
<td>2.69 - 2.74</td>
</tr>
<tr>
<td>Quantitative restrictions - imports</td>
<td>2.75 - 2.79</td>
</tr>
<tr>
<td>Restrictions on competing local production</td>
<td>2.80 - 2.84</td>
</tr>
<tr>
<td>Other forms of assistance</td>
<td>2.85</td>
</tr>
<tr>
<td>Industrial estates</td>
<td>2.86 - 2.92</td>
</tr>
<tr>
<td>Special financial assistance</td>
<td>2.93 - 2.94</td>
</tr>
<tr>
<td>Improving the pre-conditions for investment</td>
<td>2.95 - 2.96</td>
</tr>
<tr>
<td>Grant assistance</td>
<td>2.97 - 2.100</td>
</tr>
<tr>
<td>Loan assistance</td>
<td>2.101 - 2.103</td>
</tr>
<tr>
<td>Investment incentives offered by New Zealand and Australia</td>
<td>2.104</td>
</tr>
<tr>
<td>New Zealand Pacific Islands Industrial Development Scheme</td>
<td>2.105 - 2.108</td>
</tr>
<tr>
<td>The Australian Joint Venture Scheme</td>
<td>2.109 - 2.112</td>
</tr>
</tbody>
</table>

### Chapter Three - The Place of Manufacturing in the Regional Economy

<table>
<thead>
<tr>
<th>Topic</th>
<th>Paras</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td>3.1 - 3.3</td>
</tr>
<tr>
<td>The range of products</td>
<td>3.4 - 3.7</td>
</tr>
<tr>
<td>Market orientation</td>
<td>3.8 - 3.10</td>
</tr>
<tr>
<td>Manufacture for the local market</td>
<td>3.11 - 3.13</td>
</tr>
<tr>
<td>Export processing of natural resources</td>
<td>3.14 - 3.19</td>
</tr>
<tr>
<td>Export production on the basis of imported materials</td>
<td>3.20 - 3.25</td>
</tr>
</tbody>
</table>
An approach to a common policy
Encouraging island enterprise
Determining regional policies towards resource related industries
Determining guidelines on the use of incentives
An outline of common core
Appendix I: Incentive Action

Appendices: The System of Incentives

Page Numbers

Papua New Guinea 128 - 137
Fiji 138 - 149
Solomon Islands 150 - 158
Western Samoa 159 - 166
Vanuatu 167 - 168
Tonga 169 - 175
Federated States of Micronesia 176 - 178
Kiribati 179 - 183
Cook Islands 184 - 190
Tuvalu 191
Niue 192 - 196
INTRODUCTION AND SUMMARY

1.1 The independent island nations of the South Pacific offer a variety of tax incentives to encourage investment in manufacture. Some of these incentives are longstanding. Others have only recently been enacted. Still others have been phased out.

1.2 There is considerable discussion within the region on the effectiveness of incentives. Some countries query the utility of concessions such as tax holidays whilst others see them as occupying a central place. In part such differences reflect differing views about development strategy, including particularly the place of manufacturing. The differing assessments also reflect in part the varying circumstances in which the countries of the region find themselves. Some of the better endowed countries can contemplate a wide range of development options. Others have the narrowest of resource bases.

1.3 There have also been fears that, in the absence of any co-ordinated policy, the countries of the region could find themselves competitively offering incentives in an attempt to attract foreign investment, and by an unwise use of incentives encourage an uneconomic duplication of productive facilities. In the light of this concern the countries of the region have raised the possibility of harmonizing their national incentives.

1.4 In October 1980 I was commissioned by the South Pacific Bureau for Economic Co-operation and the United Nations Industrial Development Organization to:

(i) assess the effectiveness of existing industrial incentive schemes operated by developing island countries of the South Pacific, taking fully into account fiscal incentives and giving due consideration to differences in size and level of economic development among the respective countries in the region; and
make recommendations on such ways and means to improve
the effectiveness of such schemes, and to harmonize
incentive policies of Pacific Island Developing
Countries.

1.5 My report addresses these issues through five chapters.

1.6 Chapter Two summarizes the systems of incentives operated
by eleven Pacific Island countries - Papua New Guinea, Fiji, the
Solomon Islands, Western Samoa, Tonga, the Federated States of
Micronesia, Kiribati, the Cook Islands, Tuvalu and Niue. The chapter
describes the various forms of company tax concessions, including tax
holidays, accelerated depreciation, investment allowances and export
incentives. There is a brief description of taxes on interest and
dividends; taxes on individual incomes; and provisions for the
avoidance of double taxation. Tariff and protective policies are
described and, finally, there is discussion of the use of industrial
estates and the provision of special financial assistance. More
detailed descriptions of these incentives on a country by country
basis appear in appendices to this report.

1.7 Chapter Three describes the place of manufacturing in the South
Pacific regional economy. The manufacturing sector is relatively
small, accounting for only a few per cent of total employment and
providing about 37,000 jobs in the late 1970s. Within the sector
employment is concentrated in the manufacture of food and beverages,
wood and wood products and fabricated metals. By far the greater
part of manufacturing output is directed to local markets but about
one in five jobs in the sector is provided by factories processing
natural products for export. In addition there is a small but growing
export sector manufacturing on the basis of imported materials.

1.8 Chapter Four discusses manufacturing development objectives.
This is preluded by a brief review of some key economic characteristics.
The main part of the chapter is a summary of the place accorded to
manufacturing in national development plans and related documents. On
the basis of this analysis it is suggested that three major patterns are evident. Four of the largest countries - Papua New Guinea, Fiji, the Solomon Islands and Vanuatu - have reasonably balanced external accounts, relatively low population densities, and see an adequate range of agricultural and natural resource development options. They currently place little emphasis on manufacturing development, although Fiji has, and still does, emphasize the importance of such development. Two middle order countries - Western Samoa and Tonga - have severe trade deficits, higher population densities, and more limited agricultural and natural resource development options. They are, as a consequence, actively promoting manufacturing as a means of increasing production and employment. The remaining five countries - the Federated States of Micronesia, Kiribati, the Cook Islands, Tuvalu and Niue - are small and fragmented. Agricultural development opportunities are frequently limited. So are the possibilities of economic manufacture, although as the experience of the Cook Islands has shown, such development can be important. All countries are interested in developing commercial activity.

1.9 Chapter Five discusses the place of incentives in encouraging the desired patterns of development. A hypothetical investment is used as the basis for a comparative analysis of the likely impact of the main types of investment incentives upon the rates of return secured from the investment. Although the need to make precise numerical assumptions limits the generality of the results it seems probable that the more important company tax incentives offered in the region would typically add two or three percentage points to project rates of return. It is concluded, in line with much international thinking, that such a change is not likely to exert a very significant influence on investment decisions by foreign firms. This conclusion is also consistent with regional experience. The incentives do however seem likely to be of more significance in encouraging locally based enterprises. Some suggestions are made on tailoring incentives to make them more effective;

- it is important to specify objectives and to make use only of incentives which are likely to contribute directly to these;

- it is desirable to generalize incentives so that they are automatically available to all those in the target area;
Where decisions must be made on a case by case basis there is a need to combine full consideration with speedy decision.

Finally, Chapter Five places tax incentives in the wider perspective of protective and exchange rate policies and concludes that these are generally more powerful and pervasive, and that greater benefits would flow in some countries from better use of these major policy instruments than from fine tuning of incentives.

1.10 Chapter Six examines possible approaches to harmonization of incentives. The countries of the region face many common problems in promoting economic development and there are many similarities in incentive policies. I conclude that there would be advantage in ongoing regional discussion of economic and manufacturing development objectives and related incentives policies with a view to defining a possible common approach to certain problems. At the same time I conclude that differences in size, resource endowment, stages of development, tax systems and other factors mean that it would be inappropriate to adopt a fully detailed legally binding common system of incentives. Separate approaches are suggested for:

(a) encouraging the growth of island enterprises;
(b) determining regional policies towards resource related industries; and
(c) determining guidelines on the use of incentives in the manufacturing sector - this includes a possible draft common code relating to tax holidays, accelerated depreciation, investment allowances, export incentives and relief from customs duties.

It is suggested that these proposals should be discussed within the region and an appropriate programme of action is proposed.
Chapter Two

THE PRESENT SYSTEMS OF INCENTIVES

INTRODUCTION

2.1 Most South Pacific island economies have long standing incentive systems designed to encourage industrial development. These systems commonly include provision for a full or partial reduction in income tax liability for a number of years and for full or partial remission of customs duties on imports of capital equipment and, less frequently, raw materials. The concessions may be embodied in special incentive acts, in separate sections of national taxing acts, or may depend upon ministerial exercise of general powers conferred under such acts.

2.2 It is difficult to summarise the frequently complex provisions of the incentive laws of eleven nations of varying size and differing legal and fiscal systems. The plan adopted here is a regional summary by type of policy instrument. Each of the following instruments is analysed in turn:

Income Tax:
Companies:

Tax Holidays
Accelerated Depreciation
Investment Allowances
Export Incentives
Other Company Tax Concessions

Other Income Tax Matters
Tax on Interest and Dividends
Tax on Individual Incomes
Double Taxation
Customs Duty, Exchange Control and Protection:

The Tariff
Relief from Customs Duty
Exchange Controls
Quantitative Control of Imports
Restrictions on Competing Local Production

Other Forms of Assistance:

Industrial Estates
Special Financial Assistance

The emphasis in this summary is on regional patterns and variations. This inevitably leads to some loss of focus at country level. To overcome this, detailed country summaries are presented in an appendix. Table 2.1 provides an overview of the incentives offered. In this chapter values are usually expressed in the currency of the country concerned.

INCOME TAX - COMPANIES

2.3 Incorporated companies, whether privately or publicly owned are amongst the main actors in industrial development, and an ability to achieve profitability is a touchstone of their continued viability. Many developing countries offer income tax incentives designed to assist manufacturing companies achieve early profitability or to enhance their post-tax rate of return. The Pacific island economies are no exception, and have developed a variety of such incentives.

2.4 Income tax incentives need to be viewed in the light of the prevailing rates of company tax. Obviously if other considerations are equal then a country which levies a lower rate of income tax could be viewed as offering an incentive. There are, as is clear from Table 2.2, wide variations between Pacific island countries in rates of tax imposed on resident companies.
Table 2.1 INCENTIVES AND RELATED DATA - SPEC MEMBER COUNTRIES

<table>
<thead>
<tr>
<th>Maximum Income Tax Holidays</th>
<th>Accelerated Investment</th>
<th>Export Incentive</th>
<th>Effective Customs Concessions</th>
</tr>
</thead>
<tbody>
<tr>
<td>rate of company income tax</td>
<td>depreciation (manufacturing sector)</td>
<td>Investment allowance</td>
<td>Effective on income above currency</td>
</tr>
<tr>
<td>Initial concession possible</td>
<td>20% in first year</td>
<td>no</td>
<td>yes</td>
</tr>
<tr>
<td>period extension</td>
<td>10% machinery</td>
<td>30% buildings</td>
<td>30% building</td>
</tr>
<tr>
<td>years</td>
<td>of 5 years</td>
<td>no</td>
<td>no</td>
</tr>
<tr>
<td>national companies only, ceiling of K50,000 annual income</td>
<td>20% in any 5 years</td>
<td>no</td>
<td>no</td>
</tr>
<tr>
<td>national companies only, ceiling of $25,000</td>
<td>no</td>
<td>no</td>
<td>no</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>no</td>
<td>no</td>
<td>no</td>
</tr>
<tr>
<td>Western Samoa</td>
<td>no</td>
<td>no</td>
<td>no</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>nil</td>
<td>n.a</td>
<td>n.a</td>
</tr>
<tr>
<td>Tonga</td>
<td>nil</td>
<td>n.a</td>
<td>n.a</td>
</tr>
<tr>
<td>Tuvalu</td>
<td>nil</td>
<td>n.a</td>
<td>n.a</td>
</tr>
<tr>
<td>Kiribati</td>
<td>high normal rate</td>
<td>no</td>
<td>no</td>
</tr>
<tr>
<td>Cook Islands</td>
<td>write-off at will</td>
<td>100%</td>
<td>45</td>
</tr>
<tr>
<td>Niue</td>
<td>high normal rates</td>
<td>no</td>
<td>no</td>
</tr>
<tr>
<td>Niue</td>
<td>high normal rates</td>
<td>no</td>
<td>no</td>
</tr>
</tbody>
</table>

Note: All comments in the above table are necessarily highly abbreviated. For fuller details refer to main text and country appendices.
The island rates are without exception lower than those imposed on resident companies by Australia and New Zealand (42% per cent and 45 per cent respectively). Western Samoa, Tonga, Papua New Guinea, the Solomon Islands and Fiji impose rates of from 42 to 35 per cent. Rates in Niue, Kiribati, and Tuvalu range from 30 to 25 per cent, whilst Vanuatu and the Federated States of Micronesia do not impose income taxes.

Table 2.2  RATE OF INCOME TAX - RESIDENT COMPANIES

<table>
<thead>
<tr>
<th>Maximum Rate</th>
<th>Per Cent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Western Samoa</td>
<td>42</td>
</tr>
<tr>
<td>Tonga</td>
<td>37½</td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>36¾</td>
</tr>
<tr>
<td>Solomon Islands, Fiji</td>
<td>35</td>
</tr>
<tr>
<td>Niue</td>
<td>30</td>
</tr>
<tr>
<td>Kiribati, Tuvalu</td>
<td>25</td>
</tr>
<tr>
<td>Cook Islands</td>
<td>20</td>
</tr>
<tr>
<td>Vanuatu, Federated States of Micronesia</td>
<td>nil</td>
</tr>
</tbody>
</table>

Note: In Tonga the normal rate of income tax is 25 per cent. The 37½ per cent rate quoted applies only to that part of income in excess of $100,000.

2.5 The Cook Islands and the Federated States of Micronesia both impose taxes on business turnover. In the Cook Islands, Turnover Tax is levied at the rate of 4 per cent on gross income from manufacturing, except that export sales are taxable at 1 per cent. The Federated States of Micronesia levy tax on business gross revenues at the rate of $80 plus 3 per cent of gross revenue over $10,000. The relationship of such taxes to profits earned will of course depend upon a firm's rate of profit to turnover. For example, for a firm whose rate of profit to turnover equalled the average achieved by Fijian manufacturers in 1977 (i.e. 12.4 per cent) a straight 3 per cent tax on turnover would equate to the yield of a 24 per cent tax on profits.
2.6 The tax rates quoted in Table 2.2 apply to resident companies. The test of residence is usually local incorporation and such companies may be locally or overseas owned. Many countries in the region impose higher rates of tax on the profits of non-resident companies.

**Tax Holidays**

2.7 A temporary exemption of manufacturing profits from income tax is offered in some circumstances by every island member country of the Pacific Forum. Such concessions are usually offered for periods of up to five years, are sometimes limited as to value, and usually depend upon administrative approval. Broadly, three main patterns of practice are evident. Papua New Guinea and the Solomon Islands have focused their incentives on nationally owned companies meeting set criteria and have fixed upper limits to these concessions. In other countries concessions are offered to both national and foreign companies. Fiji offers incentives having fixed upper limits, whilst the remaining countries - Kiribati, Tuvalu and the Polynesian states - give full exemption of profits earned during the concession period.

2.8 Papua New Guinean tax law provides wholly nationally owned companies with an automatic exemption from income tax on the first K 50,000 of income in each year of income until December 1984. No concessions have been offered to non-national companies since 1970 when it was announced that the Pioneer Industries Act, which offered five year tax holidays to approved firms, was being phased out. The Solomon Islands gives a special concession to companies at least 60 per cent owned by Solomon Islanders. Entitlement is not automatic, although approval is normally given provided certain basic requirements are met, and operates for up to five years to a limit of $25,000. Under the Solomon Islands
Pioneer Industries Act, which is now rarely applied, profits may be exempted from tax for up to five years or until a specified profit is earned.

2.10 High income tax concession to approved enterprises for up to five years with the possibility of an extension. The eligible income is limited to an annual amount of $8,000 or a percentage of capital - whichever is greater. Special concessions may be granted to mining companies and approved companies newly engaged in certain agricultural activities.

2.10 The other countries, Kiribati, Tuvalu, Tonga, Western Samoa, Niue and the Cook Islands, all give tax holidays of up to five years to approved enterprises. In Kiribati and Tuvalu the concession, when given, applies automatically for five years. The other countries exercise discretion as to the length of holiday and have provisions enabling extension for a further five years in exceptional circumstances. Tonga, Western Samoa and the Cook Islands also have additional tax holiday provisions which may be invoked in special circumstances. Tonga has provision for a 25-year holiday in respect of investments of $3 million or more. Western Samoa offers a maximum tax rate of 15 per cent to firms establishing in an Industrial Free Zone. Neither of these provisions has been invoked. The Cook Islands has recently given the Minister of Finance power to declare a special tax rate of 5 per cent (implicitly without time limit) for companies contributing significantly to economic development.

**Accelerated Depreciation and Investment Allowances**

2.11 Income tax laws invariably allow for the capital cost of buildings and machines to be spread as an allowable depreciation charge against income earned during the productive life of the asset. To protect taxation revenues, income tax laws
prescribe maximum allowable rates of depreciation for the various types of asset.

2.12 It is common for countries to increase the allowable rate of depreciation so as to encourage firms to undertake investment in particular activities. This may be done by allowing a firm to accelerate the rate at which depreciation is claimed whilst holding constant the total amount that can be claimed over the life of the asset. In such cases the early gain has to be balanced against the prospect of lower claims in future. Alternatively, firms may be allowed to claim reductions in addition to normal depreciation. Such additional deductions are usually known as investment allowances.

Accelerated Depreciation

2.13 The countries of the region follow a wide variety of practice in respect of accelerated depreciation.

2.14 Four countries do not offer any concession in this area. The issue does not arise in Vanuatu and the Federated States of Micronesia because they have no income tax. Niue and Western Samoa do not offer the option of accelerated depreciation although powers to vary rates for the purpose of economic development are inherent in their income tax acts. In the case of Western Samoa the Enterprises Incentives Act requires concession firms to depreciate assets in accordance with normal rules and at the end of the tax holiday period the written down value of the assets is counted as the commencing value for computing future depreciation. This means in effect that Samoan law requires firms to forego normal depreciation entitlements during the period of their concession.
2.15 In discussing the concessions offered by the other Forum member countries, it is convenient to discuss the strongest acting first. Given the wide variation in practice, the ranking is inevitably approximate.

2.16 The strongest concession is offered by the Cook Islands, which permits accelerated depreciation at will for primary industry projects with capital expenditures of less than £20,000 and for projects in other sectors provided their capital expenditure is greater than £50,000. There is no requirement that assets should be depreciated during the period of their tax holiday so that eligible concession firms retain their full depreciation entitlement and are able to claim this at the most advantageous time.

2.17 Kiribati and Tuvalu do not offer any special depreciation provisions for pioneer companies but the normal rates prescribed in their Income Tax Ordinances are so generous as to be concessional. The allowable rates of depreciation for buildings are 25 per cent in the year of purchase and 10 per cent in subsequent years. For machinery and plant the rates are 50 per cent in the year of purchase and 25 per cent in subsequent years. By way of comparison normal rates of depreciation allowed by other countries in the region range from 1 to 5 per cent for buildings and 1 to 20 per cent for machinery and plant. Pioneer companies are not required to depreciate assets during their concession period.

2.18 In Fiji, all agricultural, commercial and industrial enterprises may claim an initial (accelerated depreciation) allowance of 30 per cent for machinery (excluding non-hire passenger vehicles), and 10 per cent for buildings. Agricultural
and pastoral development costs may be set off against income
in the year in which they are incurred or, at the option of the
taxpayer, in that and the succeeding four years. More generally,
approved enterprises and certain companies may claim one-fifth of
their acceptable capital spending during any five of the eight
years from expenditure. The time limit means that concession
firms which are also entitled to a tax holiday may not be able
to derive full benefit from this provision. However, the time
period of eight years and the fact that the income tax concession
is value-limited act to reduce this possibility. Special
provisions apply to hotel owners in receipt of a 7 per cent
subsidy on new hotel construction. The remaining cost of such
developments may be set off against income arising from that hotel,
or any other operated by the owner in Fiji, in any number of
years up to fifteen.

2.19 The Solomon Islands offers special depreciation provisions
for timber cutting and processing (a concessory rate of 35 per
cent), agriculture (full write-off of development costs in the
year of expenditure), and mining (write-off over five years). No
special provisions exist for manufacturing or pioneer industries.
Concession firms are not however required to depreciate their assets
during the concession period.

2.20 Papua New Guinea allows firms engaged in agriculture
manufacturing, transport and communication, building and construc-
tion and business services to claim 20 per cent of the cost of an
investment in the year of purchase, in addition to the amount
normally allowable in that year. There is a corresponding reduction
in the asset value carried forward for the purpose of calculating
the next year's entitlement.
2.21 Finally Tonga explicitly provides that firms enjoying concessions under the Industrial Development Incentives Act may subsequently depreciate their assets starting at their original value.

Investment Allowances

2.22 Only three of the countries in the region offer firms the possibility of claiming investment allowances additional to 100 per cent depreciation of their assets. The three countries are Fiji, Western Samoa and the Cook Islands.

2.23 In Fiji, hotel owners who have been granted a subsidy on construction, and the associated accelerated depreciation described earlier, may elect instead to claim an investment allowance of 55 per cent. Unused balances may be carried forward and after five years may be applied against income earned from other hotels. There is also a 40 per cent allowance for certain expenditures related to fuel economy.

2.24 Western Samoa's Enterprises Incentives Act does not provide for investment allowances but longstanding provisions of the Income Tax Act enable such concessions to be granted by the Commissioner of Inland Revenue, up to a limit of 20 per cent, and - beyond that - by the Minister.

2.25 As with accelerated depreciation, the Cook Islands offers the region's most generous investment allowances. Commercial projects in agriculture, livestock raising and fishing, having a capital value greater than $20,000, may claim an investment allowance of 55 per cent at will. Projects in other sectors with a capital value greater than $5,000 are entitled to a 100 per cent investment allowance to be claimed at the discretion of the firm.
Export Incentives

2.26 Papua New Guinea and Fiji are the only regional countries which provide tax concessions to encourage manufactured exports. Until recently the two schemes were practically identical and provided for lower rates of taxation on profits related to any increase in qualifying exports above the average level of the preceding three years. The 1982 Papua New Guinea Budget noted that the existing manufactured export incentive had only been used on a few occasions and suggested that a more generous concession was warranted. In future 100 per cent of the profits relating to the growth in sales of manufacturing exports will be exempt from tax. The incentive is available only in respect of specifically approved products. More than forty manufactured products have already been approved and any investor may request the Minister for Finance to add new products to the list.

2.27 Fiji introduced its new scheme in 1982. The incentive is no longer related to the increase in exports. Instead the new scheme provides for a rebate of from one-half to the full amount of tax chargeable on export profits. The extent of the rebate depends upon the extent of local value added in manufacture.

Other Company Tax Concessions

2.28 Income tax laws are used to promote many purposes and it is difficult to draw a line between those which relate to and those which lie outside the subject of this study. Two matters, the law relating to carry forward of losses, and incentives to training and recruitment, are however clearly relevant.
Carry Forward of Losses

2.29 National income tax laws usually make explicit provision for the carrying forward of business losses made in one year as an offset which may be claimed against income earned subsequently. It is usual to require that any such entitlement be made use of at the first opportunity. It is also usual to provide some rules to ensure that losses cannot be transferred between different business entities.

2.30 With the exception of Tonga, the income tax laws of the island members of SPEC provide for the carry forward of losses. The Solomon Islands, Kiribati, Western Samoa and the Cook Islands allow losses to be carried forward without limit. In Papua New Guinea, losses may be carried forward for seven years and in Niue and Fiji for six years. Both Papua New Guinea and Fiji provide that agricultural losses may be carried forward indefinitely. Concession firms in Fiji may carry accumulated losses forward for six years from the end of their concession period, and in Niue the income tax act does give power to authorise extended carry forward.

2.31 As noted, Tonga’s income tax act does not provide for the carry forward of losses, but the industrial development incentives act, approval under which is a pre-condition of carrying out business in Tonga, provides that losses incurred by approved enterprises may be carried forward without any time limit.

Training and Recruitment

2.32 Enhancement of the skills of the labour force is an important element in economic development and is a major objective of educational policy. The main focus of such
policies is of course remote from matters such as tax policy but two countries in the region have used their income tax laws to provide an incentive to on-the-job training.

2.33 Papua New Guinea permits employers to deduct from assessable income 200 per cent of the wages paid to apprentices registered with the Apprenticeship Board of Papua New Guinea. The purpose is to encourage employers to hire apprentices and thereby to build up the industrial and commercial skills of Papua New Guineans so that their contribution to the economy can increase over time.

2.34 The Cook Islands provides for somewhat similar incentives in its Development Investment Act. Employers are allowed a 200 per cent deduction of approved training costs incurred in training a local person to replace an expatriate. Also, employers are allowed a 120 per cent deduction of the expenses incurred in recruiting a local person ordinarily resident overseas.

2.35 Although not forming part of the income tax law, it is appropriate to mention a related Fijian incentive at this point. The Fiji National Training Council which is funded by a one per cent levy on employers' payrolls uses part of this revenue to make cash grants to employers for approved training given to their employees. The Council also assists employers in developing training schemes and programmes of their own.

OTHER INCOME TAX MATTERS

2.36 Beyond the question of taxation of income in the hands of companies, there are a number of income tax issues which relate directly to the problem of development. The objective of most industrial incentive laws is the encouragement of investment, both by local and foreign investors. As the ultimate interest
of the investor is likely to centre around his actual return from that investment, it is necessary to pay attention to the impact of the tax laws on transactions between companies and their shareholders. The main matters which arise are the imposition of withholding taxes on dividends and interest payments by companies, the treatment of such incomes in the hands of shareholders and the underlying rates of income tax payable by individuals. In addition there is a need to review the tax treaties which regulate the taxation of income paid from some Pacific Island countries to some overseas investors.

**Tax on Interest and Dividends**

2.37 Payments of interest and dividends are distinct from many other commercial transactions inasmuch as they amount to a transfer of income. The two payments differ in that the rate of interest is contractually pre-determined whilst the amount of a dividend depends upon the actual outcome of a trading period. Interest is a cost to be taken into account in determining the tax liability of the company whereas dividends are paid from tax-paid profits. They may nevertheless flow to the same person and national tax laws usually contain detailed provisions to protect tax revenue against manipulation of the boundary between interest and dividends.

2.38 These problems aside, both interest and dividends are normally assessable in the hands of recipients. They are also usually subject to a withholding tax at the time of payment. Such withholding taxes are usually final in the case of payments to non-residents who would otherwise lie beyond the fiscal reach of the taxing country. For residents, it is usual to allow the amount of the withholding tax as a credit in assessing liability for national income tax.
Table 2.3 summarises the rates of withholding tax imposed by island member countries of the Pacific Forum on dividends and interest:

<table>
<thead>
<tr>
<th></th>
<th>Interest paid to Non-Residents</th>
<th>Dividends paid to Non-Residents</th>
<th>Residents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Papua New Guinea</td>
<td>nil</td>
<td>15</td>
<td>15</td>
</tr>
<tr>
<td>Fiji</td>
<td>10</td>
<td>15</td>
<td>5</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>15</td>
<td>15</td>
<td>20</td>
</tr>
<tr>
<td>Western Samoa</td>
<td>15</td>
<td>15</td>
<td>5</td>
</tr>
<tr>
<td>Tonga</td>
<td>15</td>
<td>15</td>
<td>5</td>
</tr>
<tr>
<td>Cook Islands</td>
<td>15</td>
<td>15</td>
<td>5</td>
</tr>
</tbody>
</table>

As is evident from the table, there is some variation in practice between the six countries which impose withholding taxes. To the extent that there is a common practice, it is that payments of interest and dividends to non-residents are taxed at 15 per cent whilst those to residents are taxed at 5 per cent. There are three exceptions to this. In Papua New Guinea, interest payments generally attract no withholding tax whilst the rate of withholding tax on dividends is 15 per cent for payments to both residents and non-residents. In the Solomon Islands there is no withholding tax on interest payments to residents and the rate of withholding tax on dividends is unusually high, at 35 per cent on payments to non-residents and 20 per cent on payments to residents. These rates need to be viewed in the knowledge that the Solomon Islands treats dividends as a deductible expense in assessing company income, so that the withholding tax stands in substitution for the usual practice of applying taxes both to profits and distributions from profits. Finally, Fiji imposes a withholding tax of 10 per cent on interest payments to non-residents but no tax on such payments to residents.

Five countries are excluded from the table. Although none imposes withholding taxes, four do tax dividends and interest.
In the Federated States of Micronesia, interest receipts attract the 3 per cent tax on gross revenues. All dividends and interest derived from Kiribati and Tuvalu, including those paid abroad, are taxable at ordinary rates of income tax. In Niue, interest and dividends are assessable. Finally, Vanuatu does not tax interest or dividends.

2.42 The taxation of dividends arising from firms which have benefitted from a tax holiday can be seen as detracting from the incentive so provided. Five countries in the region have acted to offset this by providing that dividends paid during the concession period or in the following two years shall be exempt from withholding tax. Commonly this concession is subject to the proviso that the quantum of dividends shall not exceed the original value of the investment. The five countries are the Solomon Islands, Western Samoa, Tonga, Kiribati and Tuvalu.

2.43 Fiji operates a more generalised concession relating to the taxation of dividends. Recipients of dividends from Fijian incorporated companies pay tax on only a proportion of these, regardless of whether the company has been granted a concession. The taxable proportion of dividends varies according to the total income of the taxpayer. Persons whose total income is less than $3,000 are totally exempt from tax on dividends, whilst persons whose total income exceeds $5,400 pay tax on two-thirds of their dividend income. Between these two points there is a sliding scale of intermediate tax rates.

Tax on Individual Incomes

2.44 With the exception of Vanuatu, all the SPEC island member countries tax individual incomes. A number of countries
do however exempt the incomes of some primary producers from taxation. Rates of tax are invariably struck on a sliding scale from a bottom rate of about 5 or 10 per cent and a maximum rate of from 40 to 50 per cent. The only major exception is the Federated States of Micronesia, where the scale has only two steps and the maximum rate is 10 per cent. This point aside, the main variation between countries occurs in the amount of income which is exempt from taxation and, more importantly, the income level at which the minimum and maximum rates apply. Intermediate points between these limits are usually fairly evenly graded. Current minimum and maximum tax rates are summarised in Table 2.4.

Table 2.4 INCOME TAX RATES FOR INDIVIDUALS
(Expressed in National Currencies*)

<table>
<thead>
<tr>
<th>Minimum Rate</th>
<th>Maximum Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount of Income Taxable at This Per Cen</td>
</tr>
<tr>
<td></td>
<td>Rate Per Cen</td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>4</td>
</tr>
<tr>
<td>Fiji</td>
<td>5</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>15</td>
</tr>
<tr>
<td>Cook Islands</td>
<td>5</td>
</tr>
<tr>
<td>Federated States of Micronesia</td>
<td>6</td>
</tr>
<tr>
<td>Western Samoa</td>
<td>5</td>
</tr>
<tr>
<td>Tonga</td>
<td>5</td>
</tr>
<tr>
<td>Niue</td>
<td>10</td>
</tr>
<tr>
<td>Kiribati, Tuvalu</td>
<td>9</td>
</tr>
</tbody>
</table>

* Regional currencies are reasonably comparable and lie within 25 per cent either way of the Australian dollar. Papua New Guinea has the most favourable and the FSM, Niue and the Cooks the least favourable rates.
2.45 It will be seen from the last column of Table 2.4 that there is a very wide variation in the points at which the maximum tax rate becomes applicable. For Western Samoa, Tonga, Niue, Kiribati, and Tuvalu, maximum rates apply to incomes from points drawn variously at $10,000 or less. In Papua New Guinea, the maximum rate is only reached at K 30,000 (i.e. $A 40,000 approx). Although there is no explicit link between individual tax scales and the various incentive schemes operated by developing countries it is to be expected that tax scales do exert some influence upon entrepreneurial and managerial thinking. This must particularly be the case for foreign enterprises locating expatriate personnel and some countries make something of a selling point of their individual tax scales. Given the wide divergence between the level of some expatriate salaries and the basic income levels prevailing within most island economies, and the wide ramifications of such distortions, it is clear that policy formation in this area presents some major problems.

**Double Taxation**

2.46 Profits earned by a foreign-owned company and then remitted to its parent company, in another country, may be liable to taxation in both countries. It is generally accepted that such double taxation is both inequitable and a disincentive to investment. Most countries have taken steps to avoid this. There are two main approaches, which may be put into effect unilaterally, through the country's own tax laws, or bilaterally through treaty arrangements between countries. The first approach is that of exemption, under which the investor's country of residence exempts from taxation certain items of income from foreign sources. The second approach is the credit method under which the investor's country of residence treats the tax which has already been paid on income earned abroad as if it were tax paid to itself.
2.47 It will be evident from the preceding discussion that the critical decisions in the field of double taxation are those made in the investor's home country. Does its law and practice recognise the prior taxing right of the host country (i.e. the country in which the investment has been made)? If so, does that recognition extend to situations where the host country has provided a tax concession to the firm? This question is of considerable importance because it is clear that in the case of foreign investment it would be easy for the incentive provided by a tax holiday to be negated by taxation of such profits upon remittance to another country. It is also evident from my discussions that many island governments fear that the incentives which they offer may be offset in this way.

2.48 It has not been possible in the scope of this study to examine this question exhaustively, but the position can be reasonably summarised with reference to the provisions of suggested international codes, to the tax laws of Australia and New Zealand, and to the few double-tax agreements which have been concluded by island countries. Briefly, it does not seem that there is a serious problem in this area.

2.49 International thinking on problems of double taxation is conveniently described in a recent United Nations "Manual for the Negotiation of Bilateral Tax Treaties Between Developed and Developing Countries". This manual contains detailed guidelines based on an earlier OECD Model Convention which is extensively used as a guide in international tax treaty negotiations. The manual accepts the principle that the host country has a prior right to tax business income generated in its territory and the guidelines suggest alternative procedures, based on exemption and credit methods, to ensure that such profits are not taxed a second time. The manual notes that under the exemption method the problem of the investor's home country taxing income, which has
benefitted from a tax holiday in the host country, does not arise as such income is exempt. Under the credit method, however, the problem remains but can be dealt with by tax sparing provisions, either unilaterally or bilaterally. No draft guidelines are provided on this point, the initiative being left with the countries concerned. The essence of a tax sparing provision is that the investor's home country gives a credit for the tax which would have been payable by the company in the country of investment had it not benefitted from special tax holiday provisions.

2.50 Both Australia and New Zealand effectively exempt intercompany dividends from tax. In the case of Australia this is done in a somewhat indirect way. Section 146 of the Australian Income Tax Assessment Act provides for a tax rebate of the amount obtained by applying the average rate of tax payable by an Australian company to the amount of dividends included in its taxable income. This procedure effectively exempts dividends from tax, regardless of whether tax has previously been imposed on the profits from which those dividends are paid. In New Zealand the exemption is direct. Section 63 of the New Zealand Income Tax Act provides that dividends received by companies are exempt from tax.

2.51 A different situation applies in the case of dividends received by individuals rather than companies. Such dividends form part of assessable income, but both Australian and New Zealand laws (Sections 45 and 293(2) respectively) allow a credit to the extent of the lesser of the tax actually paid or that assessable under home country law. In addition, Australian law provides, in Section 23(g), that income derived by an Australian resident from an overseas source shall be exempt where that income is subject to tax in the country of origin.

2.52 The provisions outlined in the previous paragraph do not amount to tax sparing, so that dividends paid to individual taxpayers in Australia and New Zealand by companies entitled to dividend tax free concession periods in the islands could attract tax in Australia and New Zealand. The practical effect of this is probably slight, however, in that most such investment flows occur between companies and so benefit from the exemption provi-
sions applying to inter-company dividends. The simple act of legal incorporation is sufficient to entitle an individual investor to such exemption.

2.53 A limited number of double-tax agreements have been signed by Pacific Island countries. These comprise agreements between Fiji and the United Kingdom, Fiji and New Zealand, and separate agreements signed by the Solomon Islands, Kiribati and Tuvalu with the United Kingdom. These latter agreements are extended to include Sweden, Denmark and Norway.

2.54 The two agreements signed by Fiji provide (with some differences in detail) that tax paid under Fijian law on income from sources in Fiji (excluding, in the case of a dividend, tax paid on the profits out of which the dividend is paid), shall be allowed as a credit in determining tax payable in the United Kingdom or New Zealand. Furthermore, the agreements provide that tax paid in Fiji shall be deemed to include amounts which would have been payable had the firms not benefitted from exemptions or reductions granted under the major incentive provisions of the Fiji Income Tax Act and the Hotels Aid Ordinance. The agreement with New Zealand extends this principle to include tax which would have been payable had the firms not benefitted from the Fijian increased exports incentive.

2.55 The agreements between the Solomon Islands, Kiribati and Tuvalu on the one hand and the United Kingdom on the other are similar to that concluded between Fiji and the United Kingdom.
2.56 Local manufacture is an alternative to importation and its commercial attractiveness depends upon the prices at which imported materials and competing imports can be landed. In turn these are influenced by government tariff policies. High duties on materials discourage local production whilst tariffs on competing imports encourage the production of the protected goods. In this context, two aspects of tariff policy are relevant, the basic shape of the tariff itself, and the extent to which incentive legislation provides for the remission or reduction of import duties normally payable on imports of raw materials and capital equipment. In addition to altering the price relationship between overseas and locally produced goods, governments often act to influence the volume of imports either directly through quantitative restrictions or by use of exchange control. Either technique can be used to provide a local manufacturer with direct protection from overseas competition.

THE TARIFF

2.57 The island countries of the South Pacific have traditionally used the tariff mainly as a convenient device for raising revenue. Not only is the tariff relatively easy to administer but it has the advantage that the array of imports includes most of the luxury items used in an island economy. A government's revenue and income redistribution objectives can thus be promoted through a single policy instrument to a greater degree than is possible in larger industrial economies. High tariffs are typically imposed on alcoholic beverages and tobacco, motor vehicles and consumer durables. Other items are dutiable at lower rates and many may be free, but often the tariff will embody a low basic revenue rate which applies to most items.
2.58 The Pacific Island countries have generally favoured open trading conditions and most declare themselves opposed to extensive use of tariff protection. Protective rates are sparingly applied and are generally low. In Papua New Guinea only a few items carry protective tariffs and these are generally moderate as, for example, barbed wire 35 per cent, nails 27\% per cent and paper bags 20 per cent. In the Solomon Islands only the 50 per cent tariff on soap is seen as protective. Vanuatu, the Federated States of Micronesia, Kiribati and Tuvalu have not applied protective rates. In Fiji, in contrast, a large number of items are protected by tariffs ranging from 20-25, 40-50, and as high as 70 per cent. In Tonga a few locally produced items are sheltered by tariffs of 20-25 per cent. Samoa has a relatively high tariff structure and most items are dutiable at 42 per cent. Higher rates are applied in some areas. Finally, the Cook Islands has applied protective tariffs in one or two instances.

2.59 Tonga and the Cook Islands have, in their investment incentives acts, provided a mechanism for granting protection to approved firms. In Tonga, the Industrial Development Incentives Act provides under section 16, which deals with protection for approved industrial enterprises, that on application by the enterprise and recommendation by the Minister, the Treasurer may, with the approval of the Privy Council, raise the rate of Customs Duty on any goods for a specified period. The Cook Island Development Investment Act provides that import duties may be increased to protect an approved import substituting activity where this is essential for initial survival or where there is a threat of unreasonable trade competition.

2.60 Table 2.5 summarises the average rate of duty collected on imports in four countries. The data are presented at SITC section level and are thus highly aggregated. The table does, however, enable some assessment of the general level of tariffs and highlights the rates of duty levied on beverages and tobacco.
Table 2.5  
**AVERAGE RATES OF CUSTOMS DUTY**  
(as a percentage of import values)

<table>
<thead>
<tr>
<th>SITC Sections</th>
<th>Papua New Guinea</th>
<th>Fiji</th>
<th>Kiribati</th>
<th>Tonga</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Food</strong></td>
<td>1.3</td>
<td>6.5</td>
<td>17.6</td>
<td>4.1</td>
</tr>
<tr>
<td><strong>Beverages and Tobacco</strong></td>
<td>116.4</td>
<td>120.5</td>
<td>86.5</td>
<td>78.7</td>
</tr>
<tr>
<td><strong>Crude materials</strong></td>
<td>0.8</td>
<td>6.2</td>
<td>1.5</td>
<td>2.4</td>
</tr>
<tr>
<td><strong>Mineral fuels</strong></td>
<td>10.2</td>
<td>10.1</td>
<td>12.1</td>
<td>6.9</td>
</tr>
<tr>
<td><strong>Animal and vegetable fats and oils</strong></td>
<td>-</td>
<td>3.0</td>
<td>20.0</td>
<td>13.7</td>
</tr>
<tr>
<td><strong>Chemicals</strong></td>
<td>4.2</td>
<td>9.1</td>
<td>8.1</td>
<td>9.1</td>
</tr>
<tr>
<td><strong>Manufactured goods classified by materials</strong></td>
<td>4.3</td>
<td>11.9</td>
<td>6.7</td>
<td>8.1</td>
</tr>
<tr>
<td><strong>Machinery and transport equipment</strong></td>
<td>5.2</td>
<td>14.9</td>
<td>7.4</td>
<td>5.6</td>
</tr>
<tr>
<td><strong>Miscellaneous manufactured articles</strong></td>
<td>10.8</td>
<td>21.4</td>
<td>24.3</td>
<td>11.5</td>
</tr>
<tr>
<td><strong>All imports</strong></td>
<td>7.1</td>
<td>13.5</td>
<td>20.5</td>
<td>11.0</td>
</tr>
</tbody>
</table>

Notes:

Source - Annual trade reports.
Figures relate to 199 except for Papua New Guinea where they are for 1975/76. Underlying import values are c.i.f. for Fiji and Tonga and f.o.b. for Papua New Guinea. The valuation basis for Kiribati is not known.

**RELIEF FROM CUSTOMS DUTY**

2.61 All regional countries will, in some circumstances, reduce customs duties on imports of materials and capital goods, as an incentive to local manufacture. In a majority of cases such concessions are given under general powers conferred by tariff acts and are usually given sparingly. In four countries rather more widespread concessions are given in terms of specific industrial development incentive laws and regulations.
2.62 In Papua New Guinea, the Solomon Islands, Kiribati, Tuvalu and Niue, concessions are given in terms of general powers conferred by Tariff or Customs Acts. In Papua New Guinea such concessions are not common and are for limited duration. As in most other countries, tariffs on capital goods are low or non-existent. In the Solomons, a small number of firms have benefitted for concessions, more commonly on capital goods rather than materials. In addition the joint-venture agreement between the Solomon Islands Government and Solomon Taiyo provides for dutyfree imports of all items required for the company's operations. Somewhat limited, but similar, concessions are extended to all commercial fishing operations by a special schedule of exemptions to the Customs Tariff.

2.63 The Vanuatu Customs Tariff provides for exemption from import duties of goods ordered for approved development schemes. In such cases capital goods are usually admitted free of duty and imports of raw materials may be freed of duty for one year. Kiribati, Tuvalu and Niue have all declared themselves prepared to give tariff concessions in appropriate cases under the general powers of their customs acts but to date have no real history of such use.

2.64 Fiji, Tonga, Western Samoa and the Cook Islands have each enacted special concession provisions. In Fiji the Customs Tariff (Industrial Concession) Regulations are used to remit duty on raw material imports in approved cases. The concession is usually given on the basis that it will continue to a date to be notified, and in practice this usually means indefinitely. The concession is usually partial. Concessions are also given on capital goods imports for which tariffs are, in any event, generally low.
2.65 Firms approved under the Western Samoan Enterprises Incentives Act are entitled to duty free import of capital equipment and materials to the extent specified in their approval order. In general imports of capital equipment are allowed duty free. Where concessions are given on raw materials these are usually in the form of a reduction in the rate of duty on imports up to some specified total value. In addition, Samoa's Industrial Free Zone Act, which has not been applied in practice, provides for a complete exemption from payment of import duties on raw materials and capital items by firms locating in the zone.

2.67 The Cook Island Development Investment Act provides for full or partial exemption from duty for imports of capital equipment and materials. Approved firms are usually accorded such exemptions on capital equipment. Concessions have been given more sparingly for raw materials with a preference for those that are to be used in export production.

2.68 Finally on the question of relief from customs duty it is appropriate to note that a number of countries in the region provide in their customs law for the drawback (i.e. refund) of customs duty paid on materials incorporated in export goods. One of the exceptions, Tonga, remedies the situation through a special provision in its Industrial Development Incentives Act.

EXCHANGE CONTROL

2.69 Exchange control impinges on a nation's investment climate in two main ways. First, foreign investors are inevitably interested in the rules governing the remittance of earnings and repatriation of capital, and in the likely future course of policy on these matters. Secondly, exchange controls can be used
The placing of restrictions on the use of foreign exchange for the purchase of competing imports can provide protection for local producers, whether foreign or locally owned.

2.70 National regulation of the conditions under which foreign exchange can be acquired directly impinges on other countries and the International Monetary Fund has developed rules aimed at minimising the restrictions placed on payments for current international transactions. This stance generally favours an open and relaxed foreign exchange policy and the avoidance of deliberate protective measures.

2.71 The Pacific Island countries have generally maintained a position where foreign exchange is readily available for all current account transactions including the remittance of profits earned by foreign enterprises. Foreign exchange is also usually readily available for the repatriation of capital although such transactions are monitored to ensure that the capital outflow is limited to the repatriation of capital previously brought in and, in the case of large transactions, to ensure that it is spread in a way which does not seriously affect the country's short-term exchange situation.

2.72 Most countries provide some form of guarantee of the right to remit earnings and repatriate capital. Such guarantees are variously written into foreign investment control laws (Papua New Guinea and the Solomon Islands), investment incentives acts (Tonga and the Cook Islands), the constitution (Fiji), or asserted as policy in investment brochures or other official documents (Kiribati, Tuvalu, Western Samoa and Niue). The exact form of these guarantees varies but the key elements are usually:

(a) a guarantee against expropriation except in accordance with law and on payment of compensation;
(b) a guarantee of the right to remit earnings and repatriate capital subject to the laws relating to income tax and exchange control.

As can be seen, the guarantees are couched in a conditional and somewhat open-ended way.
2.73 A number of countries in the region are in a somewhat special situation respecting exchange control. Vanuatu is a tax haven and has no system of exchange control. Niue and the Cooks are part of the New Zealand currency area whilst Kiribati and Tuvalu use Australian currency. For each of these countries the local use of the national currency of one of the most likely sources of foreign investment limits the ability of the local government to restrict payments within that currency area.

2.74 With only one exception the countries of the region do not use exchange controls protectively. The exception is Western Samoa and in this case the protective effect is secondary to the primary purpose of dealing with a particularly severe foreign exchange situation. Western Samoa's exchange controls are operated on a four-tier basis. A few basic items are free of control and a short list of others are given relatively generous basic allocations. Beyond this licences are allocated which can be used for the import of any commodities other than a nominated list of items which are produced locally. Although the immediate motivation for these restrictions is the conserving of foreign exchange, the system also provides direct protection for the listed items.

QUANTITATIVE RESTRICTIONS - IMPORTS

2.75 In addition to the protective powers inherent in control of the allocation of foreign exchange, it is possible to protect local producers by directly regulating the import of competing products. Five countries have made limited use of this power. Papua New Guinea has from time to time imposed a complete ban on imports of rice and flour so as to protect local producers. In such cases it is usual to impose price controls on the local producer, the objective being to guarantee the market to that producer but not to subsidise him by allowing price increases behind a protective wall.
2.76 Fiji's Customs Act provides for the scheduling of items which cannot be imported except under licence. These powers are currently used protectively in respect of ten items including flour, steel bars, plastic pipes, ropes of man-made fibres, plastic tubing, crown corks and incense sticks. The list is shorter than that which prevailed from 1975 to 1980 and included a number of items which are now protected by increased tariffs.

2.77 Tonga's Industrial Development Incentives Act provides for the quantitative restriction or prohibition of imports of particular commodities where this is considered expedient. The power has not been used to date but may be used in the near future.

2.78 As noted above in para 2.74, Western Samoa operates its exchange controls in a way which provides protection for local producers and effectively prohibits imports of scheduled items. The items so protected are timber, roofing iron, paints, soap, jandals, beer, cigarettes, matches, salt, beef, sausages and bacon, biscuits, cakes and pastries, fruit juices, soft drinks, twisties, ice cream, eggs, toilet rolls, fresh and frozen fish.

2.79 Finally, Niue's National Development Plan states a preparedness to use quotas as a means of encouragement to local industry. Quotas are currently applied to protect the market of the local soft drink producer whilst still leaving room for some competing imports.

RESTRICTIONS ON COMPETING LOCAL PRODUCTION

2.80 Five countries in the region have explicit legal authority to assist local firms by restricting the establishment of competing units within the country. The rationale for such a move lies in an attempt to improve the production economics of the protected unit. The small size of most Pacific island markets mean that few local producers are able to achieve production volumes which would be regarded as economic in larger economies. Local market protection is intended to prevent uneconomic fragmentation of
the already small local market. The five countries with some form of local market protection are the Solomon Islands, Kiribati and Tuvalu, whose protected industries legislation is quite similar, and Tonga and Western Samoa.

2.81 The protected industries acts and ordinances of the Solomon Islands, Kiribati and Tuvalu provide that an industry may be declared protected where this is in the public interest and where such protection is necessary to ensure its development. No firm may operate in a protected industry unless licensed to do so. Protection is normally granted for five years in the first instance with the possibility of consecutive two year extensions.

2.82 The Solomon Islands is the only country to have made extensive use of these provisions. In 1980 fourteen industries were protected. These comprised beche-de-mer processing, air transport, export of crayfish, tyre re-treading, tobacco manufacture, golden lip pearl shell, dry cleaning, aerial spraying, terazzo tile manufacture, ready-mix concrete, corrugated iron, cultured pearls and the public bus service in Honiara. Kiribati has recently applied its ordinance to protect an overseas venture which has pioneered the aerial collection, processing and export of crayfish.

2.83 Tonga's Industrial Development Incentives Act provides for what is in effect a system of industrial licensing. Ministerial licensing is a pre-condition of setting up an industrial enterprise and the power to withhold approval can be used to protect the market for existing enterprises. In Western Samoa, the Enterprises Incentives Act provides that Cabinet may not approve any new enterprise where this would unduly affect any existing efficient enterprise producing a similar product. By their nature, these powers are less public in their operation than the earlier discussed systems of protected industries. Both Tonga and Western Samoa have used them to limit the number of units in some areas.
2.84 It will be apparent that in some other countries, notably Fiji, the approval system for concessions gives government the opportunity to discourage the establishment of competing enterprises. However, in these countries the system is not explicit as in the case of the countries discussed, and indeed in the case of Fiji a common private sector complaint is that policy has been administered in a way which tolerates the setting up of uneconomically small competing units.

OTHER FORMS OF ASSISTANCE

2.85 Although the primary focus of this study is on the classic forms of fiscal and regulatory incentives, it is appropriate to complete the survey with reference to the more important non-fiscal incentives. These generally fall within the area of government expenditure designed to encourage or assist industrial development. Inasmuch as most government expenditures (e.g. education and road construction) affect the conditions under which industrial enterprises operate, it would be easy to draw the boundary very widely indeed. Here, however, the focus is deliberately kept limited to the provision of industrial estates and to special forms of financial assistance.

INDUSTRIAL ESTATES

2.86 Difficulties about access to suitably located and serviced land frequently pose problems in the course of industrial development. This may be the case particularly where complex patterns of land ownership or use make it difficult to acquire leasehold or ownership rights. Such problems are common in the Pacific. Faced with these difficulties, many countries have acted to assist development through the provision of industrial and commercial sites. These measures range from the leasing of publicly owned land through the development of fully serviced leasehold sites to the construction and lease of factory buildings.
2.87 Papua New Guinea and the Federated States of Micronesia have not developed industrial estates as such but make publicly owned land available for industrial lease. In Papua New Guinea, interested persons are required to tender for the use of the land. The tenderer is required to pay a premium equal to the difference between his tender and the officially assessed unimproved value of the land, plus a rental assessed at 5 per cent of that unimproved value. In the Federated States of Micronesia, land is leased at a rental of 7 per cent of the assessed value of the land.

2.88 The Solomon Islands, Fiji and Western Samoa have all developed industrial estates. In the Solomon Islands, the main demand for land is in Honiara where the government is developing an 84 hectare flat site at Kukum. Tenants are required to pay a premium to cover development costs plus a rental calculated at 8 per cent of the assessed value of the site. There is little demand for land beyond Honiara but the government, which owns all land in Auki, Gizro, Kira Kira and Tulagi, will make land available for lease.

2.89 Fiji has developed or is currently developing a number of industrial estates. These include three separate estates in the Suva area, two estates on the northern side of Viti Levu and one on the island of Vanua Levu. By mid-1981 more than 250 sites had been created. These are available on lease with the tenant being required to pay a premium designed to recover the direct costs of development plus a rental calculated at 5 per cent of the assessed value of the site less development costs. In addition the government has built a small number of factory buildings which are leased with an option of purchase at cost after three years.

2.90 Western Samoa has developed a 60-acre industrial estate at Vaitele close to Apia. The rentals charged are concessional to the extent that they are designed to cover operating costs but include no interest charge. The Western Samoan authorities have used aid funds to provide some financial assistance for factory construction.
2.91 Tonya, with assistance from the Asian Development Bank, has gone further than other South Pacific countries in providing fully serviced factory units as part of an industrial estate. Situated close to Nuku'alofa, the Small Industries Centre has five factory sheds, buildings to house ten small scale industrial units, and 19 developed sites, all fully served for basic utilities. Rentals are calculated so as to recover operating costs plus repayment of capital over a 40 year period. The rates are concessional to the extent that no interest is payable on that capital.

2.92 Vanuatu, Kiribati, Tuvalu and the Cook Islands have not developed industrial estates to date but the problem of ensuring land availability is recognised by all and this policy issue effectively remains open. Niue is establishing a small industries centre and plans to construct two factory shells for leasing at concessional rates.

SPECIAL FINANCIAL ASSISTANCE

2.93 Papua New Guinea and Fiji, the two largest and most diversified economies within the region, have developed a number of forms of financial assistance which lie somewhat beyond the traditional range of incentives. In the case of Papua New Guinea the incentives discussed below form the core of a new approach to encouraging development. This places heavy emphasis on the advantages of letting competitive market forces shape the course of economic development and on the dangers of committing the nation to long term subsidisation of any sector. This philosophy aims at the correction or offsetting of market imperfections which may inhibit development. In contrast the traditional measures of protection and fiscal incentives have aimed at structuring the commercial environment in ways which will promote development.
2.94 The incentives to be discussed can conveniently be grouped into: those which aim to improve the pre-conditions for investment; those which centrally involve the making of grants; and those affecting the conditions on which capital funds are made available.

**Improving the Pre-Conditions for Investment**

2.95 Papua New Guinea will finance up to half the cost of feasibility studies in priority areas or in areas where the government itself requires such information. Should the project proceed, the government may choose to be accredited equity equal to its financial contribution and, if the firm decides not to proceed, the government reserves a right of access to all information gained.

2.96 The government of Papua New Guinea will provide necessary infrastructure, including buildings, for new industrial projects in return for a negotiated user charge payable annually over the life of the project. The general user charge is designed to yield the government a commercial return on its investment taking into account the degree of risk and the likely rate of return to the investor.

**Grant Assistance**

2.97 Under the village economic development fund scheme the government of Papua New Guinea makes grants of up to a maximum of 40 per cent of the capital required to set up commercial projects. The village is required to contribute land, labour, cash or other assets to the project on a self-help basis.

2.98 The Fijian government provides a 7 per cent subsidy for hotel construction or extension. This coupled with a right to accelerated depreciation of the balance of the cost over fifteen years. Alternatively, firms granted a subsidy may opt for a 55 per cent investment allowance.
2.99 As noted earlier, the Fiji National Training Council, which is funded by a one per cent levy on gross payrolls, makes cash grants to employers for approved training given to their employees and assists employers in developing training schemes and programmes of their own.

2.100 In most countries in the region, government established development banks have made major contributions to development. Although a major concern is to provide development finance at minimum possible cost, the banks generally lend at commercial rates determined with reference to their own borrowing rates and operating costs. In Fiji, however, the government directly subsidises interest rates payable on agricultural loans and on commercial loans made to persons of Fijian race.

Loan Assistance

2.101 The Papua New Guinea government operates an infant industry loan scheme to facilitate the commercial funding of priority, higher risk, projects with long run profit potential. The government will consider a standby loan of 15 per cent of required capital funds. The loans are seen as a means of overcoming identified short-term financing problems and not as a substitute for normal commercial loans.

2.102 Papua New Guinea operates a credit guarantee scheme to assist nationals who find it difficult to borrow from commercial banks because they are unable to meet conventional security and equity requirements. Under the scheme the commercial banks provide the loan, which the government guarantees to the extent of 80 per cent.

2.103 Another Papua New Guinea scheme to assist indigenous enterprise is the national investors scheme. Approved projects may be lent money, if need be on an unsecured basis, to complement commercial financing. Funds are also available for feasibility studies. Financial assistance will only be given at the project funding stage if a bank is prepared to fund at least 50 per cent of the project cost without government guarantee.
Investment incentives offered by New Zealand and Australia

2.104 Both the New Zealand and Australian governments operate schemes designed to assist the development of commercial enterprises in Pacific Island countries. Both schemes enable assistance to be given to island ventures involving an Australian or New Zealand partner but there are significant differences between the schemes. The principal aim of the New Zealand Pacific Islands Industrial Development Scheme (PIIDS) is to encourage New Zealand entrepreneurs to develop manufacturing enterprises in Pacific Island countries. The incentives offered include the provision of interest free suspensory loans which may be converted to grants and assistance with feasibility studies. In contrast the Australian Joint Venture Scheme concentrates on the provision of capital funds, on a government to government basis, for investment in the form of island equity capital in joint ventures involving an Australian partner.

The New Zealand Pacific Islands Industrial Development Scheme

2.105 The main objective of PIIDS is to provide financial assistance and incentives for New Zealand entrepreneurs developing approved manufacturing or processing operations in Pacific Forum island member countries, with the aim of fostering economic development and employment opportunities. The prime consideration for the granting of assistance is the degree of benefit that the proposal entails for the island country and compliance of the venture with the wishes of the host government. New Zealand equity or a combination of New Zealand and island equity must amount to at least 75 per cent of total equity and New Zealand equity must be at least 20 per cent. Supported ventures should be commercially viable and should not require continuing assistance.
2.106 The principal incentive offered is the provision of suspensory loans for up to 30 per cent of the cost of factory plant and equipment for new ventures or expansions. Generally the maximum size of loan is limited to $NZ60,000 but larger amounts may be lent in exceptional cases. Loans are provided interest free and are converted into grants five years after establishment provided that the venture is still operating on the basis that was approved. Small ventures may alternatively qualify for grants of up to 50 per cent of qualifying expenditure, with a maximum grant of $NZ20,000.

2.107 It is considered important that whenever possible some local equity should be introduced into ventures established under the scheme, particularly where these are based on island resources or are largely oriented to host-country markets. Under certain circumstances financial assistance may be made available for this purpose by way of grant or loan. The scheme is also able to provide financial assistance towards feasibility studies, staff training costs and transfer costs for staff and plant.

2.108 By December 1981 $NZ986,000 had been paid out or committed under the scheme. Other basic data on the scheme is summarized in Table 3.6. In all some 44 ventures which have received assistance are operating and it is estimated that total employment in these is just under 600 persons. It is noteworthy that two-thirds of the total commitments made under the scheme relate to feasibility study, training or transfer grants; and also that small venture grants outnumber suspensory loans. Projects assisted include a variety of food processing operations (many based on tropical crops), leather goods and garments, paper products, plastic casks, paints, light engineering and jewellery.
Table 3.6  PACIFIC ISLANDS INDUSTRIAL DEVELOPMENT SCHEME

BASIC DATA TO END OF 1981

<table>
<thead>
<tr>
<th>Ventures in Operation</th>
<th>Estimated number of jobs created</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiji</td>
<td>16</td>
</tr>
<tr>
<td>Western Samoa</td>
<td>7</td>
</tr>
<tr>
<td>Tonga</td>
<td>10</td>
</tr>
<tr>
<td>Cook Islands</td>
<td>6</td>
</tr>
<tr>
<td>Niue</td>
<td>4</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>44</td>
</tr>
</tbody>
</table>

Types of assistance:

- Feasibility study grants: 58
- Training grants: 33
- Small venture grants: 31
- Suspensory loans: 18
- Transfer grants: 15

155

(Note: most ventures receive more than one type of assistance).

The Australian Joint Venture Scheme

2.109 The Australian government has established a joint-venture scheme as part of its development assistance programme. Under the scheme the Australian Development Assistance Bureau (ADAB) is able to provide capital funds through island governments for use as equity capital in approved commercial joint-ventures involving an Australian partner. The funds are available for use in new ventures or in expansions of existing ventures. They may also be used to purchase local equity in existing Australian ventures. Joint venture funds can be used in any employment creating sector of the island economy, including manufacturing and service industries.
2.110 Funds provided under the scheme are granted on a government to government basis and may be used by the island government as a means of acquiring public shareholding in the venture or may be advanced to the private sector. If the funds are to be used to support local private investment then the scheme requires that they should be on-lent by a relevant financial institution in the recipient country on terms and conditions consistent with its normal operations. The Australian Joint Venture Scheme does not involve direct financial dealings with the supported venture.

2.111 The scheme places major emphasis on the need to promote commercially viable ventures. Such viability needs to be tested by detailed feasibility studies to the satisfaction of both the island government and ADAB. It is thought that the Australian partner in such ventures should normally have a minimum shareholding of around 25 per cent so as to ensure its full commitment to the project.

2.112 The scheme is financed from a regional pool within Australia's South Pacific aid program. Funds are available on a first come first served basis. Assistance of this type has been available since the late 1970's when Australia helped with the financial reconstruction of the sawmill on Savai'i in Western Samoa. Guidelines for the scheme were introduced in 1981/82. Present notional funding of the scheme amounts to an allocation of A$2.5 million for the 1981-84 triennium. Under the new guidelines 3 joint ventures have so far been approved: The National Banking of the Solomon Islands, Samoa Veneer Products in Western Samoa, and a restructured Fiji Forest Industries in Fiji, amounting to a total commitment of A$3.1 million.
Chapter Three

THE PLACE OF MANUFACTURING IN THE REGIONAL ECONOMY

INTRODUCTION

3.1 The main purpose of the fiscal and other incentives offered by Pacific Island countries is the promotion of manufacturing activity and employment. The potential for such development is obviously conditioned by the distinctive features of the Pacific Islands. Small size, isolation and narrow resource bases set limits to manufacturing development and have to be taken into account in planning appropriate policies. Before turning to these issues it is useful to sketch in this chapter the current position of manufacturing and its place in the economies of the region.

3.2 The manufacturing sector is relatively small in all Pacific Island economies. Typically, manufacturing accounts for only a few per cent of total employment and in the region as a whole employment in the sector amounted to about 36,900 in the late 1970s. Table 3.1 presents estimates of manufacturing employment in the region. The estimates are of varying quality but provide a useful starting point.

Table 3.1 MANUFACTURING EMPLOYMENT

<table>
<thead>
<tr>
<th>Country</th>
<th>Number Employed (late 1970s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Papua New Guinea</td>
<td>16,250</td>
</tr>
<tr>
<td>Fiji</td>
<td>14,300</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>2,220</td>
</tr>
<tr>
<td>Western Samoa</td>
<td>1,200</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>800</td>
</tr>
<tr>
<td>Tonga</td>
<td>1,060</td>
</tr>
<tr>
<td>Federated States of Micronesia</td>
<td>150</td>
</tr>
<tr>
<td>Cook Islands</td>
<td>440</td>
</tr>
<tr>
<td>Tuvalu</td>
<td>50</td>
</tr>
<tr>
<td>Niue</td>
<td>70</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>36,540</strong></td>
</tr>
</tbody>
</table>

Source: See notes to the more detailed Table 3.6.
3.3 Regional manufacturing is dominated by Papua New Guinea and Fiji, which together employ more than 30,000 of the region’s 36,500 manufacturing workers. Amongst the other nine member SPEC countries covered in this survey, manufacturing employment totalled 6,000. Of these, 2,200 worked in the Solomon Islands and somewhat more than 1,000 each in Western Samoa and Tonga. For most of the countries covered, manufacturing employment provided jobs for only about 3 to 7 per cent of the total workforce. Such figures are of course very low in comparison with those of developed industrial countries, which commonly range from 20 to 30 per cent of total employment.

THE RANGE OF PRODUCTS

3.4 These low levels of manufacturing employment are reflected in the generally narrow range of products manufactured in the Pacific. A number of these are common to most countries, although the depth and range of production varies markedly. Tables 3.2 to 3.4 summarise the products manufactured in Papua New Guinea, Fiji, and the other nine states. Products are classified according to the International Standard Industrial Classification. The listings are not exhaustive but an effort has been made to list all major products.

3.5 Table 3.5, which lists the numbers employed in the various industries in five countries in the region, enables the relative importance of these industries to be assessed. In each of the five countries the food, beverage and tobacco grouping is the largest employment provider. In Papua New Guinea this sector is comparable in size to the wood and fabricated metals groups and accounts for 28 per cent of manufacturing employment. In the other four countries, the dominance of the food sector is more pronounced. In Fiji, the Solomon Islands, Western Samoa and Tonga, food and related products account for half of total manufacturing employment. This high proportion is much influenced by processing of tropical crops and fish. Notable items are sugar milling in Fiji, fish freezing and canning in the Solomon Islands and Fiji, vegetable oils in Fiji, the Solomon Islands and Tonga, coconut cream in Western Samoa and desiccated coconut in Tonga. Production of foodstuffs, beverages and tobacco for the local market is also important.
Table 3.2 PRODUCTS MANUFACTURED IN PAPUA NEW GUINEA

<table>
<thead>
<tr>
<th>ISIC Code</th>
<th>Products Manufactured</th>
</tr>
</thead>
<tbody>
<tr>
<td>31</td>
<td>Food, beverages and tobacco: Bakery products, biscuits, ice cream, meat smallgoods, stock food, coconut oil, palm oil, tea and coffee packing, cocoa processing, soft drinks, cordials, beer, cigarettes, fish freezing and preserving.</td>
</tr>
<tr>
<td>32</td>
<td>Textiles, apparel and leather: Canvas goods, clothing, weaving, screen printing, thongs, sandals, tanning.</td>
</tr>
<tr>
<td>33</td>
<td>Wood and wood products: Baskets, joinery, sawn timber, plywood and veneer, prefabricated buildings, charcoal, furniture.</td>
</tr>
<tr>
<td>34</td>
<td>Paper and paper products: Paper towels, toilet rolls, stationery, printing, industrial and domestic corrugated and fibreboard containers and packaging.</td>
</tr>
<tr>
<td>35</td>
<td>Chemicals, rubber and plastics: Agricultural chemicals, soap, detergents, industrial gas, paint, plastic bags and containers, tyre retreading.</td>
</tr>
<tr>
<td>36</td>
<td>Non-metallic mineral products: Concrete blocks components and pipes, fibreglass, glass bottles and containers.</td>
</tr>
<tr>
<td>37</td>
<td>Basic metals: Castings, including stones.</td>
</tr>
<tr>
<td>38</td>
<td>Fabricated metal and machinery: General and mechanical engineering products, steel drums, metal buckets, galvanised iron sheets, merchant bars, nails, wire products, storage tanks, marine engineering including boat building, aluminium joinery, sheet metal work, water tanks, steel furniture, truck bodies, batteries, mufflers, radio assembly and refrigeration equipment.</td>
</tr>
<tr>
<td>39</td>
<td>Miscellaneous products: Handicrafts, artifacts.</td>
</tr>
</tbody>
</table>

Table 3.3  PRODUCTS MANUFACTURED IN FIJI

ISIC Group

31 Food, beverages and tobacco:
Soft drinks, cordials, fruit juices, animal feeds, baking powder and soda, biscuits, jelly, canned foods, chutney and pickles, ginger processing, coconut oil, desiccated coconut, confectionery, custard powder, dairy products, ice-cream, noodles, rice milling, small goods, spices and sauces, sugar, tea, vinegar, flour, beer, cigarettes and tobacco.

32 Textiles, apparel and leather:
Canvas goods, footwear, garments, handicrafts, suitcases, pillows, mattresses, upholstery, ropes.

33 Wood and wood products:
Sawn timber, parquet, chip board, panel board, plywood, veneer, doors, furniture.

34 Paper and paper products:
Paper bags, counter rolls, waxed paper rolls, toilet rolls, stationery, printing, napkins, corrugated containers, solid fibre containers, cardboard boxes.

35 Chemicals, rubber and plastics:
Candles, cosmetics, soap, detergents, disinfectants, industrial gas, matches, paints and varnishes, putty, concrete admixtures, coatings, plastic products, plastic pipes, polythene products, foam plastic, polythene sheeting and bags, tyre retreading.

36 Non-metallic mineral products:
Cement, readymix, concrete blocks, pipes, pre-cast units, posts, prestressed beams, sleepers etc, marble products.

37 Basic metals:
Iron, bronze and aluminium castings.

38 Fabricated metals and machinery:
Agricultural equipment, including ploughs and harrows, aluminium joinery, fluorescent lights, steel fabrication, ship building, bus bodies, batteries, mufflers, cans, drums, tool boxes, switchboards and control boxes, electroplating, filing cabinets, office furniture, hardware, wood stoves, manhole covers, pots and pans, roofing iron, guttering, sawblades, knives, nails, wire mesh, barbed wire and wire netting.

Source: Products of Fiji, 1980
Pacific Islands Yearbook, 1980
Table 3.4
PRODUCTS MANUFACTURED IN SOLOMON ISLANDS,
WESTERN SAMOA, VANUATU, TONGA, FEDERATED
STATES OF MICRONESIA, KIRIBATI, COOK
ISLANDS, TUVALU AND NIUE

ISIC Code

31 Food, beverages and tobacco:
Bakery products and soft drinks are manufactured in most countries. In the
larger countries the range of foods manufactured includes biscuits and meat
smallgoods. Fruit is processed for export in Western Samoa, the Cook Islands
and Niue. Tonga manufactures desiccated coconut. Fish are frozen and canned
in the Solomon Islands and frozen in Vanuatu. Vanuatu also cans meat. Tobacco
is manufactured in the Solomons and cigarettes in Western Samoa. Western Samoa
also has a brewery.

32 Textiles, apparel and leather:
Some clothing is manufactured commercially in most islands. This ranges
from garments of local design to export knitwear. Sandals and handbags are
manufactured in Tonga and Western Samoa and soccer balls are manufactured for
export in Tonga and Niue.

33 Wood and wood products:
Sawmills operate in the Solomon Islands, Western Samoa, Tonga and the Cook
Islands, and a coconut sawmill is being established in Kiribati. Furniture is
manufactured in most countries and joinery manufacture is widespread.

34 Paper and paper products:
Printing is available throughout the region, to various levels of sophisti­
cation. Stationery, exercise books and toilet paper are manufactured in
Western Samoa and Tonga.

35 Chemicals, rubber and plastics:
The commonest item in this group is soap, which is manufactured in the Solomon
Islands, Western Samoa and Tonga. Western Samoa also manufactures paint and
industrial gases and retreads tyres. Tonga manufactures plastic pipes.

36 Non-metallic minerals:
Concrete blocks and similar products are manufactured in most of the larger
island states.

38 Fabricated metal and machinery:
The range of metalworking facilities is inevitably limited in the smaller
island states but basic machinery and fabrication can usually be undertaken.
Corrugated iron is rolled in the Solomon Islands, Western Samoa, Vanuatu, Tonga
and the Cook Islands. Nails are manufactured in the Solomon Islands and Western
Samoa with the latter also producing barbed wire. Aluminium joinery is fabri­
cated in Vanuatu and the Cook Islands. Small boats are built in most countries
and wheeled vehicles such as handcarts, wagons and side-cars are manufactured in
a number.

Source: Various country documents
Pacific Island Yearbook 1980
3.6 The importance of natural resource based manufacture is evident again in the wood products group. For each of the countries covered in the table, this group is the second largest source of manufacturing employment.

3.7 The next largest group is fabricated metals and machinery. The range of such products is wide, both in Papua New Guinea and Fiji, with an important part of the group's output being provided on a service or contract basis. Employment is much more limited in the other industry groups: textiles, paper products, chemicals and non-metallic mineral products. It is notable that employment in these groups is often larger in Fiji than in Papua New Guinea, despite the latter's far greater population. This difference is reflected in the rather wider range of products manufactured in Fiji.

Market Orientation

3.8 In thinking about past experience and future prospects for manufacturing development in the region, it is useful to draw a distinction between three main groups of activities; these are the production of goods for use within the country of manufacture, the processing of natural products for export and, finally, the manufacture from imported materials of goods for export. The policy issues raised by these three groupings are quite distinct so that an assessment of progress made and problems encountered to date is a necessary background to policy making. The analysis which follows is selective. Readers interested in a more extensive discussion may find Chapters 3 to 5 of "Industrial Development and Trade Relations in the South Pacific"* useful.

3.9 The relative importance of the three groups is sketched in Table 3.6. As will be evident from the footnotes, the figures are of varying quality. For Papua New Guinea and Fiji the input-output tables and manufacturing censuses enable a fairly detailed assessment of market orientation. For the other countries the range of information varies from detailed listings of employment by individual firms to little more than guesswork. Despite the inaccuracies which these difficulties must inevitably cause, it is useful to make explicit my assessment of the relative importance of these sectors.

* Commonwealth Secretariat/SPEC 1978.
### Table 3.5

<table>
<thead>
<tr>
<th>ISIC Group</th>
<th>Papua New Guinea</th>
<th>Fiji</th>
<th>Solomon Islands</th>
<th>Western Samoa</th>
<th>Tonga</th>
<th>Total</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>31 Food, beverages and tobacco</td>
<td>4,599</td>
<td>5,866</td>
<td>1,157</td>
<td>565</td>
<td>553</td>
<td>12,740</td>
<td>39</td>
</tr>
<tr>
<td>32 Textiles, apparel and leather</td>
<td>236</td>
<td>537</td>
<td>77</td>
<td>90</td>
<td>40</td>
<td>980</td>
<td>3</td>
</tr>
<tr>
<td>33 Wood and wood products</td>
<td>4,547</td>
<td>2,001</td>
<td>671</td>
<td>383</td>
<td>166</td>
<td>7,768</td>
<td>24</td>
</tr>
<tr>
<td>34 Paper and paper products</td>
<td>986</td>
<td>796</td>
<td>64</td>
<td>24</td>
<td>77</td>
<td>1,949</td>
<td>6</td>
</tr>
<tr>
<td>35 Chemicals, rubber and plastics</td>
<td>393</td>
<td>496</td>
<td>(38)</td>
<td>48</td>
<td>1,003</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>36 Non-metallic mineral products</td>
<td>244</td>
<td>462</td>
<td>252</td>
<td>36</td>
<td>61</td>
<td>826</td>
<td>3</td>
</tr>
<tr>
<td>38 Fabricated metals and machinery</td>
<td>4,178</td>
<td>1,477</td>
<td>(64)</td>
<td>47</td>
<td>5,931</td>
<td>18</td>
<td></td>
</tr>
<tr>
<td>39 Other</td>
<td>1,069</td>
<td>137</td>
<td>(70)</td>
<td>1,312</td>
<td>4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Manufacturing</td>
<td>16,254</td>
<td>11,772</td>
<td>2,221</td>
<td>1,200</td>
<td>1,012</td>
<td>32,509</td>
<td>100</td>
</tr>
</tbody>
</table>

**Notes:**
- Figures for PNG classified to ISIC by author.
- Figures for Solomon Islands, groups 35-39, assumed proportional to other four countries for purpose of calculating five country total.

#### 3.10

The table suggests that of the 36,900 or so people employed in manufacturing, 29,400 were producing for the local market, 7,000 were processing natural products for export, and about 500 were manufacturing for export using imported materials. Readers who compare these figures with the less detailed estimates incorporated in para 1.14 of the Commonwealth/SPEC study noted above, will find that the figures for natural resource processing and total employment are both about 4,000 more than quoted here. The main reason for this is the exclusion from this survey of New Caledonia, with its smelter, and American Samoa with its fish canneries. A comparison with the country estimates underlying the aggregate figures contained in the earlier report suggests that during the latter part of the seventies manufacturing employment in the group of countries now being studied increased by about 3,600 persons, and that this increase incurred almost entirely in production for the local market.
3.11 The dominant position of import substituting production in island manufacture may occasion some surprise. The problems of small scale, the generally undeveloped infrastructure of the economies, the relatively high cost of some services and materials and the generally open nature of the economies, all militate against local production. It is generally assumed that in the face of these difficulties there is little scope for import substitution. Certainly the scope is limited but equally clearly it is a mistake to assume that there is none.

### Table 3.6 MANUFACTURING EMPLOYMENT IN THE SOUTH PACIFIC MARKET ORIENTATION

<table>
<thead>
<tr>
<th>Local Market</th>
<th>Natural Resources</th>
<th>Imported Materials</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Papua New Guinea</td>
<td>14,450</td>
<td>1,650</td>
<td>150</td>
</tr>
<tr>
<td>Fiji</td>
<td>9,975</td>
<td>4,100</td>
<td>225</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>1,740</td>
<td>480</td>
<td>-</td>
</tr>
<tr>
<td>Western Samoa</td>
<td>975</td>
<td>200</td>
<td>25</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>600</td>
<td>200</td>
<td>-</td>
</tr>
<tr>
<td>Tonga</td>
<td>740</td>
<td>300</td>
<td>20</td>
</tr>
<tr>
<td>Federated States of Micronesia</td>
<td>400</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Kiribati</td>
<td>150</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Cook Islands</td>
<td>280</td>
<td>60</td>
<td>100</td>
</tr>
<tr>
<td>Tuvalu</td>
<td>50</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Niue</td>
<td>30</td>
<td>30</td>
<td>10</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>29,390</td>
<td>7,020</td>
<td>530</td>
</tr>
</tbody>
</table>

**Source:**
- Solomon Islands: Total employment from Wage and Salary Employment June 1980; allocation author estimates.
- Western Samoa: Author estimates based on scaling detailed results of internal "Industrial Survey" to assumed total 1979 manufacturing employment of 1,200. Directly surveyed employment totalled 1,005.
- Cook Islands: Total from Survey of Employment and Wages, March 1979; allocation on basis of individual firm data.
- Vanuatu, Federated States of Micronesia, Kiribati, Tuvalu and Niue: Totals and allocations author guesses based on various sources.
- Totals will have a higher degree of accuracy than the allocations.
3.12 The island economies have a natural advantage in import substitution in many instances. Perishability of products, such as many food items; the high transfer costs of competing goods, such as soft drinks, concrete blocks and corrugated iron; production adapted to local tastes, as in the case of some foods and apparel; the importance of adaptability to client requirements, as in much metal fabrication and sawmilling; and shorter supply lines in a world of frequent transport problems; all act to the advantage of local producers. There is thus, in strict economic terms, frequently a comparative advantage in favour of the local producer. The limits to this are, however, evident in the low overall level of manufacturing employment rather than in the market orientation of that sector.

3.13 As noted in Chapter Two, the Pacific Island countries generally favour open trading conditions and most declare themselves opposed to extensive tariff protection. Although some have departed from this stance to some extent, it is clear from the figures in Table 3.5 above that the main local manufacturing opportunities have been found in food production, woodworking and engineering - all areas in which the factors outlined in the preceding paragraph are relevant. In contrast there has been relatively little growth in textiles and apparel, paper products and chemicals and rubber.

EXPORT PROCESSING OF NATURAL RESOURCES

3.14 The processing of local materials for export is one of the more obvious manufacturing development possibilities and is frequently advocated on the grounds of increasing local employment and added value. The figures presented in Table 3.6 suggest that such employment accounts for about one in every five factory jobs within the region. This relatively low level contrasts somewhat with the emphasis that tends to be placed on promoting such manufacture. The reasons for such emphasis are clear enough. The technical possibilities of further processing are usually self-evident. Such developments are likely to provide a stimulus to the further development of the supplying industry and provide useful learning experience in industrial management and skills.
At the same time marketing procedures often embody a degree of monopoly which facilitates investment decision making in this area. These factors all encourage natural products processing but experience to date provides a reminder that manufacturing development in such areas is also subject to economic constraints and has to be assessed in terms of its overall contribution.

3.15 Many primary product processing operations are subject to significant economies of scale deriving from basic engineering characteristics such as vat or mill size. In such cases small producers are at an immediate disadvantage, to which must be added problems such as relatively high energy and other costs and problems of fluctuating supply. In instances where, as is often the case, there are major competitive markets for both raw and processed materials (as in the case of, copra and oil, logs and timber) the attainable margin of added value from processing is strictly limited by competitive pressures. This is also so in instances where the raw material is not tradeable. In such cases high processing costs resulting from problems such as those discussed tend to reduce the return to the original producer and thus inhibit expansion.

3.16 These points are not advanced as an argument against the developing of processing industries but rather to help explain the relatively low level of employment generated by such activity as compared with import substitution. In both instances the problems which arise relate essentially to the economies of manufacturing activity as such regardless of whether the raw material being used is locally produced or imported.

3.17 Despite these difficulties, processing of natural products has proved an important base for growth. Major coconut oil mills operate in Papua New Guinea and Fiji. Palm oil is processed in Papua New Guinea and the Solomon Islands. Smaller coconut mills have been established in Vanuatu, Tonga and Western Samoa. The mill in Vanuatu was destroyed during the rebellion. Fish is canned in the Solomon Islands and Fiji and new developments are planned in Papua New Guinea and the Solomons. Fiji's sugar industry, which is the largest
manufacturing activity in the region, is being expanded into new areas including distilling, ethanol and cane board production.
A sugar refinery is also being built in Papua New Guinea.
Desiccated coconut is manufactured in Fiji and Tonga and coconut cream is processed in Western Samoa, Fiji and Niue.

3.18 Not all processing of natural products is primarily directed to export markets. Timber milling provides an interesting example. In a number of instances where mills have been established with the thought that the major part of output will be exported, it has become apparent that local demand for quality sawn timber is sufficient to absorb the major part of local production. Nevertheless, export manufacture remains important in this industry and in the wider forestry and processing industry export potential is being actively developed in both Papua New Guinea and, to a lesser extent, Fiji.

3.19 Finally the processing of tropical fruits, particularly into juices and pulps, is undertaken in a number of countries, although usually on a small scale for the local market. The main exception - the fruit and juice cannery in the Cook Islands - has had a somewhat troubled life.

EXPORT PRODUCTION ON THE BASIS OF IMPORTED MATERIALS

3.20 Finally, the figures quoted in Table 3.6 suggested that in the late 1970s, something more than 500 people were employed in manufacturing non-resource-based products for export. The low level of such employment need occasion no surprise. The factors which have worked to inhibit the development of import substitution and export processing obviously apply with at least equal force to manufacture and export on the basis of imported materials. World trade in manufactured products is highly competitive, and the Pacific Island producer has to be able to compete both with firms having vast manufacturing resources and with products from countries with wage rates lower than those generally prevailing in the Pacific.
3.21 Historically, there have been two main patterns of development in manufactured exports. Manufacturers in the two main regional countries, Papua New Guinea and, particularly, Fiji, have found themselves to have a competitive supply advantage in closely proximate island markets. Fiji, for example, exports limited quantities of products as diverse as paint, toothpaste, corrugated iron, nails and furniture to a number of neighbouring states. So does Papua New Guinea, whose markets include the northern tip of Australia. Similar patterns are evident in other countries such as, for example, the Western Samoan brewery and cigarette factory which have secured markets in American Samoa, Niue and the Cooks.

3.22 The second type of manufactured export is typified by the longstanding apparel exports from the Cook Islands to New Zealand. A right of duty free and import licence free entry to New Zealand, coupled with the major difference between New Zealand and Cook Island wage rates, has acted to offset higher costs in other areas. The trade has not, however, shown significant growth. The island labour force is not large and, being New Zealand citizens, has a right of migration to the higher wage New Zealand economy.

3.23 Exports of this type are likely to be given a significant boost by the SPARTECA agreement under which Australia and New Zealand have created preferential access conditions to their markets for products from the island member countries of SPEC. The New Zealand "Pacific Islands Industrial Development Scheme" has also provided a stimulus to export manufacture of this type.
Chapter Four

DETERMINING DEVELOPMENT OBJECTIVES IN MANUFACTURING

INTRODUCTION

4.1 Pacific island policy makers face many difficult choices in determining manufacturing development policies for their countries. These difficulties stem from a number of sources.

4.2 There is first a clear ambivalence within the region about the whole course of modern high income industrialized societies. Although it is clear that Pacific island peoples aspire to many of the products of the industrialized societies, it is also clear that many aspects of those societies are rejected. In discussing development objectives there is much emphasis on the need to build a Pacific way and to ensure that the established bases of Pacific society are not destroyed. There is frequent emphasis on the need to take time to ensure that proposed changes fit with what is already there. Such tensions are inherent in economic development but have assumed anew urgency in the years following independence. The new policy makers have had, in the space of a few years, to try and build nationally-based policies to replace those developed during the years of colonial dominance. For the countries of the Pacific, the European impact has been severe; always disturbing, frequently exploitative and often savage. Sifting and determining the good bits in this package is a demanding exercise.

4.3 Secondly, Pacific policy makers face peculiar technical and tactical problems. The small size, geographic isolation and relatively narrow resource bases of most Pacific island communities impose severe limits on the range of manufacturing activities that are likely to prove economically rewarding. Even in the larger regional countries, fragmented patterns of islands and valleys means that small size is the geographic norm. Compounding these natural constraints is a generally low level of economic infrastructure, outside the limited number of larger urban areas.
4.4 Thirdly, the Pacific island countries are forming their policies during a period of international reaction in official development thinking against the once almost automatic assumption that a rapid expansion in manufacture for the home market was the natural centrepiece in development policy. This rethinking, which has undercut many of the policy assumptions of the larger developing economies and has placed great emphasis on the advantages of outward-looking development policies, appears on the face of it to apply with particular force to the small island developing countries.

4.5 Finally, the generally slower growth in the world economy during recent years has dampened the short to medium term growth prospects of the Pacific island economies. A more stringent international investment climate means that policies which were once felt to be effective are now increasingly questioned.

4.6 All these factors need to be kept in mind in considering appropriate manufacturing development objectives. Before reviewing the response embodied in various national development plans and related documents, it is useful to review briefly some of the key economic characteristics of the countries of the region.

KEY ECONOMIC CHARACTERISTICS

4.7 The economies of the region are generally small with a large proportion of the labour force engaged in agricultural production typically on a mixed subsistence-cash crop basis. As is evident from the figures presented in Table 4.1, there are significant differences between countries. It is of particular interest that the proportion of population living in urban areas tends to be lower, and the proportion of the labour force engaged in agriculture tends to be higher in the larger countries in the region. Thus the proportion of the labour force engaged in agriculture ranges between 44 and 61 per cent in Papua New Guinea,
Fiji, the Solomon Islands, Western Samoa and Tonga, but ranges between 4 and 22 per cent in Kiribati, the Cook Islands, Tuvalu and Niue. There are, of course, significant differences within these groups. In particular, Fiji is much more urbanized than the other larger states.

Table 4.1

<table>
<thead>
<tr>
<th>Population</th>
<th>Urban</th>
<th>Agriculture</th>
<th>Manufacturing</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>Papua New Guinea</td>
<td>3,079,000</td>
<td>11</td>
<td>57</td>
<td>3</td>
</tr>
<tr>
<td>Fiji</td>
<td>619,000</td>
<td>37</td>
<td>44</td>
<td>7</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>221,200</td>
<td>9</td>
<td>45</td>
<td>6</td>
</tr>
<tr>
<td>Western Samoa</td>
<td>155,000</td>
<td>21</td>
<td>61</td>
<td>3</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>114,500</td>
<td>18</td>
<td>na</td>
<td></td>
</tr>
<tr>
<td>Tonga</td>
<td>95,000</td>
<td>46</td>
<td>51</td>
<td>2</td>
</tr>
<tr>
<td>FSM/TTFI</td>
<td>73,600</td>
<td>46</td>
<td>na</td>
<td></td>
</tr>
<tr>
<td>Kiribati</td>
<td>57,300</td>
<td>36</td>
<td>8</td>
<td>2</td>
</tr>
<tr>
<td>Cook Islands</td>
<td>18,500</td>
<td>27</td>
<td>22</td>
<td>10</td>
</tr>
<tr>
<td>Tuvalu</td>
<td>7,400</td>
<td>30</td>
<td>4</td>
<td>7</td>
</tr>
<tr>
<td>Niue</td>
<td>3,600</td>
<td>21</td>
<td>10</td>
<td>3</td>
</tr>
</tbody>
</table>

Notes: (1) population estimates mid-1979; (2) other figures various censuses 1970s; (3) FSM/TTFI population figures, for FSM, % urban relates to TTP.


4.8 The relatively lower level of agricultural employment and relatively high level of services and related industries in the smaller economies generally reflects not so much a higher stage of development but rather the evolution of externally dependent economic structures. Most of these smaller economies receive high per capita levels of overseas development assistance. The exception, Kiribati, enjoyed for a few years significant revenues from phosphate.
4.9 The extent of external dependence is evident from the figures presented in Table 4.2, which shows that the group of smallest countries (taking the geographically dispersed Federated States of Micronesia as the largest of these) has, with the exception of Kiribati, much higher levels of dependence upon overseas development assistance. This same grouping also has higher levels of Gross Domestic Product than any of the larger countries with the exception of Fiji, the most developed country in the region.

Table 4.2

ECONOMIC VARIABLES 1978

<table>
<thead>
<tr>
<th>Gross Domestic Product</th>
<th>Exports</th>
<th>Balance</th>
<th>Overseas Development Assistance</th>
</tr>
</thead>
<tbody>
<tr>
<td>(all figures $A per capita)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>519</td>
<td>214</td>
<td>28</td>
</tr>
<tr>
<td>Fiji</td>
<td>1,227</td>
<td>247</td>
<td>-219</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>382</td>
<td>143</td>
<td>-1</td>
</tr>
<tr>
<td>Western Samoa</td>
<td>304</td>
<td>63</td>
<td>-235</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>452</td>
<td>314</td>
<td>-119</td>
</tr>
<tr>
<td>Tonga</td>
<td>431</td>
<td>54</td>
<td>-185</td>
</tr>
<tr>
<td>FSM/TTPI</td>
<td>705</td>
<td>126</td>
<td>-128</td>
</tr>
<tr>
<td>Kiribati</td>
<td>660</td>
<td>381</td>
<td>130</td>
</tr>
<tr>
<td>Cook Islands</td>
<td>941</td>
<td>119</td>
<td>-777</td>
</tr>
<tr>
<td>Tuvalu</td>
<td>600</td>
<td>5</td>
<td>-208</td>
</tr>
<tr>
<td>Niue</td>
<td>632</td>
<td>59</td>
<td>-510</td>
</tr>
</tbody>
</table>

Note: Figures for FSM/TTPI relate to TTPI. For FSM alone per capita exports were $A 24.

Source: As for Table 4.1

4.10 The differences which have been noted could be multiplied, but enough has been said to emphasise the variety of regional circumstances. Papua New Guinea, because of its size and resource base, and Fiji because of its relatively developed state, are clearly special cases. The middle order states (the Solomon Islands, Western Samoa, Vanuatu and Tonga) have quite similar GDP and external assistance levels. Their resource bases are, however, somewhat different and the Solomon Islands and Vanuatu are distinctive in having a close to balanced external account (the latter helped by tourism and the financial centre). Finally,
as already noted, the smallest states are significantly more dependent upon external assistance to support their current expenditure standards.

4.11 Table 4.3 summarizes the pattern of exports from the countries under review. The most striking feature is the relatively narrow range of exports from most countries. Papua New Guinea's copper and coffee, and Fiji's sugar, are the most obvious examples of what is a general regional phenomenon.

**EX POSTS 1978**
/all values $A million

<table>
<thead>
<tr>
<th>Minerals</th>
<th>Coffee</th>
<th>Copra, tea, coconut</th>
<th>Cocoa &amp; palm</th>
<th>Oils</th>
<th>Sugar</th>
<th>Fish</th>
<th>Wood</th>
<th>Other</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Papua New Guinea</td>
<td>252.6 207.0 53.4</td>
<td>28.6 21.9 76.4</td>
<td>639.9</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fiji</td>
<td>5.1 1.0</td>
<td>9.1 85.0</td>
<td>9.3</td>
<td>2.1</td>
<td>62.6</td>
<td>174.2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>0.6 12.5</td>
<td>7.2</td>
<td>7.2</td>
<td>3.1</td>
<td>30.6</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Western Samoa</td>
<td>3.1 4.2</td>
<td>0.2</td>
<td>2.2</td>
<td>9.7</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vanuatu</td>
<td>0.7 2.1</td>
<td>14.8</td>
<td>11.6</td>
<td>0.4</td>
<td>2.3</td>
<td>31.9</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tonga</td>
<td>0.2 2.0</td>
<td>0.1</td>
<td>0.4</td>
<td>2.2</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FSM</td>
<td>0.2</td>
<td>2.0</td>
<td>2.2</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cook Islands</td>
<td>0.2</td>
<td>2.0</td>
<td>2.2</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Niue</td>
<td>0.2</td>
<td>2.0</td>
<td>2.2</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>277.3 214.1 101.0 85.0</td>
<td>57.1</td>
<td>31.9</td>
<td>150.6</td>
<td>916.7</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Notes
(1) "Other" includes re-exports
(2) Total exports from Tuvalu less than $50,000.

Source: South Pacific Commission as for Table 4.1 above, except that figures for FSM drawn from TTP Quarterly Bulletin of Statistics, December 1979.

THE PLACE OF MANUFACTURING IN DEVELOPMENT PLANNING

4.12 Most of the countries in the region prepare development plans and a summary of the relevant sections of these enables an assessment
of the place accorded to manufacturing in regional development planning.

Papua New Guinea:

4.13 Unlike most other countries in the region, Papua New Guinea does not prepare a sectoral development plan. Instead, planning objectives are focused through a rolling annual "National Public Expenditure Plan", which relates budgetary expenditures to the whole range of government development projects and objectives. The government does not attempt to plan private sector expenditures and policy making is based on the premise that market forces provide the appropriate mechanism for determining the sectoral mix of private investment decisions.

4.14 In sectoral terms, three main features stand out: the primacy of agriculture, a concern to ensure that the nation derives adequate benefit from exploitation of its natural resource industries, and a desire to ensure that manufacturing and similar industries develop only to the extent that they enjoy a comparative advantage.

4.15 The necessity of food production makes agriculture a first priority in any development strategy. In Papua New Guinea, the great majority of people live in rural areas; subsistence production is of major importance, whilst agriculture is the dominant industry in the cash economy and ranks with copper as an export earner.

4.16 Within agriculture urgent needs are seen for regeneration of the agricultural base for tree crop exports and for increased food production to replace imports and improve consumption standards. Malnutrition is a problem in both urban and rural areas and considerable difficulties are foreseen in generating a rural food surplus for urban use without putting an impossible strain on the subsistence system.
4.17 The fundamental and pervasive nature of these difficulties means that issues of agricultural and rural development have the highest priority in development planning. The huge size of the sector and the multiplicity of producers creates major problems in effective delivery of technical, financial and other assistance.

4.18 In developing natural resources such as minerals, forestry and fishing, Papua New Guinea welcomes foreign investment subject to a continuing concern to secure a fully adequate return to Papua New Guinea. Working forward from the experience gained in renegotiating the Bougainville copper agreement, Papua New Guinea is seeking to develop a framework of sector-specific fiscal regimes which will apply to all firms in a particular sector. For mining, an essential feature of the regime is that:

"foreign enterprises, whose expertise and capital are needed for commercial exploitation of mineral deposits, should receive a reasonable return on their investment but any extraordinary gains above a reasonable return on the investment will go in large part to the government."

(National Investment Priorities Schedule, Sixth Edition, p 20)

The intent of this policy is to ensure that the investor gets a fair return but that any super-profits, which are viewed as a resource rent, accrue in the main to Papua New Guinea.

4.19 Papua New Guinea is now seeking to extend similar provisions into forestry and fishing agreements. In this context the important point is that in resource exploitative industries, the stance of the Papua New Guinean government is to secure an adequate and fair return from the exploitation of those resources, rather than to subsidize their exploitation through the offering of fiscal concessions.
4.20 In considering manufacturing development the overriding aim is to be guided by comparative advantage and to avoid the dangers seen in building a manufacturing sector behind a protective wall. Official policy is stated as follows:

"It is government policy to encourage the establishment in Papua New Guinea of industries which are efficient by world standards, which can produce at or below import parity prices and which do not depend on special financial or other concessions for their continued survival. The government will consider limited, short term protection for industries where such protection is required during the early years of production and where a net benefit to the economy will result from the granting of such protection. The nature and duration of the protection for such industries will, in all cases, be agreed before the establishment of the proposed industry."

(National Investment Priorities Schedule, p 18)

4.21 This emphasis on open trading conditions means that the main opportunities for growth in manufacturing are seen in processing of local raw materials and in small scale import substitution for the local market. It is not thought likely that manufacturing output will increase rapidly or that the sector will show rapid growth in employment. This is in line with recent experience. Between 1968 and 1977 manufacturing employment increased from 11,420 to 18,969 persons, an average annual increase of 5.3 per cent. In the four years to 1977, the rate of growth averaged 4.0 per cent.

4.22 Papua New Guinean policies reflect a desire not to precipitate substantial population movements to the cities. This not only supports the emphasis given to rural development but also argues against too rapid a growth in the industrial sector. Indeed it is argued that any attempt to promote the manufacturing sector in order to provide additional employment opportunities in the cities could be counter-productive, both because higher cost protected production will discourage employment in other...
enterprises and because a more ready job availability in the cities is likely to promote migration to them.

4.23 A strong balance of payments position has enabled Papua New Guinea to maintain a very open economy and to reject continuing financial assistance to or protection for local industries. The strategy could be placed at risk by continued movement to the cities such as has in other countries often, indeed usually, been associated with major developmental change in agriculture. Rising incomes could also - by stimulating a more than proportionate rise in imports - put the balance of payments under pressure. In the long-term Papua New Guinea as by far the largest economy in the region has the potential for a sizeable industrial sector, and this will doubtless develop. At the moment, however, this need is not seen as urgent.

Fiji:

4.24 Fiji's development thinking, like that of Papua New Guinea, lays main emphasis on agricultural development needs, both for the export of tropical crops and the expansion of local food production. In Fiji tourism is an important foreign exchange earner and the manufacturing sector is relatively more important.

4.25 Fiji's Eighth Development Plan 1981-1985 foresees total employment as increasing by about 30,000 between 1980 and 1985, at an annual compound growth rate of 2.9 per cent. The same rate of increase is forecast for agricultural employment. Within agriculture subsistence activity is expected to grow more slowly whilst export agriculture and cash production for the local market are expected to show more rapid growth. Major increases in employment are foreseen in sugar cane production and cocoa. In addition, significant growth is foreseen in ginger. Local market production of rice and various types of livestock will be encouraged.
4.26 Slower growth in the world economy and higher transport costs are seen as constraining growth in tourism which is an important foreign exchange earner for Fiji. It is not seen as making a major contribution to the growth of employment opportunities during the plan period.

4.27 Policies towards manufacturing development have shown something of a change as is evident from the following quotation.

"The pattern of industrial development to date has mainly focused on import substitution industries based on imported raw materials. The scope of such a policy as a long term industrial development strategy is limited. For industrialization to have maximum impact on meeting the national objectives, it must be closely related to the development of other sectors of the economy, especially agriculture, forestry and marine resource development."

(Eighth Development Plan, para 9.7.12)

A system of industrial priorities will be established which limits priority status to industries based on local primary commodities and to industries producing imports required by primary and other sectors. Fiji is considering establishing an industrial free zone for export industries based on imported materials.

4.28 Overall, the manufacturing sector is forecast to provide an extra 2,500 jobs during the plan period. Of this total, 1,800 will be sought through the development of resource based processing industries.

4.29 The Fiji Development Plan also discusses deficiencies in the current package of incentives and promises a reformulation of this structure and consideration of other means of assistance, including loans, technical assistance, subsidized wage rates and equity participation by government.
4.30 Substantial employment increases are foreseen in building and construction (mainly infrastructural development) and government and private services. The main features of the employment forecast are presented in Table 4.4.

Table 4.4  FIJI - EMPLOYMENT BY SECTOR (000)

<table>
<thead>
<tr>
<th>Sector</th>
<th>1980</th>
<th>1985</th>
<th>Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>83.5</td>
<td>96.2</td>
<td>12.7</td>
</tr>
<tr>
<td>Forestry, fishing, mining</td>
<td>4.6</td>
<td>5.2</td>
<td>0.6</td>
</tr>
<tr>
<td>Manufacture</td>
<td>17.2</td>
<td>19.7</td>
<td>2.5</td>
</tr>
<tr>
<td>Building, construction and utilities</td>
<td>17.8</td>
<td>21.8</td>
<td>4.0</td>
</tr>
<tr>
<td>Private Services</td>
<td>44.7</td>
<td>50.0</td>
<td>5.3</td>
</tr>
<tr>
<td>Government services</td>
<td>23.2</td>
<td>27.5</td>
<td>4.3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>190.8</td>
<td>220.3</td>
<td>29.5</td>
</tr>
</tbody>
</table>

Solomon Islands:

4.31 The Solomon Islands has a strong agricultural base, with 90 per cent of the population living in rural areas and dependent on agriculture as a source of food and as a source of cash income. Only some 16 per cent of the national labour force is presently in formal wage and salary employment.

4.32 National development planning as exemplified in the draft 1980-1984 National Development Plan naturally places main emphasis on the development of agriculture with emphases on maintaining a high level of self-sufficiency in food production; on increasing the level of smallholder involvement in cash earning agricultural activities; and encouraging the development of viable, large scale commercial agricultural activities.

4.33 A striking feature of development during the past decade has been the creation of a number of large scale commercial agricultural and natural resource exploitative activities undertaken by private companies in association with the government, as in rice production, oil palm, and fishing. These developments
have spectacularly broadened the Solomon Islands export base. The once all-important copra is now joined by timber, fish and palm oil as major exports and the overall balance of payments position is relatively strong.

4.34 These successes are reflected in future development planning which sees the principle engines of growth as

- a high rate of investment in agriculture, forestry, fisheries and, if possible, minerals;
- a sustained drive to deepen and strengthen the role of small-scale economic activity in rural and urban areas;
- priority for government investment in economic infrastructure in areas with genuine potential for productive economic activities.

4.35 The draft plan does not place major emphasis on the growth of the currently small manufacturing sector. Commercial, industrial and business activities are all to be encouraged but the authorities do not favour protection other than against "killing" competition during the early stages of a project.

4.36 The total number of persons in wage and salary employment is expected to increase from 18,500 in 1979 to 22,500 in 1984.

Western Samoa:

4.37 Unlike the three countries reviewed above, Western Samoa has a severe balance of payments problem. It also faces problems in providing jobs for a rapidly expanding labour force, a problem which has been accentuated by a narrowing of emigration opportunities to New Zealand.
4.38 In 1979, 68.8 per cent of the workforce was engaged in the village subsistence sector, comprising village farming and fisheries and home-making. Employment in the monetized sector totalled about 19,500. Existing unemployment was thought to total about 1,350. The labour force is forecast to increase by about 1,600 persons a year and, during the 1980-1984 plan period, a need is seen for some 6,800 new jobs.

4.39 It is hoped to create about 4,400 new jobs in the monetized sector during the 1980-84 plan period. About 300 of these will be in agriculture and 300 in government services. The bulk of the remaining 3,800 jobs are to be sought in manufacture.

4.40 This need to provide jobs in the monetized sector is reflected in the forecast GDP increases during the plan period. During this period manufacturing output is forecast to increase at an average rate of 12.0 per cent per annum, as compared with an economy wide increase of 4.2 per cent per annum and a 3.2 per cent per annum increase in agriculture. Despite these differences in growth rates, the absolute increase in agricultural production is still expected to be about two and a half times that from manufacture.

4.41 Agricultural development has two main emphases. First, an expansion of village production of traditional crops both for own use and for sale and an increase in commercial production through the government-owned WSTEC holdings and other government and private enterprises. In terms of cash production, main emphasis is placed on the development and regeneration of the three long-established tree crops, coconuts, cocoa and bananas. There is also emphasis on coffee and tropical fruit production.

4.42 In recent years Western Samoa has established a number of import substituting manufacturing concerns including a brewery, a feed mill, and a cigarette factory. Small units have been established for production of a wide range of products.
4.43 In the current planning period some shift in emphasis is envisaged towards export production, particularly on the basis of processing of local products. Such firms will be given priority under incentives and an export incentive is being considered. Although import substitution potential is seen as limited, the tariff is currently being reviewed with regard to its protective effect.

Vanuatu:

4.44 Recently independent Vanuatu has a reasonable balance of payments and is giving immediate priority to the re-establishment of customary ownership by its indigenous peoples of land alienated to European ownership under colonial rule. More than 80 per cent of the population is spread through the rural areas of the islands of Vanuatu and most of these are engaged in subsistence agriculture. There is also extensive plantation and small holder production of cash crops for export.

4.45 Vanuatu's exports are dominated by copra, which accounted in 1979 for 51 per cent of exports. Vanuatu's copra production is relatively very high by Pacific standards and is in the vicinity of 400 kilograms per capita as compared with about 100 kgs per capita in the Solomon Islands and Samoa and about 50 kg per capita in Papua New Guinea and Fiji. The next most important export is frozen fish. Other significant exports include cocoa, beef and manganese. Vanuatu's balance of payments also benefits from a significant level of tourism and from registration and other revenues generated by its tax haven.

4.46 The primary development emphasis is on an expansion of agricultural production particularly through the development of plantations which have reverted to customary ownership. It is planned to develop production of coconut, palm oil, cocoa, pepper and cattle. It is expected that the benefits of the planned programmes will flow on to the small-holder producers.
4.47 There is very little manufacturing activity in Vanuatu and there is no significant urban unemployment problem. The emphasis at this stage is on the development of small rural-based industries to meet local needs, although there has been some consideration of some larger ventures such as a brewery, an oil mill and biscuit manufacture.

Tonga:

4.48 Tonga faces a severe trade imbalance, which has worsened over recent years. In 1979 imports exceeded exports by more than four to one. This imbalance is somewhat reduced by tourist and similar earnings.

4.49 Tonga, as Table 4.5 shows, is also one of the more densely populated countries in the region and there is pressure on land for local food production. It appears that real output from agriculture declined slightly from 1975 to 1979. Exports showed no growth but there may have been an increase in produce marketed locally.

Table 4.5 POPULATION DENSITY 1979

<table>
<thead>
<tr>
<th>Country</th>
<th>Persons per square km</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tuvalu</td>
<td>285</td>
</tr>
<tr>
<td>Kiribati (excluding Christmas Islands)</td>
<td>169</td>
</tr>
<tr>
<td>Tonga</td>
<td>137</td>
</tr>
<tr>
<td>Cook Islands</td>
<td>77</td>
</tr>
<tr>
<td>TIPPI</td>
<td>72</td>
</tr>
<tr>
<td>Western Samoa</td>
<td>53</td>
</tr>
<tr>
<td>Fiji</td>
<td>34</td>
</tr>
<tr>
<td>Niue</td>
<td>14</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>10</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>8</td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>7</td>
</tr>
</tbody>
</table>

(Note: persons per sq km is a very rough indicator of population pressure. The only adjustment made for this table is that for Kiribati, for which inclusion of the large and thinly populated Christmas Island would reduce the national total to 82 persons per sq km.)
4.50 Tonga's small manufacturing sector has shown significant growth in recent years with the establishment of the small industries centre, a coconut oil mill and a new desiccated coconut factory. Between 1975 and 1979, employment in the sector increased from 611 to 1062.

4.51 Tonga sees an urgent need to increase the production of goods and services and to secure an increase in the real incomes of its people. To this end they see three urgent priority needs:

(a) infrastructural developments in road, wharfing and air services;
(b) the promotion of agriculture and fisheries; and
(c) the promotion of manufacturing industry.

4.52 Rural development emphases include expansion of production of traditional subsistence and cash crops, a greater emphasis on development in the outlying islands, vanilla development in Vava'u and improvement in fisheries.

4.53 Further development of manufacturing is envisaged with the possibility of an expansion of the small industries centre, and some changes in protective policy.

Federated States of Micronesia:

4.54 The four Federated States of Micronesia (Truk 39,000, Ponape 23,000, Yap 9,000 and Kosrae 5,000) are basically agricultural economies dependent to a marked degree in recent decades on financial assistance from the United States as the administering authority of the Trust Territories of the Pacific Islands.
4.55 The newly independent states see an urgent need to build a more self-reliant economy. The main growth possibilities are seen in agriculture, marine resources, and tourism.

4.56 Agriculture is the largest income and employment producing sector and constitutes the main economic activity of approximately 50 per cent of all households. It is characterised by part-time family activity with most production for family consumption. Major areas for development include coconut products, staple crops, vegetables and fruits, pepper, rice, pork, beef, poultry and eggs. The main policy emphasis is on expanding production of those crops which are already produced within the area.

4.57 The Federated States of Micronesia have major marine resources and the exploitation of these by nationally-based facilities is a major development priority. Wharf and related facilities are being upgraded and cold storage and possibly canning facilities are envisaged. The extensive lagoon areas are seen as offering unique opportunities for oyster, shrimp and fish cultivation.

4.58 Tourism is not a major industry in the Federated States at present. It is, however, of major importance in neighbouring Guam and Saipan. A considerable long term potential is felt to exist although this is moderated by transport difficulties and a concern about whether tourist development, as in Guam and Saipan, is compatible with maintaining traditional patterns of life.

4.59 There is little manufacturing activity in the Federated States with such activity as there is being focused on meeting local needs. Possible areas for expansion include processing plants. There is something of an unemployment problem in the Federated States but it is thought that in the next few years the needs of infrastructural development, funded through a continuing compact with the United States, will ensure an adequate supply of job opportunities.
4.60 Development planning in Kiribati is dominated by the need to build up new income earning capacity in the economy to compensate for the loss of the now exhausted phosphate deposits on Banaba. Development possibilities are limited by the geographical fragmentation of the country. Kiribati comprises twenty-two widely scattered inhabited islands. These typically have populations of about 2,000 persons except for South Tarawa which has a population of 18,000 with a density per square kilometre of more than 2,000.

4.61 In 1978, just over one fifth of the working age population was in wage employment. The majority of the remainder were engaged in subsistence production in the village economy. A major objective of development planning is to assist an increase in production from subsistence agriculture and fishing.

4.62 In addition, the 1979-1982 National Development Plan defines three major emphases in increasing monetary production in Kiribati. These are the development of a tuna industry using cultivated milkfish as bait (two pole and line boats are currently operating); secondly, a coconut replanting programme is being continued; and finally it is hoped to develop some small industries.

4.63 The main constraints on development of manufacturing are seen as a lack of management skills, the small size of the local market, the high cost of imported materials, a lack of local materials and a lack of local skills. These are severe limitations but it is hoped to expand manufacturing and industrial activity by local people. In addition it is hoped that foreign investment, preferably in the form of joint ventures, may be attracted to development possibilities in commercial fishing, coconut products, mining (seabed deposits of phosphate and manganese) and tourism.
Cook Islands:

4.64 In the Cook Islands, continuing migration to New Zealand has led to a decline in the size of the workforce during recent years. Agricultural employment and production have fallen significantly. Employment in the service sector has increased, partly as a result of tourist development, whilst manufacturing employment (which accounts for about 10 per cent of the labour force) remains reasonably steady.

4.65 The Cook Islands economy is much influenced by its links with New Zealand. The longstanding right of duty and licence free access to the New Zealand market has helped sustain the operations of the fruit juice factory and the two major clothing factories. The opening of the airport on Rarotonga, coupled with an automatic right of entry to New Zealand, facilitated the surge in emigration during the 1970s and more recently has permitted the development of a significant tourist market.

4.66 The Cook Islands does not have a sectoral development plan but in recent years has placed much emphasis on stimulating the development of local business activity in service and manufacturing activities.

Tuvalu:

4.67 Tuvalu has a predominantly subsistence economy, with about 70 per cent of the economically active population being engaged in village agriculture, fishing or other household pursuits. Two-thirds of those engaged in cash employment are employed on Funafuti, mainly in the government sector. In addition, some 250 Tuvaluans are employed overseas as seamen.
4.68 Tuvalu's Second Development Plan 1980-83 places main emphasis on agricultural and infrastructural development. At the same time it is hoped to increase the level of small business activity which is at the moment confined to a few local companies.

Niue:

4.69 Niue's monetary economy is dominated by the government sector, which accounts for about 72 per cent of monetary GDP. A prime objective of the Niue National Development Plan 1980-1985 is to provide an increase of some 230 job opportunities, particularly in the private sector. The government's major thrust in developing employment opportunities will be to encourage private sector investment in agriculture, agro-based industries and light manufacture.

MANUFACTURING DEVELOPMENT - THE REGIONAL PERSPECTIVE

4.70 It is evident from the preceding review that for most countries in the region manufacturing development objectives are modest. The prime concern throughout the region is with the development of agriculture, with the twin objectives of increasing national food supplies and increasing exports of tropical agricultural products. Next priority is accorded to exploitation of other natural resources such as fish, minerals and forestry. The development of urban manufacturing usually ranks last in the scheme of priorities. Within manufacturing a distinction needs to be drawn between industries processing agricultural and other natural resource products and those dependent on imported raw materials. Priority is given to the former grouping.

4.71 This broad picture disguises some significant variations between countries. Three major patterns are evident:
A. Four countries - Papua New Guinea, Fiji, the Solomon Islands and Vanuatu - have reasonably balanced external accounts, relatively low population densities, and see an adequate range of agricultural natural resource and related development options. In consequence little emphasis is given to manufacturing development. Fiji differs somewhat. It has the highest per capita GDP, and the most developed manufacturing sector. It has followed a deliberate policy of encouraging manufacturing.

B. Two middle order countries - Western Samoa and Tonga - have severe trade deficits and higher population densities - particularly in the case of Tonga. Agricultural and other natural resource development options are more limited and the countries are actively promoting manufacturing as a means of increasing production and providing employment. There is a preference for industries processing natural resources but import substitution and export production on the basis of imported materials are both being actively promoted.

C. The remaining five countries - the Federated States of Micronesia, Kiribati, the Cook Islands, Tuvalu and Niue - although somewhat diverse, show some common features. The five countries are the smallest in our grouping and the larger of the countries are extraordinarily fragmented geographically. Agricultural development opportunities are often somewhat restricted although there is considerable variation between countries. The group has a high level of dependence upon overseas financial assistance and development plans are predicated on the continuation of such assistance. The countries generally do not see very many opportunities for manufacturing development but are interested in encouraging foreign commercial investment, particularly in resource development, and in encouraging a general increase in local entrepreneurial activity.
Chapter Five

APPROPRIATE POLICIES - THE PLACE OF INCENTIVES

INTRODUCTION

5.1 The test of an incentives policy is that it promotes well chosen objectives, effectively and economically. The main purpose of this chapter is to examine the likely effectiveness of the earlier summarized incentives offered by SPEC member countries in promoting the objectives discussed in the previous chapter. Before proceeding to a detailed examination of this question, it is necessary to comment briefly on some wider issues.

5.2 There are major differences amongst economists on the extent to which governments should interfere with the free play of market forces in attempting to promote objectives such as those discussed in the last chapter. For example, many economists would argue that whilst tariff protection may encourage the faster growth of the protected industry, the costs which it imposes on consumers of the industry's products will almost certainly outweigh the gains resulting from faster growth in the protected industry. Similarly, against the gains which may result from the growth of a firm encouraged by a tax holiday have to be set the costs of collecting that tax revenue from some other source and the consequences of diverting resources such as labour capital and entrepreneurial skills from other areas where they might have yielded better results. Faced with such dilemmas much economic advice is advanced on the basis that the course of economic development is best determined by market forces alone and that the best policies are those that interfere least with the workings of the market.
5.3 Although these issues are too large to be resolved here, I should indicate that such are not my views. Rather, as I see it, the circumstances of the real world are such as to require positive interventions by government. The concentration of industrial power and experience in the developed economies, and factors such as economies of scale and uncertainty, all mean that market forces alone are unlikely to provide an adequate stimulus or guide to development. And, of course, historical and colonial experience shows that the free play of markets was all too often entirely consistent with stagnation. In short, continuing public intervention is necessary to secure an appropriate pattern of development.

5.4 This said, market forces do remain of fundamental importance. Also, public policies can be counter-productive. As noted in the previous chapter, the defining characteristic of a developed economy is the existence of a wide array of commercially viable enterprises. Continued commercial viability depends upon an ability to respond to evolving market conditions and there is a danger that a tradition of government intervention will encourage firms to seek a solution to their problems through government rather than through adaptive change by the firm itself. Also, there is the problem that the desired benefits which provide the focus for a policy are usually much more visible than the often diffuse costs of the policy. There is thus a danger that one may conclude that a policy is succeeding because some specified objective is being achieved even though a fuller accounting would show that that gain was outweighed by associated costs elsewhere.

5.5 Ultimately this is a matter of balance. The desirable extent of intervention cannot be settled in the abstract by appeals to theory but depends upon a practical weighing of the gains likely to flow from securing the declared objective and the costs likely to be incurred in promoting it.
5.6  Assessment of the costs of a policy is difficult because these can arise in many ways. A tax holiday entails the foregoing of public revenue. This is arguably no cost if the firm would not otherwise have come into being, but equally there is a cost if the firm would have established anyway. On such matters certainty is not possible. Further, the encouragement of activity in one area may divert money and scarce entrepreneurial skills from other sectors. Similarly any public expenditure requires money which could be used elsewhere, perhaps more profitably. As noted earlier, analogous problems arise in assessing the cost of tariffs. Such questions are all subtle in that they depend on the interaction of many influences. The costs and gains of intervention are often hard to define and difficult to measure.

5.7  Policy making is difficult. Objectives and policy instruments are often fringed with uncertainty. But the issue cannot be avoided. Policies must be formed and in the end uncertainty simply establishes the need for open discussion and argument about the direction and efficacy of policy.

COMPARING INCENTIVES

5.8  As we saw in Chapter 2, a temporary exemption of manufacturing profits from income tax is offered in some circumstances by every island member country of SPEC. In addition, many countries offer some form of accelerated depreciation, whilst a few offer an investment allowance. The effectiveness of such incentives depends both on their amount and on whether they accrue in ways likely to modify the behaviour of the recipient. In comparing the incentives offered, it will be useful to work in terms of a hypothetical firm. As with all arithmetic examples, the outcome is conditioned by our initial numerical assumptions. Reasonably chosen number do however have the advantage of giving some feel of the comparative weight of the incentives - a feature which is usually absent from both literary and more complex algebraic analyses.
5.9 The essential characteristics of the project are set out in Table 5.1. A firm is contemplating investing $175,000 in a manufacturing operation which will build up to annual sales of $296,000 in its third year of operation and to a gross surplus (before deductions for depreciation or tax) of $60,000. The assumed rate of company tax is 35 per cent. The project is shown as paying no tax in its first two years and a reduced rate of tax in its third year. This results from the offsetting of the $39,500 loss incurred in the first year against profits earned in years two and three. Beyond year three, profits continue to rise slightly as depreciation entitlements, which are calculated on diminishing values, fall. In practice this may well not be realistic as the firm might be expected to undertake some further investment. However, no such additional investment is assumed.

5.10 In comparing project benefits which arise in future from an investment made now, it is usual to discount future benefits because money held now is generally valued more highly than the promise of money in future. As the concessions which we are discussing have rather different time profiles, discounting is appropriate. In the commentary which follows I make use of the two standard measures; the net present value of the project (calculated at a discount rate of 15 per cent), and the internal rate of return of the project. These measures are defined in a footnote below and are exemplified in Table 5.2

Note: The net present value of a project measures the sum of the discounted values of annual net cash flows from the project less investment costs plus the residual value of the investment at the end of the project. In terms of Table 5.2 the net present value of our base case proposal is -$10,378 at a discount rate of 15 per cent. This negative value indicates that the project does not quite meet the desired rate of return. The internal rate of return of a project is that discount rate which exactly balances discounted costs and benefits and gives a net present value of zero. This internal rate is determined arithmetically by a process of trial and error. For our base case the internal rate of return is 14.0 per cent (to the nearest 1/10th of a per cent - the NPV of -$374 being insignificant in these terms).
Table 5.1

A HYPOTHETICAL PROJECT

<table>
<thead>
<tr>
<th>Total investment $170,000 comprising:</th>
<th>Original investment year 0</th>
<th>Residual value year 11</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buildings</td>
<td>80,000</td>
<td>62,107</td>
</tr>
<tr>
<td>Plant and equipment</td>
<td>50,000</td>
<td>9,843</td>
</tr>
<tr>
<td>Working capital</td>
<td>45,000</td>
<td>45,000</td>
</tr>
<tr>
<td></td>
<td>175,000</td>
<td>116,950</td>
</tr>
</tbody>
</table>

Depreciation rates: Buildings 2½ per cent DV
Plant and equipment 15 per cent DV

Production Account

<table>
<thead>
<tr>
<th>Year</th>
<th>Sales</th>
<th>Materials</th>
<th>Wages and Overheads</th>
<th>Gross Surplus</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>180,000</td>
<td>140,000</td>
<td>70,000</td>
<td>-30,000</td>
</tr>
<tr>
<td>2</td>
<td>266,000</td>
<td>160,000</td>
<td>76,000</td>
<td>30,000</td>
</tr>
<tr>
<td>Years 3-10</td>
<td>296,000</td>
<td>160,000</td>
<td>76,000</td>
<td>60,000</td>
</tr>
</tbody>
</table>

Appropriation Account

<table>
<thead>
<tr>
<th>Year</th>
<th>Depreciation</th>
<th>Tax</th>
<th>After Tax Profit</th>
<th>Gross Surplus</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>9,500</td>
<td>-</td>
<td>-39,500</td>
<td>-30,000</td>
</tr>
<tr>
<td>2</td>
<td>8,325</td>
<td>-</td>
<td>21,675</td>
<td>30,000</td>
</tr>
<tr>
<td>3</td>
<td>7,320</td>
<td>12,199</td>
<td>40,481</td>
<td>60,000</td>
</tr>
<tr>
<td>4</td>
<td>6,460</td>
<td>18,739</td>
<td>34,801</td>
<td>60,000</td>
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<tr>
<td>5</td>
<td>5,722</td>
<td>18,997</td>
<td>35,281</td>
<td>60,000</td>
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<tr>
<td>6</td>
<td>5,090</td>
<td>19,219</td>
<td>35,691</td>
<td>60,000</td>
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<tr>
<td>7</td>
<td>4,547</td>
<td>19,409</td>
<td>36,044</td>
<td>60,000</td>
</tr>
<tr>
<td>8</td>
<td>4,079</td>
<td>19,572</td>
<td>36,349</td>
<td>60,000</td>
</tr>
<tr>
<td>9</td>
<td>3,677</td>
<td>19,713</td>
<td>36,610</td>
<td>60,000</td>
</tr>
<tr>
<td>10</td>
<td>3,330</td>
<td>19,835</td>
<td>36,835</td>
<td>60,000</td>
</tr>
</tbody>
</table>

TOTALS

<table>
<thead>
<tr>
<th>Years</th>
<th>Depreciation</th>
<th>Tax</th>
<th>After Tax Profit</th>
<th>Gross Surplus</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-5</td>
<td>37,327</td>
<td>49,935</td>
<td>92,738</td>
<td>180,000</td>
</tr>
<tr>
<td>6-10</td>
<td>20,723</td>
<td>97,748</td>
<td>181,529</td>
<td>360,000</td>
</tr>
<tr>
<td>1-10</td>
<td>58,050</td>
<td>147,683</td>
<td>274,267</td>
<td>480,000</td>
</tr>
</tbody>
</table>

5.11 The project is being assessed over its first ten years of operation and yields an internal rate of return of 14 per cent. This is close to the firm's desired rate of return of 15 per cent, at which discount rate the project has a negative net present value, of -$10,378, in the absence of any incentives.
### Table 5.2 DISCOUNTING THE COSTS AND BENEFITS OF THE HYPOTHETICAL PROJECT

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Cash Flow (equals depreciation + after tax profit less investment cost plus residual value from Table 5.1)</th>
<th>Net Present Value</th>
<th>Discounting Rate of after tax 15 per cent</th>
<th>Net Discounting Value at Factor ((1.15)^n)</th>
<th>Net Discounting Value at Factor ((1.14)^n)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>Investment -175,000</td>
<td>-175,000</td>
<td>1.000</td>
<td>-175,000</td>
<td>1.000</td>
</tr>
<tr>
<td>1</td>
<td>-30,000</td>
<td>-26,087</td>
<td>1.150</td>
<td>-26,316</td>
<td>1.140</td>
</tr>
<tr>
<td>2</td>
<td>30,000</td>
<td>22,676</td>
<td>1.323</td>
<td>23,084</td>
<td>1.300</td>
</tr>
<tr>
<td>3</td>
<td>47,801</td>
<td>31,427</td>
<td>1.521</td>
<td>32,264</td>
<td>1.482</td>
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<tr>
<td>4</td>
<td>41,261</td>
<td>23,591</td>
<td>1.749</td>
<td>24,430</td>
<td>1.689</td>
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<td>5</td>
<td>41,003</td>
<td>20,389</td>
<td>2.011</td>
<td>21,296</td>
<td>1.925</td>
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<tr>
<td>6</td>
<td>40,781</td>
<td>17,631</td>
<td>2.313</td>
<td>18,579</td>
<td>2.195</td>
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<td>7</td>
<td>40,591</td>
<td>15,260</td>
<td>2.660</td>
<td>16,222</td>
<td>2.502</td>
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<td>8</td>
<td>40,428</td>
<td>13,216</td>
<td>3.059</td>
<td>14,172</td>
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<td>9</td>
<td>40,287</td>
<td>11,452</td>
<td>3.518</td>
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<td>3.252</td>
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<tr>
<td>10</td>
<td>40,165</td>
<td>9,927</td>
<td>4.046</td>
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</tr>
<tr>
<td>11</td>
<td>Residual Value 116,950</td>
<td>25,140</td>
<td>4.652</td>
<td>27,672</td>
<td>4.226</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>-10,378</td>
<td>-374</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

For each year Net Present Value = \[
\frac{\text{net cash flow}}{\text{discounting factor}}\]

(calculated values may vary slightly as in practice discounting factors were calculated to five decimal places).

5.12 How much will this firm benefit from:

- (a) a five year tax holiday?
- (b) an accelerated depreciation allowance?
- (c) an investment allowance?
- (d) import duty concessions?

In practice the extent of benefit will depend upon the exact details of the concession and upon the detailed fiscal regime of the country. Here we have to limit analysis to some of the more important variants.
**Tax Holidays**

5.13 Most countries in the region offer a simple five-year tax holiday. For our firm this would entail a tax saving of $49,935, which when discounted at 15 per cent would have a present value of $28,181. This would be sufficient to lift the net present value of the project as a whole from -$10,378 to $17,803. The net present value becomes positive and the internal rate of return of the project increases from 14.0 to 17.0 per cent.

5.14 The extent of tax savings during a tax holiday is affected by normal provisions for carry forward of losses. If losses could not normally be carried forward, the value of the tax holiday would increase. However, in our example we have assumed that losses may be carried forward so that even in the absence of a tax holiday the loss incurred in year one removes tax liability in year two and reduces that in year three. This assumption is realistic for, as was seen in Chapter 2, the countries of the region all allow losses to be carried forward either through their income tax laws or, in the case of Tonga, through its incentives legislation.

5.15 Tax holidays are of most benefit to those firms which move to early profitability. In contrast, firms which move slowly through break-even to profitability may derive little benefit, particularly if the tax holiday is of short duration.

5.16 Fiji has dealt with this problem by allowing firms to carry forward losses incurred during a tax holiday and use them as an offset in the years following the tax holiday. In the case of our firm an opportunity to carry its initial year loss forward to year 6 would reduce tax liability in that year by $13,825 with a discounted present value of $5,977. The internal rate of return of the project would increase to 17.6 per cent.

5.17 Most countries in the region impose no ceiling on their tax holidays but Fiji limits the amount of income entitled to a tax holiday to the greater of $8,000 or a percentage (which varies from 15 to 25
per cent on fixed investment, so that under Fijian law its concession entitlement would be reduced somewhat depending on its number of employees. Assuming that our firm employs between 25 and 50 persons, it would be entitled to a maximum annual concession of the tax on income equal to 20 per cent of its fixed investment. This amounts to an annual maximum of $7,000 (i.e. $26,000 x 0.35 = $7,000). Our firm's concession under this rule, and allowing for carry forward as in Fiji, would entail a total tax saving to the firm of $34,886. The discounted present value of the project would total $9,936 and the internal rate of return would be 16.0 per cent, 2 per cent higher than our base case but 1½ per cent less than under an unrestricted five-year tax holiday with carry forward.

5.18 The intent of ceilings such as those discussed in the previous paragraph is to ensure that profits are free of tax provided they do not rise above the specified rate of return. Beyond that point the state's taxing right is reasserted. Such practice can be justified in terms of both equity and efficiency; equity because those who earn high rates of return can reasonably be expected to contribute to public revenue; and efficiency because that high rate of return reduces the necessity for the incentive.

ACCELERATED DEPRECIATION

5.19 The depreciation concessions offered by SPEC member countries vary considerably. Generally they are additional to tax holiday provisions, and firms can postpone claiming depreciation until the end of the tax holiday period. This means that in the years following the tax holiday, depreciation provisions are higher than they otherwise would have been, profits are accordingly lower, and so are taxes.

5.20 Because most depreciation is calculated on a diminishing value basis and because allowable depreciation rates for buildings are low, depreciation entitlements spread forward over a very long period. At the same time, discounting diminishes the present value of remote benefits. Limiting our attention to our usual ten-year project appraisal
period, the advantages of deferred depreciation are limited to
the higher entitlements in years 6 to 10. The net present value
of the project increases to $19,822 as compared with $17,803 in
the case of a simple five-year tax holiday and the internal rate
of return rises from 17.0 to 17.2 per cent. The concession is
clearly of marginal importance.

5.21 More substantial benefits accrue when an entitlement to
delay depreciation is coupled with a right to accelerate the
rate of write-down. As noted in Chapter 2, the Cook Islands permit
write-down at will; Kiribati allows high rates of depreciation for
buildings (25 per cent in year of purchase followed by 10 per cent)
and plant (50 per cent followed by 25 per cent); Fiji allows write­
off of one-fifth of capital in any five of eight years; whilst the
Solomon Islands and Papua New Guinea offer more limited concessions.
Space does not permit analysis of all these variants but the Kiribati
example is interesting.

5.22 Kiribati rules would enable depreciation of $82,725 to be
written off during years 6 to 10 as compared with $20,723 under normal
schedules. The consequent saving in tax is $21,702 and when coupled
with the $49,935 tax saving under the tax holiday provisions increases
the discounted present value of the project as a whole to $36,710.
The internal rate of return rises to 17.6 per cent.

Investment Allowances

5.23 Finally, we need to look briefly at investment allowances.
As noted in Chapter 2, only three countries offer investment allowances
in addition to normal or accelerated depreciation. Fiji offers various
incentives in respect of hotel construction and investments promoting
fuel economy. In Western Samoa firms may be granted a right to
additional depreciation of 20 per cent. Finally the Cook Islands
accord manufacturing firms the right to a 100 per cent allowance which
may be granted on its own or in addition to a tax holiday. It is useful
to consider both these latter cases.
5.24 Taking the investment allowance on its own first, and working within the limits of our example including our hypothetical depreciation rates, it will be in the interests of the firm to apply the concession in addition to claiming normal depreciation entitlements. Writing off of $130,000 of fixed investment against profits will give an exemption from tax reaching into year 5 and entailing a total tax saving of $45,499 with a present value of $25,976. This increases the net present value of the project as a whole from our base case negative value of -$10,378, to a positive $15,598. The internal rate of return for the project increases from 14.0 to 16.6 per cent. It will be seen that on the figures of our example, a 100 per cent investment allowance delivers roughly equivalent benefits to a five-year tax holiday.

5.25 The combination of a five-year tax holiday and a 100 per cent investment allowance is, as is to be expected, considerably more valuable than either standing alone. The concession reaches into the eighth year of the project and gives a total tax saving of $95,436. The discounted present value of the project rises to $33,450 and the internal rate of return to 18.6 per cent.

The Income Tax Incentive Compared

5.26 The various incentives discussed so far are compared in Table 5.3. It is important to recall that the results depend upon the particular numerical assumptions that we have made; nevertheless, the broad pattern of the results gives a reasonable feel for the comparative strength of the incentives.

5.27 For our purposes, the most convenient summary measure is provided by the internal rate of return. In the absence of concessions this was 14 per cent, just one per cent below our assumed target rate of 15 per cent. A five-year tax holiday increased the prospective rate of return to 17 per cent and all but one of our various concession packages lay within one per cent of this figure either way. On the figuring of our example, the concession packages increased the firm's internal rate of return by from 2 to 4 per cent. The only exception was the combination of the tax holiday plus the investment allowance which led to a 4.6 per cent increase in the rate of return.
Table 5.3  
A COMPARISON OF INCENTIVES  
(assessed over ten years)

<table>
<thead>
<tr>
<th>Tax Saved</th>
<th>Discounted Present Value of Project* $</th>
<th>Internal Rate of Return of Project %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base case - no concessions</td>
<td>nil</td>
<td>-10,378</td>
</tr>
<tr>
<td>Five-year tax holiday</td>
<td>49,935</td>
<td>17,803</td>
</tr>
<tr>
<td>Five-year tax holiday with carry forward of losses beyond holiday period</td>
<td>60,435</td>
<td>22,342</td>
</tr>
<tr>
<td>Five-year tax holiday with ceiling and carry forward</td>
<td>34,886</td>
<td>9,936</td>
</tr>
<tr>
<td>Five-year tax holiday with deferral of depreciation</td>
<td>55,746</td>
<td>19,822</td>
</tr>
<tr>
<td>Five-year tax holiday with accelerated depreciation</td>
<td>71,637</td>
<td>26,332</td>
</tr>
<tr>
<td>Investment allowance on fixed assets in lieu of tax holiday</td>
<td>45,499</td>
<td>15,598</td>
</tr>
<tr>
<td>Investment allowance on fixed assets plus tax holiday</td>
<td>95,436</td>
<td>43,828</td>
</tr>
</tbody>
</table>

* at discount rate of 15 per cent

5.28 We can now make a more general assessment. The investor's return accrues through his tax-paid profits. The state can increase that flow by reducing the amount of tax which it imposes and it can do this in a variety of ways. The limits of what it can do are however set by its rate of taxation and by the profitability of the project.

5.29 In our example of a 35 per cent tax rate, the state has the power to vary the proportion of post-tax to total profits anywhere within the range of 0.65 to 1.00 of that profit stream. The latter figure can be achieved only by foregoing tax entirely for the full project period and, for our project, this would increase the internal rate of return to 19.6 per cent.**

** The increase from 14.0 to 19.6 per cent by a factor of 1.4 is rather less than is suggested by the ratio of pre-tax to post-tax profits; namely $1.00 \div 0.65 = 1.54$. The difference is explained by the residual value of the project, which is not affected by taxation.
5.30 Higher tax rates would give a higher gearing, but the important point to recognise is that the upper limit to the rate of return that can be secured by way of tax concession depends upon the pre-tax rate of return of the project. If that should fall below the investor's target rate of post-tax returns, then no amount of tax concessions will make the project attractive.

5.31 The situation can thus be summarised as follows:

(a) if under normal tax rates, the firm's after-tax rate of return is below target whilst its pre-tax return is above the target rate, then concessions could be designed which lifted the post-tax rate of return above the target level. Whether any particular concession would be effective depends upon the facts of the case;

(b) if the pre-tax rate of return from a project falls below the firm's post-tax rate, then no amount of tax concessions will make the project attractive;

(c) if, under normal tax rates, the firm's after-tax rate of return is above target, then there is no need for a tax concession.

Import Duty Concessions

5.32 As was noted in Chapter 2 all regional countries will in some circumstances, reduce customs duties on imports of materials and capital goods, as an incentive to local manufacture. In a majority of cases such concessions are given under general powers conferred by tariff acts and are usually given sparingly. In
Fiji, Tonga, Western Samoa and the Cook Islands rather more widespread concessions are given in terms of specific industrial development incentive laws and regulations.

5.3 In considering the effect of such duty concessions we assume that the firm in question has the same characteristics as before and, in addition, that it produces primarily for the local market, using both local and imported raw materials. It is assumed that the firm currently pays a 20 per cent tariff on its imported materials. The additional numerical assumptions are set out in Table 5.4.

Table 5.4

<table>
<thead>
<tr>
<th></th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3 to 10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local sales</td>
<td>180,000</td>
<td>250,000</td>
<td>270,000</td>
</tr>
<tr>
<td>Exports</td>
<td></td>
<td>16,000</td>
<td></td>
</tr>
<tr>
<td>Output</td>
<td>180,000</td>
<td>266,000</td>
<td></td>
</tr>
<tr>
<td>Local materials</td>
<td>50,000</td>
<td>60,000</td>
<td></td>
</tr>
<tr>
<td>Duty paid imports*</td>
<td>90,000</td>
<td>100,000</td>
<td></td>
</tr>
<tr>
<td>Total materials</td>
<td>140,000</td>
<td>160,000</td>
<td></td>
</tr>
<tr>
<td>* includes duty</td>
<td>15,000</td>
<td>16,667</td>
<td></td>
</tr>
</tbody>
</table>
5.34 In considering a reduction in tariff on materials, consideration is limited to the case where liability to pay the 20 per cent duty on materials is removed permanently and where the firm enjoys no other concessions. In practice, such concessions are often given temporarily and in conjunction with an income tax holiday.

5.35 Removal of the 20 per cent duty reduces duty payable during the 10 year appraisal period by $164,994 and the gross surplus of the enterprise can be assumed to increase by the same amount. Income tax liability will thus increase, by $57,748, leaving a net increase of $107,246 in tax paid profits. At a discount rate of 15 per cent, the net present value of the project increases by $52,639 from our base case of -$10,378 to a positive $42,261. The internal rate of return of the project rises from 14.0 to 19.6 per cent, a rate significantly higher than the 17.0 per cent yielded by the five year tax holiday.

5.36 In passing it is worth noting that countries which have given temporary duty concessions have often encountered difficulties at the end of the concession period. Faced with a sudden increase in costs, the firm may suddenly find its competitive position seriously eroded. In some cases this problem has been accentuated by competition from a later established firm which continues to enjoy the incentive.

The Effectiveness of Incentives

5.37 How effective have incentives been in practice in encouraging the manufacturing development sought by Pacific Island countries and what is their potential? These are difficult questions. Available information on the administration of incentives is limited and varies between countries. More fundamentally the picture that can be formed from an examination of experience to date is clouded because we cannot tell what would have happened had no incentives been offered or had the packages been somewhat different. Nevertheless it is important to distil what we can from regional experience to date. The following paragraphs do this on a country by country basis.
Papua New Guinea:

5.38 The Papua New Guinean manufacturing sector is largely foreign owned (to the extent of 86 per cent in 1974) and an important objective in the years since independence has been the development of locally based enterprise. In 1974, Papua New Guinea introduced a 5 year tax exemption for income earned by national companies. The scheme was intended to facilitate the transfer of economic power to national interests and in the first three years was widened progressively to achieve this purpose. It soon became apparent however, that the costs of the exemption were escalating rapidly and that a major portion of the revenue cost was benefitting expatriates despite the safeguards which had been introduced. In 1978 the scheme was amended and a ceiling imposed on the amount of benefit which could accrue to any one company. By the end of 1979 about 200 companies had benefitted from the scheme to a total cost in revenue foregone of K9.2 million.

5.39 In 1976 it was announced that because of a change in government priorities no further tax holidays would be approved under the old provisions of the 1965 Pioneer Industries Act. During the period from 1965 about 55 companies had been granted such concessions with a total revenue cost (to end 1979) of K3.3 million.

5.40 As noted earlier Papua New Guinea has developed a considerable array of grant and loan incentives. The Village Economic Development Fund provides for grants of up to 40 per cent of the capital required for small scale and preferably village based rural development activities. In 1980 181 grants to a value of K1.5 million were made. An analysis of grants made during 1978-80 shows the following sectoral distribution: agriculture 27 per cent, manufacturing 3 per cent, construction 5 per cent, transport 26 per cent, services 38 per cent.
5.41 The Credit Guarantee Scheme provides for a government guarantee of 80 per cent of the amount of approved bank loans. From 1976 to early 1981 guarantees had been given in respect of loans totalling K3.1 million. Actual payments against these guarantees totalled only K0.1 million. Most of the nearly 200 applications approved by early 1981 had been for either trade stores or basic motor vehicles.

5.42 The National Investor Scheme provides an additional source of loan funds for Papua New Guinean business groups wishing to initiate relatively large scale commercial projects. To early 1981 some four projects had been approved. These comprised a cattle project, a softwood plantation, a supermarket and an office block.

5.43 In addition to the preceding schemes which are aimed at Papua New Guinean investors there are a number of schemes designed to assist investors interested in promoting large scale projects. As at early 1981; infrastructure was being provided, subject to a negotiated user charge, for the Ok Tedi copper project; some three projects had been approved for assistance under the feasibility studies contribution scheme; whilst about five projects had been assisted with loan finance under the infant industry loan scheme.

Fiji

5.44 Such data as is available on the operation of the Fiji system of incentives suggests that the most valuable concession given in practice is that relating to fiscal tax on imports. In a 1977 study Chen Young (in a report prepared for UNIDO on behalf of the South Pacific Commission) estimated that in 1973 the tax loss involved in concessions
to 58 concession firms for which data was available amounted to $2,215,000 fiscal tax on imports and $119,000 income tax. Analysis of concessions granted to 35 firms in the eight months to May 1982 shows that 23 firms received concessions related to imports whilst only 11 were granted income tax concessions. In value terms the imbalance would be much more pronounced.

5.45 The Fiji concessions relate primarily to manufacturing firms and within manufacturing, concessions have been widely spread. Chen-Young's study showed heavy concentrations in food processing, wood and wood products, paper and paper products and, particularly fabricated metals and machinery. The 1982 data showed concentrations in food processing, textiles, chemical products (mainly household) and metal products.

5.46 In 1973 similar numbers of locally-owned and foreign firms benefitted from the incentives. Twenty-six were stated to be locally owned; 25 foreign owned; and six were joint ventures. Of the 35 firms approved in the eight months to May 1982, 17 were locally owned; six were foreign; whilst 12 were joint ventures.

5.47 Chen-Young and, more recently, the Central Planning Office have attempted to assess the effectiveness of incentives through surveys of business opinion. Their conclusions are very similar and accord with opinions expressed to me in a number of interviews. The main points which emerge are:-

- The income tax concessions are not generally seen as a significant incentive to investment
- The granting of concessions against fiscal duty on imports is an important concession
the complicated procedures involved in processing applications for approval of new industries act as a disincentive.

- there is widespread dissatisfaction about difficulties experienced in obtaining work permits for skilled technicians and management personnel.

Solomon Islands:

5.48 During the past decade the Solomon Islands Government has promoted a number of major resource related developments, in which the government is an important minority shareholder and has negotiated with its foreign partners comprehensive agreements covering the major commercial and fiscal aspects of the investment package. This emphasis on bilateral bargaining has led to a case by case tailoring of incentives and reduced the emphasis placed on tax holidays and other concessions.


"We were told that potential new investors give a high priority to applying for this relief, but that this may in large measure be only because there is provision for the relief. It was suggested that this may lead the potential investor to demonstrate that his project is only marginally viable, whereas the decision on whether or not to proceed with a project is made by reference to longer term commercial considerations. On the
other hand there was some feeling that the existence of the relief may help to create a favourable impression of Solomon Islands as an area for investment, and may as a result play some part in attracting investment. On balance, we feel that there is insufficient evidence for or against the provision for us to recommend any change. We recommend that Pioneer Relief be retained, but that any applications for the relief should be subjected to critical review and the relief only granted when there is a strong case for doing so."

5.50 The provision is not in fact used very often and it is of interest that the major company benefitting from it agreed to a change in its entitlement. This project came to profitability earlier than expected and agreement was subsequently reached on an earlier than planned termination of the tax holiday.

5.51 During the last few years Solomon Island owned companies have been entitled to a value limited exemption or partial exemption from tax for up to five years. A lot of firms have applied for the incentive. The Tax Review Committee noted that it had been given no evidence that the provision had any effect in encouraging Solomon Islanders to enter business. They suggested that the benefits so far seem to have been to businesses which were already successfully established. The Committee concluded however that it was too early to judge the success of the Solomon Island businesses and recommended the continuation of the scheme.

5.52 The Solomon Islands have made only limited use of powers to grant exemptions from customs duty. A number of firms have been accorded exemptions from payment of duty on capital items and a few have been accorded temporary exemption from import duties on raw materials. The 1972 joint venture agreement with Solomon Taiyo provided for duty free import, by the joint company, of all items required for its commercial operation.
Western Samoa

5.53 Western Samoan's Enterprises Incentives Act became law in 1965. In early 1980 the Department of Economic Development undertook a comprehensive review of the workings of the Act. By that time 96 enterprises had been approved of which 63 were still operating. Employment by approved enterprises totalled 1615 persons. It was estimated that the concessions given to the firms amounted in 1978 to about $100,000 income tax foregone and about $860,000 customs's duty foregone. The latter figure was unusually high because of large capital imports for three major manufacturing investments. In this regard it is also necessary to recall that Samoa has a relatively high tariff structure under which most imports are dutiable at 42 per cent. The Department concluded from its survey of businesses that the incentive scheme had been a major factor in promoting industrial development.

5.54 As is apparent from Table 5.5 most of the supported firms were engaged in manufacturing and this sector accounted for just over 1,000 of those employed. Of these close to one-half were employed in food processing, beverages or tobacco manufacture. Wood processing, particularly sawmillings, was the next most important group. Other important sectors were services (mainly hotels) and transport.

Table 5.5 WESTERN SAMOA - EMPLOYMENT IN FIRMS RECEIVING INCENTIVES

<table>
<thead>
<tr>
<th>No. of firms</th>
<th>Estimated employment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>5</td>
</tr>
<tr>
<td>Food, beverages and tobacco</td>
<td>16</td>
</tr>
<tr>
<td>Clothing and footwear</td>
<td>7</td>
</tr>
<tr>
<td>Sawmilling, wood products</td>
<td>7</td>
</tr>
<tr>
<td>Metal products</td>
<td>8</td>
</tr>
<tr>
<td>Other manufacturing</td>
<td>8</td>
</tr>
<tr>
<td>Hotels and other services</td>
<td>7</td>
</tr>
<tr>
<td>Transport</td>
<td>3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>61</strong></td>
</tr>
</tbody>
</table>

Source: Based on data from Department of Economic Development.
5.55 It is noteworthy that just over half of the total employment was provided by five major companies, all Samoan based, including the national airline, two hotels, and two manufacturing plants. Analysis of the shareholding of the supported companies shows a preponderance of local companies. Of the 61 companies for which data was available 46 were local (some of these had minor foreign shareholdings), 7 were joint ventures where control was divided between Samoan (often government) and foreign shareholders, and 8 had a foreign firm as the major shareholder. Table 5.6 shows an analysis of the shareholding in the supported companies.

Table 5.6 WESTERN SAMOA - SHAREHOLDING IN FIRMS RECEIVING INCENTIVES

<table>
<thead>
<tr>
<th></th>
<th>Samoan Capital</th>
<th>Foreign Capital</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Government</td>
<td>Private</td>
<td></td>
</tr>
<tr>
<td>Samoan controlled firms</td>
<td>1,700</td>
<td>1,600</td>
<td>100</td>
</tr>
<tr>
<td>Joint ventures</td>
<td>700</td>
<td>900</td>
<td>700</td>
</tr>
<tr>
<td>Foreign controlled firms</td>
<td>200</td>
<td>100</td>
<td>800</td>
</tr>
<tr>
<td>Total</td>
<td>2,600</td>
<td>2,500</td>
<td>1,600</td>
</tr>
</tbody>
</table>

Source: as for Table 5.5 but supplemented with a few author estimates.

5.56 It is clear from the preceding figures that the great majority of enterprises supported by incentives are Samoan based and that the Government of Western Samoa has itself played a major role as an investor. The number of foreign firms attracted by the incentives is not large. In assessing the effectiveness of the Western Samoan system of incentives it is important to recall the greater relative importance of relief from customs duties as compared with the value of income tax concessions. Samoa's high tariff structure means that in the absence of concessions local manufacturers can face high rates of duty on machinery and materials. The concessions given are thus likely to have played an important part in enabling firms to establish. The temporary
nature of the concession has created problems however. A longer term solution would seem to depend on revision of the tariff structure so that machinery and materials are dutiable at lower rates.

Vanuatu:

5.57 Vanuatu does not have a formed system of incentives. It does not impose an income tax and is an established tax haven. This has encouraged the development of a significant financial infrastructure in Vila and the well developed financial and other services are felt to provide a distinct incentive. There have also been some major tourist developments.

Tonga:

5.58 A late 1980 survey of firms licensed under the Tongan Industrial Development Incentives Act suggested current employment of just under 600 persons in firms operating under license with about another 400 persons expected to be employed in plants which were under construction but not yet operating. This latter figure included 300 persons expected to be employed in a new public sector desiccated coconut mill financed under Australian aid. In the manufacturing sector most approvals related to small scale import substituting operations but there were also several firms engaged in leather goods and timberwear production for export markets. Total projected employment in approved tourist facilities was something less than 200. A clear majority of the approved projects were controlled by Tongan nationals. There were also a significant number of joint-ventures and a smaller number of foreign controlled enterprises.

Federated States of Micronesia:

5.59 The Federated States of Micronesia has very low rates of taxation and little in the way of incentive legislation.
Kiribati:

5.60 The various incentives offered by Kiribati have attracted inquiries from investors interested in setting up various small scale resource exploitative ventures and a number of firms have had concessions granted to them.

Cook Islands:

5.61 The Cook Islands have for many years had a relatively high level of employment in manufacturing. Two clothing factories have exported to New Zealand for many years as has the fruit and juice cannery. Over the years a considerable number of ventures has been granted incentives but no overall analysis of these is available. It is clear that the right of access to the New Zealand market has been an important incentive which has encouraged interest from New Zealand companies. The relatively open migration situation has also encouraged the setting up of commercial ventures by Cook Islanders returning from New Zealand and by expatriate New Zealanders.

Niue:

5.62 A small number of local firms have been granted incentives in Niue.

5.63 This review of country experience and our earlier numerical analysis enable us to form some idea of the overall effectiveness of incentives. In considering this, it is useful to distinguish between investment by foreign firms and investment by locally based enterprises.

ATTRACTING FOREIGN INVESTORS

5.64 Most incentives in the region seem to have been originally directed at the encouragement of investment by foreign firms. In practice, however, most countries have found that most of the firms
applying for and being granted incentives are owned and managed by local businessmen, including both native born citizens and resident expatriates. It appears that the incentives offered have not been particularly effective in attracting foreign investment. This need not occasion any great surprise.

5.65 A lift of a few percentage points in the internal rate of return will certainly make a project more attractive than it otherwise would be, and so can be expected to induce some projects to go ahead. The problem is to determine how frequently this is likely to be the case. Pure theory is of limited help here and is indeed likely to be misleading. Theoretical emphasis on finely balanced equilibria and marginal adjustments implies a process of smooth and continuous adjustment and so encourages the belief that even a small overall increase in rates of return will release a range of investments which had been held back because they fell marginally short of the desired minimum return. This seems unlikely.

5.66 Investment is a complex process and requires decisions on a variety of issues. Sources of supply must be secured, labour must be available, an appropriate production process must be chosen, an adequate market has to be in prospect and the investor will look for political and social stability. Assuming that all these factors are set fair, a preliminary costing may decide the issue unequivocally one way or the other, or the project may remain in the balance in which case incentives may well play a part.

5.67 Recent international literature is generally sceptical about the effectiveness of incentives. Grant Reuber, in his book *Private Foreign Investment in Development*, concluded (page 13):

"The evidence assembled in several studies on the effectiveness of incentives in attracting foreign investment to the less-developed countries is somewhat inconclusive, in large measure because of the many elements affecting the investors' decisions and the difficulty of separating out the partial effect of the incentives provided. Nevertheless, these studies generally suggest that the incentives provided, while of some consequence, in stimulating the inflow of foreign investment were relatively ineffective."
More recently, David Lim - in his paper on Taxation in the 1980
Unido/World Bank volume Policies for Industrial Progress in
Developing Countries, argued:

"Empirical studies show that, in general, foreign investors
and host governments differ sharply in their estimations of
the major determinants of private foreign investment.
Foreign investors usually consider the most important
factors to be: establishment of, and adherence to, a national
development programme; favourable terms for the transfer of
profits and repatriation of capital; nondiscrimination
against foreign ownership and control; freedom from detailed
and burdensome regulations on organization, ownership and
management; and protection of their share of a domestic or
export market. The emphasis that most host governments give
to tax incentives is therefore misplaced."

5.68 These sceptical judgements accord both with our earlier
analysis and with experience to date in the Pacific Island countries.
During the course of my discussion in both public and private
sectors, I found a widespread dissatisfaction with current incentive
policies and a questioning of their effectiveness, particularly in
attracting foreign investment. The most notable foreign investments
which have occurred are those related to the exploitation of some
natural resource such as copper, fish, timber or tropical crops and
where related manufacturing operations have developed these have
generally flowed from the island government's exercise of its resource
bargaining power rather than as a result of inducement by way of
incentive. Foreign investment has been secured in other areas, both
for local market production and in a few instances for export
production based on imported materials. Incentives have usually been
offered in such cases and must be assumed to have played some part,
but we are not in a position to say more than that.

5.69 Assessing the effectiveness of incentives is made more
difficult by the fact that if incentives are offered it will obviously
be worth while for the firm to spend some time in ensuring that they
are secured. An increase of 2-4 per cent in the rate of return of a
project may not be enough to make a project attractive, but if the
project is attractive anyway that 2-4 per cent extra return will
justify investing many hours in dealing with the bureaucracy which is
thereby likely to be encouraged to attach undue significance to the
incentive.
5.70 Finally, on the effectiveness of incentives in attracting foreign investment, it is noteworthy that many private firms in the area complained that governments' overall attitude to foreign investment and the difficulty of securing prompt decisions discouraged the types of investment the incentives were intended to promote. I am not able to judge how this balances out but have no doubt that uncertainty and prolonged negotiations are powerful disincentives to the overseas investor. The preparation of feasibility studies and analysis of commercial possibilities is time consuming and often constitutes a major outlay, particularly for firms which have no established base in the territory of interest. Prolonged negotiations rapidly add to this expense and must be assumed to act as a powerful disincentive. Purely in dollar terms, a few extra weeks spent in negotiations adds significantly to the cost of a project and directly reduces, dollar for dollar, the cash value of any incentive which might be forthcoming.

ENCOURAGING LOCAL INVESTMENT

5.71 As was noted earlier, Pacific Island countries have in practice accorded most investment incentives to local entrepreneurs, either native-born or expatriates. In Papua New Guinea and the Solomon Islands, incentives have been specifically directed at indigenous entrepreneurs.

5.72 Given the small scale of many of these enterprises, it is unlikely that their proponents make sophisticated financial analysis of their prospects or that they think of a tax holiday as adding so many percentage points to the internal rate of return of the project. Rather, it is likely that the promise of tax exemption is seen as a clear indication of official support offering the possibility of a faster recovery of the cost of the original investment. There is room for argument about the desirability of subsidizing the more rapid accumulation of wealth by an emergent grouping of capitalist manufacturers in the islands. But there is no doubt that such an argument can be built. If the development course to be followed is one of encouraging the rapid growth of individual entrepreneurs - as has been characteristic of industrial growth in most countries - then tax
holidays would seem to have a part to play. The danger is that loosely administered they may merely tend to further concentrate wealth in those commercial classes which have established access to positions of political power and that they may do this without significantly enhancing the productive structure of the island economies.

5.73 Obviously these are large issues and it would be wrong for me to attempt a judgement on them in this context. The answers have to be distilled over time by the peoples and governments of the region. Suffice it to say that there is a problem and that it is inherent in the transition to a modern high income cash economy. Furthermore the issue does not really relate solely to the encouraging of local entrepreneurship but is present in a related form in incentives aimed at foreign investors. The strains that industrial development place on the island economy stem essentially from the technical, productive and class relationships inherent in the factory system. The accumulation of capital in entrepreneurial hands imposes strains regardless of whether the entrepreneur is foreign or local, private or state. It may well be that any enhancement of the role of local entrepreneurs helps ease the problems of transition.

TAILORING INCENTIVES

5.74 It will be clear from the preceding discussion that there must be considerable doubt about the effectiveness of the incentives offered within the region. In many countries quite generous incentives have been on longstanding offer with little obvious effect upon the pace of development. They nevertheless carry the implication that when a firm does decide to set up an operation it will expect, almost as a matter of course, to be exempted from tax for a period, with consequential cost to public revenues. These considerations suggest that quite apart from the possibility of regional harmonization, which is discussed in the final chapter, there is a need for countries in the region to review their own policies in the light of their experiences to date. Many are already doing so.

5.75 It is possible at this point to draw some conclusions about the desirable features of an incentives policy.
5.76 First, it is clearly important to specify the objectives of the incentives and to make use only of those incentives which seem likely to contribute directly to those objectives. The key questions are what is it that we want done and who are we trying to encourage to do it? Who are we trying to encourage to do what? Our discussion on foreign and local investment certainly suggests differences in motivation and in needs. Appropriate policies need to recognize such differences. The specification and tailoring of incentives has to be an ongoing process and will be much assisted by continuing public debate on objectives and policies.

5.77 Second, it would seem desirable to generalize incentives, so far as this is possible, so that they are automatically, or as nearly so as possible, available to all those in the target area. If we can define the criteria which meet our objectives with sufficient clarity so that potential investors can accurately assess their own entitlements (as is the case under a tariff, for example), the information ordinarily available to investors is markedly increased. The investor is thus much better placed to make a quick assessment of the probable merits of the proposal and will have fewer grounds for fearing prolonged negotiations. For the government there is the direct benefit of a reduction in the burden of administering incentives case by case. Such considerations are particularly important in the case of duties on plant and raw materials, where there is a strong case in many countries for giving concessions on a general basis through the tariff rather than administratively case by case.

5.78 Thirdly, where concessions must remain dependent on administrative decision, then there is a need to combine full consideration with speedy decision. This is not an argument for cutting corners. Where large investments are being considered a lot of money is at stake and many other issues are likely to arise. These need to be properly considered and can justify prolonged administrative effort. On the other hand, where investments are small, prolonged negotiations add disproportionately to both the private and public costs of the project. If the amount at stake, and the
possibility of adverse effects is small, then the risks of speedy decision-making are slight.

5.79 Fourthly, it is desirable to make the terms of a concession specific. In some countries the concession is given on a provisional basis so that the exact level of an entitlement can only be determined after the event. Such practices are without merit. Uncertainty about actual future entitlements must remove most of the incentive whilst the existence of an unresolved future liability creates the possibility of future conflicts a waste of administrative time and unproductive public expenditure.

5.80 Fifthly, the action of discounting in reducing the value of distant concessions argues strongly against the granting of unduly prolonged incentives. To take an extreme example, a $1,000 concession given in twenty-five years has a present value of only $30 at a discount rate of 15 per cent. Such a concession can have no more than a negligible effect on any investment decision now, but imposes a definite obligation on the children of those who granted the concession. Distant incentives are unlikely to be cost-effective. This strongly suggests focussing incentives on the early years of a project.

TAX INCENTIVES IN A WIDER PERSPECTIVE

5.81 In concluding this chapter it is useful to widen our earlier analysis by comparing the strength of income tax incentives with that of tariff and exchange rate policies. In analysing tariff changes we can use the extended version of our earlier model. For exchange rates we have to resort to more general commentary.

5.82 The imposition of a tariff on competing imports is a standard means of providing protection for local manufacture. To assess the possible impact of tariff action, I assume that the imposition of a 10 per cent tariff on competing imports enables the local firm to increase its local prices by the same amount. Revenues, profits and income tax liabilities increase accordingly. On this basis, after tax profits earned during the ten-year appraisal period increase from
$274,267 to $442,617. The net present value of the project increases from -$10,378 to $72,958 and the internal rate of return from 14.0 to 22.4.

5.83 A 10 per cent tariff is compared with a five-year tax holiday and a 20 per cent duty concession in Table 5.7. It is clear that the tariff has a stronger potential effect than does the tax holiday. The duty concession ranks in between. The percentage tariff increase which we have assumed is quite small and a larger increase could be expected to have rather greater effects. Of itself, however, this does not establish that the tariff is the preferred measure. Clearly, it exerts more leverage but other factors have to be taken into account.

Table 5.7

<table>
<thead>
<tr>
<th>TAX HOLIDAYS AND TARIFF CHANGES</th>
<th>Discounted Present Value of Project* $</th>
<th>Internal Rate of Return of Project %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base case - no concession</td>
<td>-10,378</td>
<td>14.0</td>
</tr>
<tr>
<td>Five-year tax holiday</td>
<td>17,803</td>
<td>17.0</td>
</tr>
<tr>
<td>Abolition of 20 per cent duty on raw materials</td>
<td>42,261</td>
<td>19.6</td>
</tr>
<tr>
<td>Imposition of 10 per cent duty on competing imports</td>
<td>72,958</td>
<td>22.4</td>
</tr>
</tbody>
</table>

5.84 First we need to acknowledge that our numerical assumptions are quite restrictive; the firm may, for example, be prepared to forego some of the possible price increase in the hope of increasing sales. Equally the authorities might well think twice about giving tariff protection to a project which was already earning a 14 per cent return. Accepting the figures as they are, however, the different measures have quite different revenue implications. Whereas a tax holiday entails the foregoing of public revenue, a tariff increase will increase revenues both from the tariff itself and from tax on increased local profits. This beneficial effect on public revenues is, however, offset by the increase in prices which consumers would
have to pay as a result of the increase. The incentive is in effect funded by the consumer. Finally, the tariff may be objected to on allocational grounds. The powerful leverage inherent in the tariff may encourage investment in areas where the manufacturer could not otherwise expect to cover his costs. In contrast the tax holiday although offering less leverage has the advantage that it will only be attractive to firms which have the potential to achieve profitability at existing price levels. Such firms are clearly preferable in terms of investment priorities.

5.85 Exchange rate policy is more far reaching, and more difficult to summarize than any of the incentive measures which we have discussed so far. It is nevertheless of fundamental importance because the exchange rate exerts an influence on the cost structure and thereby the profitability of practically every business in a country. A devaluation simultaneously provides encouragement to exporters, by increasing the local currency value of their exports, and to producers for the local market, by increasing the price of competing imports. It is, however, very difficult to assess the effect of a devaluation on a particular firm because the measure is general and affects all others as well. While one firm may benefit because of an increased ability to sell on the local market, it may lose something because its own suppliers are also enabled to increase prices because of the devaluation. Its employees may also seek increase in wage rates. These complexities render arithmetic examples, such as we have used earlier in this chapter, inappropriate.

5.86 It is, however, possible to state that the various measures which we have discussed fall into a natural hierarchy both in terms of generality and strength. The exchange rate is by far the most general and, depending on the extent of variation, can exert great leverage. A tariff increase is more limited in that it provides encouragement only for import substitution (and may indeed hinder exporting). It does, however, provide a highly geared incentive which can range from an across-the-board change (equivalent to half
a devaluation), to highly specific changes intended to benefit only one or two firms. Finally, tax holidays are granted to specific firms by administrative action and are limited as to the amount of financial benefit by the actual profitability of the firm.

5.87 The major conclusion which follows from this hierarchy is that changes, or even existing distortions in the major policy instruments, are quite capable of swamping the effect of minor policy instruments. Thus, if an exchange rate is seriously over-valued, the disincentive offered both to export production and import substitution is likely to far outweigh the positive effect of fiscal incentives designed to encourage such incentives.

5.88 It is not, of course, an easy matter to determine an appropriate exchange rate. Technical and political problems abound but the figures presented in Table 5.6 suggest that the relationships deserve closer attention. In reading the table, which is based upon readily available trade data, it is important to recall that the more comprehensive and relevant balance of payments (for which comparable regional data are not available) is affected by invisible as well as trade transactions. Thus the foreign exchange situation in Fiji is, because of tourism, somewhat stronger than suggested by Table 5.8. The figures can also be misleading for other reasons. Most notably, the favourable position shown for Kiribati has already passed with the exhaustion of the phosphate deposits on Ocean Island.
Table 5.3  TRADE BALANCES IN THE SPEC REGION, 1978

<table>
<thead>
<tr>
<th>Country</th>
<th>Trade Balance per capita $A</th>
<th>Gross Domestic Product per capita $A</th>
<th>Trade Balance as per cent of GDP %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kiribati</td>
<td>130</td>
<td>660</td>
<td>20</td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>28</td>
<td>519</td>
<td>5</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>-1</td>
<td>382</td>
<td>-</td>
</tr>
<tr>
<td>Fiji</td>
<td>-219</td>
<td>1,227</td>
<td>-18</td>
</tr>
<tr>
<td>Federated States of Micronesia</td>
<td>-128</td>
<td>705</td>
<td>-18</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>-119</td>
<td>452</td>
<td>-26</td>
</tr>
<tr>
<td>Tuvalu</td>
<td>-208</td>
<td>600</td>
<td>-35</td>
</tr>
<tr>
<td>Tonga</td>
<td>-119</td>
<td>431</td>
<td>-43</td>
</tr>
<tr>
<td>Western Samoa</td>
<td>-235</td>
<td>304</td>
<td>-77</td>
</tr>
<tr>
<td>Niue</td>
<td>-510</td>
<td>632</td>
<td>-81</td>
</tr>
<tr>
<td>Cook Islands</td>
<td>-777</td>
<td>941</td>
<td>-82</td>
</tr>
</tbody>
</table>


Such points allowed, the figures remain striking. They show that the balance of trade varies markedly amongst SPEC member countries and ranges from a situation of near balance in Kiribati, Papua New Guinea and the Solomons, to trade deficits amounting to more than three-quarters of Gross Domestic Product in Western Samoa, Niue and the Cook Islands. Such imbalances certainly suggest that for some countries exchange rates are well out of balance and should be reviewed. In such cases, fine tuning of incentive policies would seem somewhat fruitless as compared with the more persuasive gains which could be secured by altering the exchange rate.
Chapter Six

REGIONAL ISSUES

INTRODUCTION

6.1 The principal questions to which this report is directed are the sense and practicality of attempting to harmonize the various industrial incentive schemes operated by Pacific Islands Developing Countries. My terms of reference carry a presumption that harmonization of incentives is desirable, and I am instructed to recommend a practical approach to harmonization:

"taking into account national industrial development objectives, investment policies, unemployment problems, geographical characteristics as well as disparities in development of developing island countries and the wish of developing island countries for a programme aimed at rationalization of industrial development."

In addition I am required
(a) to identify the costs and benefits of harmonization;
(b) to suggest the form that such harmonization might take; and
(c) to suggest possible steps to be pursued in establishing a harmonization scheme.

6.2 The countries of the region face many common problems in promoting economic development and there are many similarities in incentive policies. There would consequently be advantage in an ongoing regional discussion of economic and manufacturing development objectives and related incentive policies with a view to defining a common approach to certain problems and to distilling the elements of a code of common practice. A possible framework for such a code is discussed later in this chapter (paras 6.33 to 6.53). The proposed code (see para 6.51) draws very much on experience within the region. It is advanced in the belief that the interests of the peoples of the region will be better served by an ongoing discussion about the aims and instruments of development policy than they would be by the adoption of a detailed and rigid treaty.
6.3 The main principles underlying the proposed code are:

(a) incentive programmes for encouraging small scale entrepreneurial activity are a national rather than a regional policy issue. A continuing regional exchange of information on experience with such schemes could improve their effectiveness, but there is no particular merit in attempting to harmonize such incentives;

(b) issues of regional concern about incentives do arise around:

(i) competition between countries on the terms and conditions under which foreign investment is attracted into the region;

(ii) the possibility that national incentive policies are encouraging widespread and uneconomic duplication of industrial investments;

(c) in dealing with these two issues it is appropriate to work on a sector by sector basis.

The Costs and Benefits of Harmonization

6.4 During the course of my discussions with officials and others in Pacific Forum island countries, the issue of what benefits would arise from harmonization was frequently raised. Many with whom I spoke were frankly sceptical of the likely utility of such a move. Others did see merit in the proposal. As I see it, there are three main areas of benefit which could possibly flow from harmonization of investment incentive policies.

6.5 Firstly, harmonization would limit competitive offering of incentives between island countries. As we have seen, there are grounds for querying the effectiveness of tax incentives as an attraction to foreign firms. Most commentators agree that host governments attach more weight to such incentives than do the firms to which they are offered. Faced with a sluggish response host governments may tend to up the stakes by offering higher incentives; and if one government moves then others may feel obliged to follow. David Lim has argued:
"The only time that tax incentives affect private foreign investment is when other developing countries are already providing them. A country that does not grant them will be at a disadvantage in competing for foreign private investment."

(UNIDO/World Bank "Policies for Industrial Progress in Developing Countries", p 176)

Lim's initial judgement seems a little too sweeping but that in his second sentence is undoubtedly correct.

6.6 A regional agreement setting upper limits on the extent of tax holidays granted could provide a check on the offering of unduly generous concessions. However, as we have seen, most tax holidays offered in the region are limited to five years with a possibility of extension. Three countries - Tonga, Western Samoa and the Cook Islands - do have statutory provisions for more generous incentives but these have not been invoked to date. There is thus not really any significant evidence of unwise bidding up of incentives. The gain from harmonization would be correspondingly small. Indeed, because most of the foreign investment which has occurred in the region is directed to the exploitation or processing of a particular resource or to the supplying of a particular market, the countries of the region are often not in direct competition in attracting a particular foreign investment. The situation would be different if the countries of the region had large surplus labour forces and were in a position to compete with the major export oriented manufacturing industries of the Asian mainland. There is undoubtedly an element of competition between some countries of the region in attracting projects receiving financial assistance under the New Zealand Pacific Islands Industrial Development Scheme. Again, however, many of these projects are resource or market specific, but a few are footloose and may have been influenced in their final location by national incentives.

6.7 Secondly, it is argued by some policy makers that national incentive policies are encouraging widespread and uneconomic duplications of industrial developments. To the extent that this is so a harmonization of incentives could be expected to contribute towards some rationalization of industrial development within the region.
6.8 Again, however, whilst it is important to guard against this
danger, there is not a great deal of evidence of uneconomical
duplication of manufacturing capacity and where it does occur it
seems usually to have been promoted by instruments other than tax
incentives. There is, for example, some argument in the region
about issues such as the proliferation of coconut oil mills, the
array of fish processing facilities, and facilities such as the
Western Samoan match factory. In every case the determination of
an optimal regional structure for an industry is a complex matter
and I am not in a position to resolve such issues here. A number
of comments are however in order.

6.9 First, much argument about uneconomic duplication of plants
is based on fairly simple conclusions about economies of scale.
While it is true that in many manufacturing processes unit production
costs fall markedly at higher volumes of output, the most economic
pattern of investment is also affected by supply, storage, transport,
marketing and management considerations. These may justify fragmenta-
tion of production facilities, even though this entails an increase
in unit factory production costs. However that may be, in the case
of oil milling such duplication as may have occurred could only have
been avoided by substituting some effective regional investment decision
making process in the industry in place of existing national processes.
Fragmentation reflects the difficulties inherent in securing a common
view and agreement on necessary action rather than the existence of
tax holidays for what are in many cases publicly owned facilities.

6.10 Second, in many industries such as fish processing the pattern
of development is much influenced by the corporate organization of the
industry. Competing firms may be prepared to use common facilities
but more frequently prefer to process through their own systems.
Competitive duplication of processing facilities is likely to result.
Again, tax holidays have very little, if anything, to do with this.
6.11 Finally, in dealing with smaller import substituting factories producing for local markets, much duplication of facilities is to be expected, as, for example, in food processing and preparation and concrete block manufacture. The possibility of rationalization arises only where it would be more economic to supply one island economy from a plant located in another. It is true that tax holidays will give some encouragement to duplication but in practice protective tariff and exchange control policies play a much more important role. In the absence of such protection, the producer would be aware that he would be exposed to full competitive pressures once his tax holiday was passed.

6.12 All in all, I do not consider that tax incentive policies are likely to have played a major part in inducing such uneconomic duplication of investment as has occurred. This said, it does need to be acknowledged that such policies do reinforce the essentially national orientation of development planning. The adoption of a common code would weaken that emphasis but the impact of this would be minor particularly in instances where major differences in tariff policy persisted.

6.13 The third argument in favour of harmonization of incentives is that the adoption of a common code would make it easier for the overseas investor to assess what incentives were available and thereby the profitability of investment in the region. This would be particularly so if the criteria for eligibility to incentives were public. There is no doubt that the considerable variation in incentive legislation between countries creates a confusing impression and there would be utility in a common code in terms of the improved information flow to investors. This gain should not, however, be overstated. A great many factors, material supplies, wage rates, power costs, availability of supporting services and so on, need to be taken into account in making an investment decision. Investors will often face difficulties in getting such information together. Moreover, inasmuch as most tax incentives depend upon the exercise of administrative discretion, the critical question of what assistance will actually be forthcoming will not be answered until a decision is actually made.
Against these limited gains have to be weighed the costs associated with moving to harmonization. The costs would depend upon the type of harmonization attempted. The main options are discussed more fully later but briefly they are:

(a) adoption of a common code

(b) agreement on upper limits of incentives to be offered.

In either case a harmonization scheme could allow for variation between groups of countries and could be made binding to greater or lesser degree. It will be apparent that the first option, the adoption of a common policy, in the sense that countries agreed to offer exactly the same incentives, would be more far reaching and onerous than the second, under which countries would be prevented from offering incentives beyond agreed limits.

The costs involved in such a scheme are basically of two kinds. These are, most importantly, a restriction on the freedom of action of the signatory states and secondly the administrative costs of devising an agreed harmonization policy and giving it legal effect in each state.

Undoubtedly the greatest cost is that associated with the loss of some freedom of action at national level. Signatories would be bound by the agreement and would lose freedom to adopt policies which went beyond the terms of that agreement. If the regional policy was well formed the loss need not be great - indeed it could provide a safeguard against unwise policy making. But it would involve some loss of sovereignty and it would inevitably lead to some situations where national policy makers found themselves unable to adopt particular courses of action, which in the current circumstances they felt to be appropriate, because of the restrictions imposed by the agreement. Against this they would have the satisfaction of knowing that other states were similarly constrained from some actions which might rebound to their disadvantage.

During my discussions some officials expressed a concern that any attempt at harmonization would ignore the fact that the various countries of the region have differing resource endowments and are
at different stages of development and thus have need of differing policies. This is an important objection. If it is accepted that tax incentives have a part to play in promoting development, then it follows almost automatically that that part will change as development proceeds. In principle, a harmonization agreement could recognize this by classifying countries into different groups, but the fact would still remain that effective judgement on what type of incentives were appropriate to a particular country would have been transferred from a national to a regional level.

6.18 The administrative costs of putting an agreement in place would be significant, particularly in the case of a common policy. Negotiating an agreement between eleven nation states is inevitably time consuming particularly when dealing with tax systems and legal systems as diverse as those of the Pacific Island states. So also would be the amendment of national incentive legislation - though this need not be any more difficult than the revisions of such legislation which are periodically undertaken in most countries. The public services of most states in the region are small and the number of persons available for framing and administering development and incentive policies is very limited. They face major workloads and I query whether the international and national effort required to secure a binding-harmonization of incentives would be a fruitful use of their time.

6.19 On balance, these factors seem to me to rule out the case for a fully detailed and binding harmonization of investment incentives. This does not however imply that there is not a case for moving through some more flexible process towards a common policy code.

Possible Forms of Harmonization

6.20 Inquiries to other regional bodies identified only one treaty aimed at harmonizing investment incentives. This was the 1973 Caribbean Community "Agreement of the Harmonization of Fiscal Incentives to Industry". Although I do not, for the reasons already discussed, recommend development of a similar agreement within the SPEC region, a brief review of the agreement will be useful at this point.
6.21 The principal feature of the Caribbean agreement is the imposition of maximum periods for which relief from income tax and customs duty may be granted to approved enterprises. The agreement imposes ceilings and the signatory states are free to vary the actual amount of concessions given provided they remain below those limits. The maximum time periods for which concessions may be given vary as between countries and as between groups of enterprises.

6.22 Member countries are divided into three groups comprising more and less developed countries, with Barbadoes occupying an intermediate position. Enterprises are split into four groupings. Enclave or export-zone type operations together with highly capital intensive industries (having capital investment of at least $25 or $50 million depending upon country grouping) form one group. Remaining enterprises are split into three, depending upon the extent of local value added. Table 6.1 shows the maximum concession periods permitted in terms of the agreement.

Table 6.1 CARIBBEAN HARMONIZATION AGREEMENT

<table>
<thead>
<tr>
<th>Category of enterprise</th>
<th>More developed countries (other than Barbadoes)</th>
<th>Barbadoes</th>
<th>Less developed countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enclave or highly capital intensive</td>
<td>10</td>
<td>10</td>
<td>15</td>
</tr>
<tr>
<td>Other, having added value of from</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) 50 per cent improvements</td>
<td>9</td>
<td>10</td>
<td>15</td>
</tr>
<tr>
<td>(ii) 25 to 50 per cent</td>
<td>7</td>
<td>8</td>
<td>12</td>
</tr>
<tr>
<td>(iii) 10 to 25 per cent</td>
<td>5</td>
<td>6</td>
<td>10</td>
</tr>
</tbody>
</table>

6.23 In addition, the Caribbean agreement provides for common ceilings on the amount of tax relief accorded in respect of export profits and prohibits the more developed countries from according such relief to a wide range of manufactured products of types likely to be produced in the less developed countries in the region.
Finally, the agreement also provides for some elements of common practice in treatment of depreciation and carry forward of losses for concession firms.

6.24 Comment is needed on a number of matters.

6.25 First, the Caribbean agreement was made within the context of a prior treaty establishing a free trade association in the region and after steps had been taken for establishment of a common market. This is relevant in the light of our earlier comments on the hierarchy of incentives ( paras 5.81 to 5.89 ). As we noted then, the leverage exerted by tax incentives is less than that of protective and exchange rate policies. Harmonization makes more sense in situations where these more powerful instruments are already harmonized or in the process of harmonization.

6.26 Secondly, it is noteworthy that the time limits imposed by the agreement are very high by the standards of the South Pacific region. It follows that adoption of a similarly structured agreement in the South Pacific would have little effect upon actual practice unless lower ceilings were imposed. The high levels also suggest either that in the pre-treaty situation Caribbean tax holidays were typically even longer or that the difficulties of securing agreements led to little more than a formalization of existing practice.

6.27 Thirdly, the finely graded variation between groups and categories suggests an unreal degree of sensitivity and precision in investment decision making.

6.28 Finally, it is worth testing the shape of this agreement against the three lines of argument in favour of harmonization discussed above. These were:

(1) prevention of competitive offer of incentives; the scheme could be effective depending upon the time limits set. To make any impact in the SPEC region the time limits would have to be very much shorter;
(ii) encouraging rationalization; again much depends upon the time limits set. The actual time limits set in the Caribbean example would be more likely to encourage uneconomic duplication than the present array of national practice in the SPEC region;

(iii) improving information; because the agreement sets ceilings rather than imposing common rates, overseas investors could still have to rely on national information in assessing actual practice.

6.29 For these reasons, and those stated earlier, I conclude that the Caribbean agreement does not provide a useful model for the SPEC region.

6.30 I am even more sceptical about the utility of attempting to establish a mandatory common code. As we have seen, the circumstances of the Pacific Forum member countries vary greatly. Their resources, their stages of development, and the priority which they accord to manufacturing vary greatly. So do their tariffs, exchange policies and tax systems. To attempt within this diversity to impose identical policies on matters such as length of tax holiday would have little effect in practice and would divert attention from more serious issues of development policy.

6.31 I do not argue that incentives are unimportant or that there is no point in attempting to form the elements of a common policy. Rather my point is that given the diversity of wider policies in the region, no great benefits would flow from detailed harmonization of incentives.

6.32 What then is an appropriate course? I sketch a possible approach below.

An Approach to a Common Policy

6.33 There are three central issues which any common incentives policy must address. These are:

(i) encouraging the growth of island enterprises - both private and publicly owned;
(ii) determining regional policies which will ensure that the countries of the region derive maximum benefit from the development of their natural resources in agriculture, fisheries, forestry, mining and tourism, in accordance with national priorities;

(iii) determining regional guidelines on the type and extent of incentives appropriate in encouraging manufacturing development.

These are discussed below.

Encouraging Island Enterprise

6.34 One of the defining characteristics of a developed economy is the dominance in the economic affairs of the country of a wide array of commercial enterprises. Encouraging the growth of such enterprises, particularly locally owned ones (in both public and private sectors) has a central place in development planning. Pacific Forum member countries are concerned to develop local entrepreneurial activity.

6.35 As we have seen, Pacific Forum member countries more frequently grant investment incentives to local than to foreign companies, whilst in Papua New Guinea and the Solomon Islands some incentive legislation applies exclusively to locally based entrepreneurs. In addition, Papua New Guinea and Fiji have devoted considerable resources to the provision of business and commercial advisory services to their indigenous peoples.

6.36 Because most local enterprises are small and by their very nature are focussed almost invariably on the national market, there is little possibility of conflicts of interest between Pacific island countries over policies designed to encourage such enterprise. There is therefore really no need to contemplate harmonizing incentives aimed at small scale local businesses. There is instead an opportunity for regional exchange and co-operation in developing such programmes. A first step could be the convening of a regional workshop on policies for encouraging local enterprise. The participants should desirably be drawn entirely from within the region from the various institutions and agencies involved in encouraging local enterprise. The relevant
government departments, the development banks, the trading banks and the business community itself provide a regional pool of people with relevant expertise and experience. Key topics would include:

(i) experience in granting incentives to small businesses - how important are incentives and how far do they go in meeting the problems actually encountered by small businesses?

(ii) legal problems of setting up businesses;

(iii) the provision of capital to small businesses;

(iv) general financial management including problems of working capital;

(v) developing management skills for small businesses;

(vi) dealing with technical problems.

6.37 The list could be extended but the important point here is to recognize that the most important regional information source on small business lies with those people who have been involved in assisting its development in the region. SPEC could make a major contribution to such development by facilitating the exchange of information between those people and providing them with a forum in which possible new policies could be argued and shaped.

Determining Regional Policies Towards Resource Related Industries

6.38 The distinguishing feature of a number of regional resource based industries, including various agricultural products, fishing, forestry, mining and tourism, is that the countries of the region enjoy a comparative economic advantage. Within these areas a wide range of industries produce for the international market and generate revenue sufficient to meet wages and all other costs of production including a return on capital. In some areas the natural resource endowment of the region is sufficient to enable an island government to bargain for a higher return, effectively enabling the country to
earn an economic rent in addition to returns to labour and capital. The situation varies markedly from country to country and from product to product. It may also change erratically through time.

6.39 Within areas such as these it should be a first objective to secure the necessary investment without recourse to tax holidays. Indeed, as the Bougainville experience shows, it may be possible to exploit a bargaining position by imposing additional tax. Similarly in entering into a fishing agreement a bargaining position may be sufficient to secure investment in processing facilities.

6.40 In areas such as these there is a clear danger that individual countries may, in attempting to attract investment, act in ways which undercut the bargaining position of other SPEC members. An appropriate response is the development of regional mechanisms capable of framing and maintaining common policies for dealing with resources of regional rather than purely national interest. The Forum Fisheries Agency is an example of such an attempt to form a common approach. It is also, incidentally, illustrative of some of the difficulties of securing such an approach. Such difficulties need cause no surprise. Differing resource endowments and differing opportunities work against any easy achievement of common policies.

6.41 Nevertheless there is a clear regional interest in securing a common understanding of development options and possibilities in the various resource industries and, beyond that, attempting to frame common policies towards them.

6.42 Again, this is not something that can be secured with a stroke of a pen, least of all if that pen is wielded by an outside expert. Meaningful agreements will only be secured through the active participation of persons with relevant experience within the region and with a proper understanding of regional aspirations. The agreements will be collective efforts distilled over a period of time.

6.43 Given the considerable number of industries of possible interest, there is a danger that regional policy forming would be unreasonably time consuming. It is also entirely possible that when it comes to the
crunch some countries would not be prepared to participate in forming common policies. Equally, preliminary investigations might well rule out the possibility or utility of such agreements for a wide range of commodities.

6.44 In this situation I recommend that the question of policies towards resource based industries should be placed on the agenda of the meeting subsequently proposed for discussing incentives policies with a view to determining the attitude of SPEC member countries towards forming regional sector specific policies and, if this is favoured, ascertaining which sectors should be dealt with first.

6.45 Finally on this question, it is necessary to acknowledge that even although the region as a whole may have sufficient resource bargaining power in a particular sector as to render incentives unnecessary, the development options in some countries may be so limited as to persuade the country to use incentives in that sector in an attempt to secure faster overall development. The likelihood of such conflicts of regional and national interest is high and flows directly from principles of comparative advantage. Regional policies would have to take account of such differences.

Determining Guidelines in the Use of Incentives

6.46 The countries of the South Pacific region have now had considerable experience in the use of incentives and many countries in the region have been reviewing their experience and rethinking their policies. These national reviews, together with this study, provide an opportunity for a new regional look at the use of incentives in the region and the basis for an assessment of appropriate policy.

6.47 As I have already indicated, I do not see a strong case for a detailed and legally binding harmonization of incentives. The development needs and circumstances of the countries in the region vary greatly and there is little evidence to suggest that the incentives offered in the region have led to unwise competitive bidding in attempting to attract foreign investors or to uneconomic duplication of investments.
Indeed the countries of the region have generally been fairly restrained in the incentives which they have offered. They are mindful of the revenue costs of concessions and they are fearful of encouraging the development of enterprises which would only be able to survive with continuing financial concessions or assistance. The very smallness of the communities and their relatively low income levels places major constraints on policy makers in these areas.

6.48 Despite their different situations, the countries of the region have followed broadly similar paths in the use of incentives. All those which impose income taxes have made use of tax holidays to attract foreign investment, although Papua New Guinea and the Solomons have now moved away from this position. Tax holidays when offered have generally been for periods of up to five years. This similarity of practice suggests that it might well be relatively easy to reach agreement on the desirable limits of practice through discussion between the policy makers of the region. It is also likely that such discussions would, by enabling an exchange of views and experience, be of considerable help to national policy makers.

6.49 I propose that SPEC should convene a regional meeting of national policy makers to:

(i) review the place of incentives in national and regional development policies;

(ii) consider the desirability of promoting a regional workshop on encouraging the development of local enterprises (as discussed in paras 6.34 to 6.37 above);

(iii) consider the desirability of developing regional sector specific policies for natural resource based industries (as discussed in paras 6.38 to 6.44 above);

(iv) consider the adoption of a non-mandatory code of common practice covering the granting of incentives to foreign and larger scale local enterprises in manufacturing and other activities (as discussed below).
A Possible Common Code

6.50 The essential elements of a draft common code are presented below. These are seen as being preambled by a declaration recording the fact that representatives of Pacific Forum island member countries, having reviewed experience in the use of fiscal incentives in their countries, have concluded:

(i) that the decision on whether or not to offer such incentives is properly a matter for national governments in the light of their own development priorities taking into account such information as there is on the likely effectiveness of such incentives;

(ii) that in determining the extent of fiscal incentives Pacific Forum island member countries should remain aware of the dangers of competitive offering of incentives and of using incentives in ways which could lead to uneconomic duplication of productive capacity within the region.

6.51 Bearing these conclusions in mind, the meeting could then invite member governments to consider their national incentive packages in the light of the following guidelines:

(a) Income tax concessions: Tax holidays should be limited to a maximum period of five years and should desirably be subjected to an annual upper limit in value terms, the amount of such limit to be determined in the light of national circumstances.

(b) Accelerated depreciation: Member countries should be free to determine the rates at which depreciation may be claimed in determining taxable income and to approve the deferral of such claims during the period of any tax holiday.

(c) Investment allowance: Investment allowances additional to normal depreciation should not be offered to firms benefitting from tax holidays. Where an investment allowance is granted instead of a tax holiday, this should be limited to the claiming of no more than 50 per cent of the value of qualifying assets as an allowance additional to normal depreciation.
(d) **Export incentives:** Countries adopting income tax related incentives should follow the pattern originally adopted by Papua New Guinea and Fiji. The incentives should be limited to a reduction by no more than one-half of the normal tax liability on any increase in qualifying exports over the average level of the previous three years. (Note: recent changes to the export incentive systems of Papua New Guinea and Fiji may make it difficult to achieve agreement on this point. I suggest, nevertheless, that the proposal outlined above provides an appropriate starting point.)

(e) **Customs and related duties:** Project specific concessions of customs and related duties on imports of raw materials and capital equipment should not normally be granted for periods longer than two years from the date of first production from the project. This limitation should not be seen as inhibiting generalized reductions in tariff rates applicable to imports of raw materials, plant and equipment, or the granting of automatic duty exemption for materials imported for use in production in an export processing zone.

(f) **Sectors of application:**

(i) concessions of the above types should be restricted primarily to firms engaged in manufacturing activities;

(ii) concessions of the above types should not be accorded to enterprises engaged in the exploitation or processing of major natural resources in the region unless the granting of concessions is authorized by the terms of a regional, sector-specific, policy adopted by Pacific Forum island member countries;

(iii) none of the proposed limitations on concessions should be construed as limiting the freedom of a country to devise appropriate policies for encouraging the development of small scale entrepreneurial activity in any sector by nationals of the country concerned, (Note: the definition of small scale would need to be considered. This could be defined in terms of employment, turnover, or capital).
The draft code is advanced as a basis for discussion. Although I do not favour adopting a detailed mandatory code, I have framed the draft code in a way which would mean that most countries in the region could adhere to it without making major changes in incentive policy.

**Recommended Action**

6.53 The procedures which I recommend should now be followed are:

(a) publication and circulation of this report amongst Pacific Forum member countries;

(b) the convening by SPEC of a meeting of relevant persons from member countries to review the place of incentives in national and regional development policies and to consider the policy recommendations relating to:

(i) encouraging the growth of island enterprises;
(ii) determining regional policies for natural resource industries;
(iii) a possible common code on incentives;

(c) in the light of the deliberations of that meeting, and assuming acceptance of the general direction of my recommendations, necessary follow up action would include:

(d) the convening of a regional workshop on encouraging the growth of island enterprises;

(e) reporting back to governments on the question of regional, sector specific, resource policies with a view to determining sectoral priorities for development of such programmes;

(f) reporting back to governments on the draft common code for granting of incentives, with a view to determining a national attitude to such a code.

6.54 I believe that this sequence of actions would make a major contribution to regional development and incentives policies and assist national policy makers reassess the utility and adequacy of their current policies. I believe that the region has a great wealth of practical experience in these matters which can be tapped to the mutual benefit of all.
THE SYSTEM OF INCENTIVES - PAPUA NEW GUINEA

INTRODUCTION

Papua New Guinea has a distinctive package of incentives. Its key features reflect the lessons learned in negotiating the terms under which foreign firms exploit some of Papua New Guinea's rich natural resources and also an economic philosophy which emphasizes the importance both of letting competitive market forces shape the main course of development and of avoiding the danger of committing the nation to long term subsidization of any sector. At the same time the policy recognizes that different constraints apply in promoting foreign and local investment and, to a greater extent than any other country in the region, Papua New Guinea has devised special forms of assistance aimed at stimulating indigenous enterprise.

As compared with other Pacific Island countries Papua New Guinea today places main emphasis on incentives which do not involve the foregoing of public revenue from income tax or customs duty. Historically Papua New Guinea did make a greater use of income tax holidays than it does today. The Pioneer Industries Act 1965 offered five year tax holidays for approved firms but in 1976 it was announced that no further firms would be granted pioneer status. Still in force, although several times modified in form since its first introduction in 1974, is a system of limited exemption from income tax for national firms.

Papua New Guinea's policies towards foreign investment are based upon what is now seen as a strong national bargaining position in promoting development of its natural resources. This was not always the case and when first started Bougainville Copper Limited was granted a tax holiday by the then Australian authorities. On the road to independence the Papua New Guinean government forced a renegotiation of the agreement, withdrew the tax holiday and introduced a new tax regime under which the company is taxed at normal company rates until such time as the original investment, plus a specified of return (of at least
Papua New Guinea now seeks to extend similar principles into negotiations on the exploitation of other major resources, particularly in forestry and fishing. For example, the sixth edition of the National Investment Priorities Schedule states that new foreign fishing ventures will normally be permitted only if on-shore processing facilities are developed, the fishing operation is integrated with, or acts in support of, local fishermen, and the company accords the state the right to purchase up to 25 per cent of production for export on a right of first refusal basis.

Despite these emphasis on maximising Papua New Guinean returns from the venture some incentives are offered. These concentrate on diminishing the risk faced by the investor or giving him some freedom of manoeuvre in scheduling his financial flows, e.g. accelerated depreciation provisions. In addition, some entail a reduction in tax liability in return for promoting specific benefits to Papua New Guinea. Six new incentives which are summarized in the detailed notes below, are listed in the National Priorities Schedule. These comprise:

- accelerated depreciation
- training scheme
- provision of infrastructure
- export incentive scheme
- infant industry loan scheme
- feasibility studies contribution scheme

Although these incentives are oriented towards foreign investment they apply equally to national investors.

In addition to these generally applicable incentives, Papua New Guinea operates several schemes aimed at encouraging national investors to undertake business ventures. Two of these, income tax exemptions for national companies, and the Village Economic Development Fund Scheme which provides grants in support of commercial projects, date from 1974. The Credit Guarantee Scheme, which guarantees 80 per cent of approved loans by commercial banks, dates from 1976. Finally,
in 1980, the government set the National Investors Scheme in motion. This provides for government advancing an unsecured loan in support of national equity and commercial borrowing for approved projects costing more than K125,000.

Responsibility for administering these various incentives is widely spread amongst departments and usually depends upon the interaction of several directly concerned agencies.

Finally, by way of introduction, mention should be made of NIDA, the National Investment and Development Authority. NIDA is a statutory authority responsible for the promotion, regulation and control of foreign investment. NIDA is not responsible for administering any incentives but is the convenient first point of contact in dealing with the Papua New Guinea government. It co-ordinates departmental appraisal of new foreign investment proposals and the formulation of the conditions under which ventures may be registered.

INCOME TAX - COMPANIES

Normal Company Tax Rate

<table>
<thead>
<tr>
<th>Type</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-resident</td>
<td>48 per cent</td>
</tr>
<tr>
<td>Resident</td>
<td>36% per cent</td>
</tr>
</tbody>
</table>

Depreciation Rates

Examples of depreciation rates, which may be calculated on either a straight line or diminishing value basis, are:

<table>
<thead>
<tr>
<th>Asset Type</th>
<th>Straight Line</th>
<th>Diminishing Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>concrete building</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>industrial machines (general)</td>
<td>10</td>
<td>15</td>
</tr>
<tr>
<td>motor vehicle</td>
<td>20</td>
<td>30</td>
</tr>
</tbody>
</table>
Income Related Tax Concessions

Income Tax Act Section 154 Exemption of the first K50,000 for National Companies

Section 154 was introduced in 1976 to take the place of previous provisions. Section 154, as most recently amended, exempts the first K50,000 of income earned by wholly nationally owned companies in each year of income up until 31 December 1984, but excluding companies which were entitled to benefit under the previous exemption. The previous provisions, under Section 40B, had not imposed any cash ceiling on the concession and were proving expensive because of the very large earnings of a few companies. The old drafting of the provisions was also not entirely effective in excluding expatriates from the benefits of the concession.

Depreciation Concessions

Accelerated Depreciation Provision

Investors in manufacturing, transport and communication, building and construction and business services, are since 1979, entitled to accelerated depreciation on items of investment which have a useful life of over five years. The 1982 Budget Speech announced that this concession would be extended to agriculture. Eligible investors are allowed to claim 20 per cent of the cost of the investment in the year of purchase as an additional allowance over what would otherwise be allowed in that year. For the remaining life of the asset normal depreciation applies on the residual value of the capital equipment. The entitlement is not available for investment in retail, fishing, forestry and mining sectors, which are not considered to need it, nor to agriculture where investment can already be fully written off in the year of expenditure.

Investment Allowances (Additional Depreciation)

Papua New Guinea does not offer any investment allowance over and above full depreciation of asset values.
Export Incentive for Manufactured Goods

Export incentives were introduced in 1978 to encourage development of manufacture where the national market alone was too small to support an industry. Changes to the scheme were announced in the 1982 Budget Speech. The revised incentive exempts from company tax the full amount of profits related to the growth in export sales in the current year over the average value of export sales preceding three years. The incentive is thus related to the increase in exports and if there is no increase in exports above the average value for the base period, then the benefit reduces to zero. Where companies in any year make a profit on exports but a loss on overall operations, benefits accruing under the scheme can be carried forward for two years after they are earned. The incentive is available only in respect of specifically approved products. More than forty manufactured products have already been approved and any investor may request the Minister for Finance to add new products to the list.

Training Incentives

The Income Tax Act has, since 1979, allowed a 200 per cent deduction from assessable income for wages paid to apprentices registered with the Apprenticeship Board of Papua New Guinea. The purpose is to encourage employers to hire apprentices to build up the industrial and commercial skills of Papua New Guineans so that their contribution to the economy can increase over time. This incentive is not limited in sectoral terms.

Carry Forward of Losses

Losses may be carried forward for up to seven years. Primary producers are not subject to this limitation and may carry forward losses indefinitely.

INCOME TAX - OTHER INCOMES AND AVOIDANCE OF DOUBLE TAXATION

Individuals

The normal rate of tax on individuals ranges from 4 per cent on the first K1,000 of taxable income to a maximum rate of 50 per cent on every kind of taxable income which exceeds K30,000.
Interest and Dividends

Interest when paid by a Papua New Guinea resident to an overseas recipient is generally free of tax but may, in some circumstances be subject to a withholding tax of 48 per cent of the gross amount. A dividend withholding tax of 15 per cent is payable on all dividends declared by resident companies. Non-resident companies, having already paid a higher rate of company tax are not liable to further tax on remittances of branch profits. The dividend withholding tax is legally a tax on the recipient of the dividend and its subsequent status depends on that of the recipient. For non-residents the tax is final. In the hands of resident companies the withholding tax may be offset against liability to pay such tax on subsequent payments of dividends or, in the case of public companies, used as a credit against the next year's tax liability. For resident individuals the withholding tax is creditable against the individual's normal tax liability to the extent of the lesser of either (a) the dividend withholding tax; or (b) the average rate of tax applicable to that dividend income.

Avoidance of Double Taxation

Papua New Guinea has no double tax agreements with any other country. They do however have a close working relationship with the Australian tax authorities and the tax laws of the two nations include sections relating directly to the other.

CUSTOMS DUTY - EXCHANGE CONTROLS AND PROTECTION

The Tariff

Papua New Guinea has a single column tariff. Many items are free of duty and many more are dutiable at low rates such as 5, 10 or 15 per cent. High ad valorem or specific duties are imposed on a range of luxury or less essential items including confectionery, perfumery, jewellery and radios, and passenger cars all at 70 per cent. Moderate tariffs of a protective nature are imposed on a range of items including barbed wire 35 per cent, nails 27½ per cent, paper bags 20 per cent and a range of chemical products 17½ per cent. Overall however the Papua New Guinea tariff is essentially levied for revenue rather than protective purposes and official policy is opposed to any major extension of protective tariffs. Many industrial raw materials are free of duty as is most industrial machinery. Office machinery is
dutiable at 10 per cent. The tariff is supplemented by a general import levy of 3½ per cent additional to the rates specified in the tariff.

**Relief from Customs Duty**

Under general provisions of the Customs Act companies can apply for exemption from import duties on materials which are significant to project operations. Such exemptions are not common and are limited as to duration. As noted above there are no import duties on most capital goods.

**Exchange Control**

Foreign exchange is readily available for all normal current transactions. In assessing applications for capital payments the principal objective is to ensure that funds are due and payable to a non-resident, and that Papua New Guinean assets are not sold at an artificially high value. There is free convertibility in respect of all current payments whilst capital remission is subject to central bank approval which is administered liberally.

**Quantitative Control of Imports**

Papua New Guinea has made limited use of quantitative controls as a means of protecting particular industries. Customs Prohibited Import Regulations have been issued from time to time in respect of frozen poultry, and flour, and impose a complete ban on such imports. In such cases it is usual to impose price controls and to maintain the approved price at import price party. The objective is to guarantee the market to the local producer but not to provide any form of continuing subsidy.

**OTHER FORMS OF ASSISTANCE**

**Industrial Land**

The Government of Papua New Guinea has not developed any industrial estates. To date there has been a sufficient supply of government owned land in urban areas to meet the demand for commercial and industrial sites. Land for lease is valued by the Valuer General who assesses an unimproved value of the site plus a rental assessed at
5 per cent of the unimproved value.

**Improving the Pre-Conditions for Investment**

(a) **Provision of Infrastructure**

The government will provide the necessary infrastructure, including buildings, for new industrial projects in return for a negotiated user charge payable annually over the life of the project. Additional incentives are available for industries outside existing major centres. The general user charge ranks behind senior project debt and is designed to yield the government a commercial return on its investment taking into account the degree of risk and the likely rate of return to the investor. For industries located outside Port Moresby, Lae and Arawa - Kieta - Panguna the government may negotiate a lower user charge which would however be designed at least to cover its own cost of borrowing. The minimum project size for this incentive is generally K300,000. To date assistance under this scheme has been limited to the major Ok Tedi project.

(b) **Feasibility Studies Contribution Scheme**

The government will finance up to 50 per cent or K100,000, whichever is the lesser, of the cost of feasibility studies in industries having priority status in the National Investment Priorities Schedule or for which the government desires feasibility information. Should the project proceed the government may choose to be accredited equity equal to its financial contribution. If the firm decides not to proceed then the government reserves the right of access to all information gained. To mid 1981 three projects have been approved under this scheme.

**Grant Assistance**

**Village Economic Development Fund Scheme**

Since 1974 the government has been prepared to make available to nationals of Papua New Guinea grants up to a maximum of 40 per cent of the capital required to set up commercial projects considered feasible within the resources of a village group which contributes land, labour, cash or other assets to the proposed venture on a self-help basis. This direct financial assistance is generally for small-scale, and preferably village based, rural development with a maximum capital requirement of between K50,000 to K125,000.
Loan Assistance

(a) Infant Industry Loan Scheme

In order to facilitate the commercial funding of priority, higher risk, commercial projects with long run profit potential, the government will consider a standby loan facility of up to 15 per cent of the capital funds required to implement the project. Such loans are intended as a means of overcoming identified short-term financing problems and are not seen as a substitute for normal commercial loans. Loans are made at interest rates marginally higher than other commercial project funds and are repayable as soon as possible and prior to payment of any dividends by the industry. About four projects have been assisted under this scheme.

(b) Credit Guarantee Scheme

This scheme, which was introduced in 1976, is designed to assist nationals of Papua New Guinea who find it difficult to borrow from commercial banks because they are unable to meet the banks' conventional security and equity requirements. Under the scheme the commercial banks provide the loan facilities whilst the government, acting through the Department of Finance, guarantees to pay the banks 80 per cent of the loans plus interest not recovered from projects which it has approved. The guarantees are applicable on loans of up to K20,000 for any one individual, and, for a business group or company, K20,000 per member or shareholder up to a maximum of K100,000.

(c) National Investors Scheme

This scheme, operative since 1980, assists national investors wishing to initiate "investment type" projects greater than K125,000. Approved projects may be lent money, if need be on an unsecured basis, to complement commercial financing. Funds are also available for feasibility studies. Financial assistance will only be given at the project funding stage if a commercial bank, or the PNG Development Bank, indicates willingness to fund at least 50 per cent of the total project cost in the form of loan financed without government guarantee.
**Business Advisory Service**

As well as offering specific financial assistance to national investors the Papua New Guinea government operates a long-standing Business Advisory Section in the Department of Commerce. The section assists business groups with incorporation procedures and offers assistance in managerial, legal, secretarial, staff training and technical problems. Advice can be given to persons in any sector of the economy. The service operates through offices in each of the twenty provinces.
THE SYSTEM OF INCENTIVES - FIJI

INTRODUCTION:

Fiji has a long standing system of concessions to encourage industrial and tourist development. The central elements of the system are concessions under the Income Tax Act, including value limited income tax concessions and special depreciation provisions; concessional rates of duty on imports of raw materials and capital equipment; and a subsidy on hotel construction.

The concessions depend on ministerial exercise of powers conferred by the relevant Acts. To assist Ministers there is a Business and Industrial Development Committee (BIDC), which is a co-ordinating body having representation from the Ministry of Commerce and Industry, the Ministry of Finance, the Ministry of Labour, Industrial Relations and Immigration, the Ministry of Lands and Mineral Resources, the Ministry of Agriculture and Fisheries, and the Ministry of Urban Development, Housing and Social Welfare. The Committee operates at official and ministerial levels.

As well as considering applications for incentives, the BIDC processes applications from foreign investors wishing to set up or expand businesses in Fiji. There is no separate law governing foreign investment in Fiji, and companies may be registered and carry on business provided they meet the requirements of the Registrar of Companies. However, most projects will require one or another government approval and in such cases are processed through the BIDC. The BIDC is also involved in consideration of issues such as work permit applications and protective policy.

There is widespread agreement in both official and private circles that the current system of incentives and the administration of these is in need of review. It is commonly claimed that the absence of quantitative criteria for granting incentives, uncertainty
as to entitlement, and administrative delays significantly reduce the effectiveness of the incentives offered.

Fiji's Eighth Development Plan 1981-85 states that priority is being given to reformulating and extending the system of incentives so as to better accord with industrial development policy. It is intended to formulate quantitative criteria related to factors such as employment, local added value, and foreign exchange contribution. A restructuring and streamlining of the BIDC is also foreseen. It is intended that implementation of investment and incentive proposals will become the responsibility of a single agency acting within policy guidelines established by the BIDC. The ministerial committee, assisted by an upgraded committee of officials, will be responsible for decisions on policy. It will meet as required to review policy guidelines, to consider proposals in areas not covered by the guidelines, and to act as an appeal authority.

In 1980 an Economic Development Board was established by statute with members drawn from employer, employee, commercial and rural sectors. The primary function of the Board is to promote the economic development of Fiji and, in particular, to advise the Prime Minister on appropriate policies.

The Fiji authorities do not maintain an ongoing record of the aggregate value of incentives given. A 1977 study showed the following pattern of concessions as at August 1977:

<table>
<thead>
<tr>
<th>Firms approved</th>
<th>162</th>
</tr>
</thead>
<tbody>
<tr>
<td>Firms receiving:</td>
<td></td>
</tr>
<tr>
<td>(a) Fiscal and customs concessions on machinery</td>
<td>74</td>
</tr>
<tr>
<td>(b) Fiscal and customs concessions on materials</td>
<td>133</td>
</tr>
<tr>
<td>(c) Income tax</td>
<td>64</td>
</tr>
<tr>
<td>(d) Accelerated depreciation</td>
<td>16</td>
</tr>
<tr>
<td>(e) Export incentives</td>
<td>2</td>
</tr>
</tbody>
</table>
Chen-Young estimated that in 1973 the tax loss involved in concessions to the then 58 concession firms amounted to $119,000 income tax and $2,215,000 fiscal tax on imports. Against this loss of $2.4 million the government derived an estimated $3.2 million in revenue from fiscal and customs duty on imports, and from income taxes on the concession companies and their employees.

**INCOME TAX - COMPANIES**

**Normal Company Tax Rate**

<table>
<thead>
<tr>
<th>Category</th>
<th>Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non resident</td>
<td>42½ per cent</td>
</tr>
<tr>
<td>Resident</td>
<td>35 per cent</td>
</tr>
</tbody>
</table>

**Depreciation Rates**

Examples of usual depreciation rates, which are applied on a straight line basis, are:

- concrete buildings: 1½ per cent
- industrial machinery (lathe): 7 per cent
- vehicles (motor car): 30 per cent

**Income Related Tax Concessions**

(a) **Enterprises approved under Third Schedule of Income Tax Act**

An income tax concession of up to five years from the start of production is available for enterprises approved under the Third Schedule of the Income Tax Act of 1974. The Act provides for ministerial extension of the concession for up to three more years.

The concession is given as an annual exemption from tax on income, the eligible income being the greater of $8,000 or a percentage of the lesser of the paid equity capital or fixed capital investment of the company. The percentage referred to is determined according to the following scale:

- up to 25 employees (full-time equivalent): 15 per cent
- from 26 to 50 employees (full-time equivalent): 20 per cent
- more than 50 employees ("""") 25 per cent.
The following factors are considered when appraising an enterprise for income tax concessions:

1. whether it is a priority industry;
2. extent of use of local raw materials;
3. contribution to exports;
4. degree of import substitution;
5. labour intensity;
6. magnitude of local value added;
7. location and contribution to revitalization of depressed areas.

(b) Mining Companies

In terms of the Income Tax Act (Section 16 (2) (a)), the Minister may, when he is satisfied that it is expedient for the economic development of Fiji, exempt, either fully or in part and for any period, the income of a mining company. In practice the concessional rate accorded is usually half the normal non-resident rate of tax of 45 per cent. The concession is normally given for a period of from 7 to 10 years. Prospecting costs may be offset against income from other sources and may be spread forward at the discretion of the Commissioner.

(c) Agricultural Companies approved in terms of the Seventh Schedule of the Income Tax Act

Act No.7 of 1981 amended the Income Tax Act 1974 so as to provide a ministerial power to grant tax holidays to approved companies newly engaged in coconut growing, rice growing, dairy farming, beef production or goat farming or in the processing or exporting of agricultural produce. Companies specified by the Minister as entitled to this concession are exempt from income tax on income derived by it for any five of the ten years from the start of commercial production. Losses may be offset against income from other sources.

Depreciation Concessions

(a) Initial Depreciation Allowance

Under the depreciation provisions of the Income Tax Act, all agricultural, commercial and industrial enterprises are entitled to claim initial depreciation allowance of 30 per cent
for machinery (excluding non-hire passenger vehicles), and 10 per cent for buildings. This concession constitutes an acceleration of, and is not additional to, normal depreciation entitlements.

(b) Accelerated Depreciation Allowances for Specified Companies

New industries may qualify for accelerated depreciation allowances if they propose to incur substantial capital expenditure which the Minister of Finance is satisfied is expedient for the economic development of Fiji. Approved enterprises may claim, instead of any other depreciation, a deduction of one-fifth of its depreciable capital expenditure on buildings, plant and equipment during any five of the eight years from the date of expenditure.

(c) Agricultural and Pastoral Development Costs

Agricultural and pastoral development costs may be set off against income in the year in which they are incurred or, at the option of the taxpayer, in that and the succeeding four years.

(d) Hotels

For hotel owners in receipt of subsidy on capital expenditure (see below) the remaining 93 per cent of such expenditure incurred in the construction of hotel premises and related amenities (exclusive of the cost of land) may be offset against income arising from the hotel (or any other hotel operated by that owner in Fiji) in any number of years up to fifteen. This stands in substitution for normal depreciation. (Hotels Aid Ordinance, Section 7).

(e) Mining Companies

Capital expenditure to develop mines and to extract, treat, refine and sell minerals may be set off against total income at the rate of one-fifth of the expenditure during any five of the eight succeeding years. This does not apply to prospecting costs for which an offset has been claimed in terms of Section 21 (1) (c).
(f) Profits on sale of old or obsolete equipment

Through the 1980 Income Tax Amendment a taxpayer instead of paying tax on the profit from sale of old or obsolete equipment, has the option to set-off the profit against the cost of the replacement asset rather than returning it as income.

Investment Allowances (additional depreciation)

(a) Hotels

Hotel owners who have been granted a subsidy, in terms of the Hotels Aid Ordinance (see below), may elect instead to claim an investment allowance equal to 55 per cent of the total capital expenditure on the project, excluding the cost of land. The unused balance of the allowance may be carried forward and after five years may be applied against income earned from other hotels. These allowances are additional to normal depreciation.

(b) Fuel economy investment allowances

A fuel economy investment allowance of up to 40 per cent of the expenditure incurred upon plant and machinery purchased to replace plant and machinery used in a trade or business, and using an alternative energy to electricity or fuel oil and its derivatives.

Export Incentives

The 1982 Income Tax amendment introduced a new system of export incentives to replace the old system of concessions which related to the increase in exports of approved products and trades. Under the new scheme the following relief is generally available. Where the local manufacturing cost of the product exported:

(a) is not less than 30 per cent, a rebate of one half of the tax chargeable on the export profits;

(b) is between 40% and 50%, a rebate of three-quarters of the tax chargeable on the export profits;

(c) is over 50%, full amount of tax chargeable on the export profits is exempted.
Where separate records are not maintained the Commissioner is authorised to determine export profits on the basis of total export sales divided by total sales of all products and applying that fraction to total profits on sales.

Exporters of Fiji timber are given additional relief in that alternatively to the previously mentioned methods for profits determination export profits may be deemed to be equal to 10% of the free on board value of sales with the maximum profits not exceeding 50% of the chargeable income arising from the sales of indigenous timber. For three years commencing January 1982 the relief available in respect of forestry exports is double the profit generated from exports provided that such relief does not exceed the overall chargeable income.

**Carry Forward of Losses**

(a) **General**

Business losses may generally be carried forward for six years. Losses in agricultural and pastoral industries may be carried forward indefinitely until they are fully recovered from profits.

(b) **Enterprises Approved under Third Schedule of Income Tax Act**

Losses incurred by an approved enterprise during the concession period may be carried forward and set off against profits earned during the six years following the concession period.

(c) **Hotels**

For hotels which have claimed an investment allowance under the Hotels Aid Ordinance losses may be carried forward for six years from the last year in which the investment allowance was claimed (Section 22 (5)).

**INCOME TAX - OTHER INCOMES AND AVOIDANCE OF DOUBLE TAXATION**

**Individuals**

The normal rate of income tax on individuals rises progressively from a rate of 5 per cent on the first $600 of chargeable income to a maximum rate of 50 per cent on such part of
the individual's chargeable income as is in excess of $20,000. Income derived by an individual from coconut growing, rice growing, dairy farming, beef production or goat farming has been exempted from normal tax for a period of five years from January 1981. Individuals are still obliged to file a return of income and remain liable for tax on income from other activities.

Interest and Dividends

A withholding tax is imposed on dividends paid by Fiji incorporated companies. The rate of withholding tax is 5 per cent on payments to residents and 15 per cent on payments to non-residents. Individuals in receipt of dividends from a company incorporated in Fiji are exempted from payment of ordinary income tax on a proportion of such dividends. The proportion varies according to a sliding scale and ranges from 100 per cent where the total income of the taxpayer does not exceed $3,000 to $1 \frac{1}{3} \text{ per cent}$ where income exceeds $5,400.

Avoidance of Double Taxation

Fiji has double taxation agreements with the United Kingdom (1975) and New Zealand (1976). Both agreements provide (with some differences in detail) that tax paid under Fijian law on income from sources in Fiji (excluding, in the case of a dividend, tax paid on the profits out of which the dividend is paid), shall be allowed as a credit in determining tax payable in the United Kingdom or New Zealand. Furthermore, the agreements provide that tax paid in Fiji shall be deemed to include amounts which would have been payable had the firms not benefitted from exemptions or reductions granted under the major incentive provisions of the Fiji Income Tax Act and the Hotels Aid Ordinance. The agreement with New Zealand extends this principle to include tax which would have been payable had the firms not benefitted from the Fijian increased exports concession.

CUSTOMS DUTY - EXCHANGE CONTROL AND PROTECTION

The Tariff

The Fiji tariff contains two columns, one for fiscal and the other for customs duty. Custom duties are low, and range from
7½ per cent to free. Fiscal duties do the main work in the tariff and are high on luxury goods and for consumer durables. For motor cars fiscal plus customs duties range from 80-147½ per cent, depending on engine size. Duties on capital equipment and material are low but many worked items carry protective duties. These range from 20-25 per cent through 40-50 per cent, to 70 per cent on some items. During the last few years protective duties have been raised on a wide range of products now made in Fiji. These include many food products and other household items, paper products, nails, bolts and nuts, and many others.

Relief from Customs Duty

The Customs Tariff (Industrial Rebates) Regulations provide for a rebate of the whole or any part of any duty payable on machinery, equipment and raw materials imported for use in the manufacture of goods in Fiji. The remission on raw materials is usually given on the basis that it shall continue to remain in force to a date to be notified. In practice so far such concessions are extended indefinitely.

The Minister of Finance is also empowered under the Customs Tariff Act to remit or refund on an ad hoc basis as he may consider necessary the whole or part of any duty payable or paid by any person.

Additionally, Customs Regulations provide for a drawback of duty paid on materials used in the manufacture of certain specified goods when such goods are exported from Fiji.

As a form of assistance to the Hotel Industry the Tariff provides specially reduced duty rates on items such as air conditioners, water heaters and washing machines.

For approved mining projects investors are granted generous duty concession on imports of machinery and equipment.

Exchange Controls

Fiji does not impose any restrictions on current account overseas exchange transactions, including payments of dividends. Capital account transactions are monitored but approval is readily
obtainable for repatriation of capital previously brought into Fiji. Interest rates are low in Fiji and the Central Monetary Authority exercises a degree of control over local market borrowings by overseas firms. Exchange controls are not used to provide protection to local producers.

Quantitative Control of Imports

Fiji's Customs Act provides for the scheduling of items which cannot be imported except under licence. The third schedule regulates imports of motor vehicles, tractors, self-propelled machines and gold and provides a means of exchange control. The fourth schedule provides licensing protection for a range of local products. The following items were under licence control in July 1981:

1) Flour and Sharps
2) Seed Potatoes
3) Bulk Tra
4) Mild Steel Bars
5) PVC Pipes
6) Ropes of Man Made Fibres
7) Plastic Tubing and Sheeting
8) Crown Corks
9) Incense Sticks and Blending compound
10) Split Peas

The list is shorter than that which prevailed from 1975 to 1980 and included a number of items which are now protected by increased tariffs.

OTHER FORMS OF ASSISTANCE

Industrial Estates

The Fiji Government has developed a number of industrial estates to ensure the availability of industrial land at reasonable cost and also to encourage regional development. Industrial estates which have been developed at Walu Bay and Vatuwaqa in Suva and Vakamasuisuasua on Vanua Levu are now fully operational. Other areas where industrial estates have been developed are Ba, Vatukoula on the northern side of Viti Levu and at Kalabu in Suva. By mid-1981, 255 industrial lots had been created, of which about 84 per cent had been allocated to industrial or service industry users. During the period of Development Plan Eight (1981-85) the Government plans to develop
industrial estates at Nadi, Lautoka, Kalabu (Stage II) and Vakamasuisa (Stage 3). Sites are made available on lease with the tenant being required to pay a premium, designed to recover the direct costs of development, and an annual rental. Although normally paid as a lump sum, the premium may in some cases be spread over a period of years. The rental is calculated at 5 per cent of the assessed value of the site less development costs. In addition the government has built a small number of factory buildings on the Kalabu and Vatuwaqa estates. These are leased, with a purchase option at a cost being available after three years.

Grant Assistance

(a) Hotel Construction

Section 5 of the Hotels Aid Ordinance provides that the Minister of Finance may grant a subsidy at the rate of 7 per cent on the capital cost (excluding the cost of land) of building a new hotel or extending an existing one. The subsidy may be paid upon completion or by instalment upon certification of progress payments. Firms which have been granted a subsidy are entitled to claim the remaining 93 per cent of the capital cost as depreciation in any of the ensuing 15 years. This stands in substitution for normal depreciation provisions. Firms which have been granted a subsidy may elect instead to claim an investment allowance equal to 55 per cent of the total capital cost of the project, excluding the cost of land. The unused balance of the allowance may be carried forward and after 5 years may be applied against income earned from other hotels.

(b) Interest Rate Subsidy for Agricultural Development

The Fijian Government subsidises interest rates payable on agricultural loans made by the Fiji Development Bank. The subsidy ranges from 5½ to 6 per cent on the first $20,000 of farm development costs to 3½ per cent on the first $6,000 of housing costs.
(c) **Financial Assistance for Training**

The Fiji National Training Council, which is funded by a 1 per cent levy on gross payrolls, makes cash grants to employers for approved training given to employees and assists employers in developing training schemes and programmes of their own. Beyond this direct assistance to firms, the Council is responsible for a wide range of training courses additional to those provided by the main tertiary educational institutions.

**Business Advisory Services**

In addition to the main structure of incentives, which are available to persons of all races, the Fijian authorities have introduced some special measures to assist and encourage business development by persons of Fijian race. The Business Organisation and Management Advisory Services of the Department of Fijian Affairs provides advice and assistance on the establishment and management of businesses. In addition the government provides financial assistance to Fijians borrowing from the Fiji Development Bank for commercial purposes. The assistance is by way of a 1½ per cent subsidy on the interest rate payable by commercial borrowers.
THE SYSTEM OF INCENTIVES - SOLOMON ISLANDS

INTRODUCTION

The Solomon Island system of incentives depends upon provisions embodied in a number of statutes. The most important:

- The Income Tax Act which provides for five year tax holidays for "pioneer companies" and for companies with 60 per cent Solomon Island ownership.

- The Customs and Excise Act which empowers the remission or refund of duties on imported goods.

- The Protected Industries Act which can be used to limit production in particular industries to named firms.

- The Foreign Investment Act, which is basically a control act requiring registration and approval for all foreign investors, but also offers guarantees on remittance of earnings and repatriation at capital.

A notable feature of commercial development in the Solomon Islands during the last decade has been the promotion of a number of major resource related development projects, in which the government is a substantial minority shareholder, and where the government has negotiated with its foreign partners comprehensives agreements covering the major commercial and fiscal aspects of the investment package.
This emphasis on bilateral bargaining has naturally led to a case by case tailoring of incentives. At the same time the success achieved in promoting major commercial projects has reduced the short to medium term need to promote smaller scale industrial development. Nevertheless such development has also been encouraged.

Decisions on whether to grant a tax holiday or relief from customs duty lie with the Minister of Finance, advised as needs be by the relevant departments. In practice such relief has been given sparingly, usually for major projects. In 1979 a working party reviewed the Income Tax Act and while recommending that the incentive provisions be continued, made it clear that it had been unable to find evidence as to whether the incentives were effective. The working party recommended that applications for pioneer relief should be subjected to critical review and should only be granted when there was a strong case for doing so.

A similar scepticism prevails about the Protected Industries Act. Historically some 14 industries, including export of crayfish, soap manufacture, ready-mix concrete and corrugated iron, have been declared protected and in practice only one licence has been issued in respect of each industry. Each order is reviewable every two years.

Under the Foreign Investment Act the Minister of Commerce and Industry is to ensure that investment by foreign enterprises is compatible with national development policies. He is assisted in this by an advisory Commercial Investment Committee, chaired by the Secretary of Trade Industry and Labour with the Secretary of Finance as alternate chairman and containing members from the Ministry of Finance, the
the Monetary Authority, the Development Bank and the Central Planning Office. The government is particularly interested in foreign investment proposals for large scale development of natural resources, for manufacturing, including advanced technology, import substitution, exports, local food processing, and for the development of tourism. A foreign enterprise can only proceed if the Minister approves its registration under the Act and in so doing the Minister may attach conditions on matters such as geographical location and localization of staff.

INCOME TAX - COMPANIES

Normal Company Tax Rate

- Non-resident 45 per cent
- Resident 35 per cent

Depreciation Rates

Depreciation is calculated on a diminishing value basis and there are two basic rates. There are:

- buildings and other structures 5 per cent
- all other assets, including plant and motor vehicles 25 per cent

Income Related Tax Concessions

(a) Pioneer Industries

The Minister of Finance may under provisions of the Income Tax Act, declare a company which is about to commence business to be a pioneer company where this is in the public interest. Profits earned during the pioneer period are exempt from tax. The pioneer
period may be limited to one in which a specified profit is earned, thereby guaranteeing a fixed amount exempt income, or the period may end up to five years after the company can reasonably be expected to commence production. Factors taken into account in considering applications include export contribution, degree of import substitution, labour intensity, use of local materials and rural development contribution.

(b) **Solomon Island Companies**

This provision which has been in operation since 1978, applies both to companies and unincorporated business. The concession provides for full or partial exemption for up to five years and to a limit of $25,000 at the discretion of the Minister of Finance, although the Minister may with the consent of cabinet extend the concession to ten years with a limit of $50,000. To be entitled to the concession the company must be incorporated in the Solomon Islands and be 60 per cent beneficially owned by Solomon Islanders. Application must be lodged within six months of commencing business and the firm is required to maintain proper records, file tax returns and make P.A.Y.E. payments.

**Depreciation Concessions**

(a) **Timber Concessions**

There is a concessionary depreciation rate of 35 per cent for assets used in cutting, extracting and processing timber, within the boundaries of a timber concession and for employee accommodation. The proceeds
on sale of depreciated assets in excess of their cost price are exempt from tax.

(b) Agriculture and Research

The full capital cost of the following expenditures is an allowable deduction in the year in which it is incurred.

- purchasing and planting coconuts, oil palm and cocoa
- providing yards, fences and water supplies for livestock
- prevention of soil erosion
- experimentation, scientific or other research.

(c) Mining

Capital expenditure on mining operations may be written off over five years on a straight line basis.

Investment Allowances (additional depreciation)

The Solomon Islands does not offer any concessions by way of additional depreciation. An investment allowance did exist but was abolished in 1973 as it was felt to be serving no useful purpose.

Export Incentives

The Solomon Islands does not operate any form of export incentive.

Carry over of losses

Losses may be carried forward without restriction as to time.
INCOME TAX - OTHER INCOMES AND AVOIDANCE OF DOUBLE TAXATION

Individuals

The normal rate of income tax on individual incomes rises from 15 per cent on the first $1,000 of taxable income to a maximum rate of 45 per cent on such part of taxable income as exceeds $15,000.

Interest and Dividends

Overseas payments of interest are subject to a withholding tax of 15 per cent except that payments on deposits with banks in the Solomon Islands are exempt. Withholding tax is deducted from all dividends paid by resident companies at the rate of 20 per cent from resident shareholders and 35 per cent from non-resident shareholders. These rates need to be viewed in the knowledge that the Solomon Islands system of dividend taxation differs from that of other countries in the region. Whereas in most regional countries dividends are treated as a distribution from tax-paid profits, in the Solomon Islands the gross amount of dividends is a deductible expense for the purpose of calculating the taxable income of the resident company paying the dividend. The withholding tax is a final tax for resident shareholders with income less than $10,000 and for all non-residents. Dividends paid by a pioneer company are free from withholding tax provided they are paid within two years of the end of the pioneer period.

Income distributed from Solomon Island businesses during the period of their tax holiday is taxable in the hands of the recipient. In other words the concession is to the enterprise but does not extend to the shareholders or owner. In this way money re-invested in the firm benefits from the concession whilst distributed income does not. In the case
of companies, normal withholding taxes are applied on dividends paid, whilst in the case of unincorporated enterprises the concession is only available in respect of money ploughed back into the firm.

Avoidance of Double Taxation

The Solomon Islands has a double taxation agreement with the United Kingdom which is extended to Sweden, Denmark and Norway.

CUSTOMS DUTY, EXCHANGE CONTROLS AND PROTECTION

The Tariff

The Solomon Islands tariff is basically a revenue tariff with rates varying according to the degree of essentiality of the product. A wide range of essential items including basic foods, raw materials and capital equipment attract no duty. Other items in these categories are dutiable at 10, 20 or 30 per cent. Confectionery is dutiable at 50 per cent as are large outboard motors, and air conditioners. The duty on motor cars ranges from 50 to 100 per cent according to size. Only one tariff item, a duty of 50 per cent on soap, is generally seen as protective in intent.

Relief from Customs Duty

(a) General Provisions

A small number of firms have been granted exemption from customs duty under general powers conferred on the Minister by Section 8 of the Customs Act. Exemption from payment of duty on capital goods is accorded more readily than exemptions on materials for use in production. As it happens most
capital items are already free of duty. A few firms have been accorded temporary exemption from duties on materials.

(b) **Fishing equipment and packaging materials**

The 1972 joint-venture agreement between the Solomon Islands Government and Solomon Taiyo provided for duty free import, by the joint company, of all items required for its commercial operation, including fuels and packaging. Somewhat similar, but in some ways more restricted concessions, are given generally by a schedule of exemptions to the Customs Tariff. These exemptions include fishing nets, gear, lines, hooks, wire and preservatives along with fishing boats and deck equipment, the exemption, in each case, applying only when imported for use by commercial fishermen. The Tariff also exempts all imports of packaging materials for commercial use. This latter exemption is not restricted to the fishing industry.

(c) **Duty drawback provisions**

The Customs Act provides for the drawback of duty on imported materials used in the production of exported goods.

**Exchange Control**

Foreign currency is readily available for all types of current payments. No restriction is placed on remittance of dividends, profits and other earnings due to overseas residents. Approval is also given to the repatriation of capital. Guarantees are accorded on these matters by the Foreign Investment Act. The foreign exchange control system is not used to provide protection for local production.
Restrictions on Competing Local Production

The Protected Industries Act has been used to limit to single firms the right to undertake production in particular industries. Such protection is accorded by issue of licenses which are reviewable every two years, the intention being to limit protection to that necessary to ensure the successful establishment of the industry.

The following industries are currently protected: processing of beche-de-mer, air transport, export of crayfish, tyre re-treading, tobacco manufacture, soap manufacture, golden lip pearl shell, dry cleaning, aerial spraying, terrazzo tile manufacture, ready-mix concrete, corrugated iron, cultured pearls, public bus service (Honiara).

OTHER FORMS OF ASSISTANCE

Industrial Land

The government owns all land in Honiara, Auki, Gizo, Kira Kira, and Tulagi. The main area of industrial land is an 84 hectare flat site at Kukum in Honiara. Serviced land is available on a 50 years lease. Tenants (which in the case of a foreign company must have been approved by the Commercial Investment Committee) are required to pay a premium designed to cover the immediate development costs of servicing the site (including a contribution to support low housing development), plus an annual rental calculated at 8 per cent of the assessed value of the site. A number of 0.1 hectare sites are immediately available. Investors requiring larger sites are required to justify their need. There are at present some 48 firms operating at Kukum with an emphasis on commercial and service industries but including a number of manufacturing undertakings. Demand for sites beyond Honiara is currently very limited.
THE SYSTEM OF INCENTIVES - WESTERN SAMOA

INTRODUCTION

The Western Samoan system of incentives is centred on the Enterprises Incentives Act of 1965. This Act empowers cabinet to approve the establishment of particular enterprises and to grant income tax holidays of up to five years and reductions in customs duty. In addition the Industrial Free Zone Act 1974 provides for the complete exemption from import duty and a maximum income tax rate of 25 per cent for approved firms exporting at least 95 per cent of their product from Western Samoa. To date no incentives have been given under this Act. Finally, although agricultural incentives lie beyond the scope of this survey it is appropriate to note that the Income Tax Act of 1974 provided for the exemption from taxation of income derived by the producer from the sale or other disposal of primary production during 1975 to 1984 inclusive, with provision for a phase out beyond that point in a manner related to the increase in exports.

In making its decision on applications under the Enterprises Incentives Act Cabinet is advised by the Incentives Board. The Board is chaired by the Minister of Economic Development who is one of five voting members. The other voting members, each appointed by Cabinet, are two members of the Legislative Assembly, a member of the Chamber of Commerce and a Planter, both the latter are to be citizens of Western Samoa. The Board also includes, an ex-officio non-voting members, the Director of Economic Development, the Financial Secretary, the Commissioner of Inland Revenue and the Controller of Customs.

In terms of the Enterprises Incentives Act concessions may be approved only for enterprises in scheduled industries. The schedule is wide ranging and comprises:-

(a) The processing of agricultural produce;
(b) Factories of any type;
(c) Hotel and visitor support facilities;
(d) Fisheries and fisheries development;
(e) Afforestation;
(f) Research;
(g) International Shipping;
(h) Film production and related industries.

Applications are considered on their merits taking into account the state of the particular industry, the benefits granted to previous enterprises operating in that industry, and the benefits that the applicant enterprise is expected to yield in promotion of exports, substitution of imports, use of local materials and creation of employment.

A 1980 survey showed that 63 firms which had benefitted from the incentives were currently operating with a total 1979 employment of 1,615. It was estimated that in 1978 income tax foregone totalled WSS100,400 and customs duty foregone WSS862,400.

The major problem encountered in recent operation of the Enterprises Incentives Act relates to customs duty concessions. Western Samoan rates of duty are high, commonly ranging from 42-47 per cent. Temporary reduction of such duties, often to a rate of 7½ per cent, and usually with a fixed WSS value limit as to the aggregate amount of the concession, leads to difficulties on transition back to full duty status. This is particularly the case where there is more than one concession firm active in a product range. It is thought that the solution to this problem lies in a revision of the tariff which is currently under way. A major objective of this revision is to lower duties on raw materials and raise those on finished goods in such a way as to preserve the existing customs duty revenue yield.

INCOME TAX - COMPANIES

<table>
<thead>
<tr>
<th>Normal Company Tax Rate</th>
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<tbody>
<tr>
<td>Non resident</td>
<td>48 per cent</td>
</tr>
<tr>
<td>Resident</td>
<td>42 per cent</td>
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</tbody>
</table>
Depreciation Rates

Examples of normal depreciation rates which are calculated on a straight line basis for buildings and diminishing value basis for other assets are:

- reinforced concrete buildings 1 per cent
- industrial machinery 20 per cent
- motor vehicles 20 per cent.

Income Related Tax Concessions

(a) Enterprises approved under the Enterprises Incentives Act

An approved enterprise may be granted a tax holiday of up to five years and there is provision for extension on approval for up to a further five years. Such extensions are rare.

(b) The Industrial Free Zone

The as yet unused Industrial Free Zone Act provides for an initial five year exemption from tax on profits derived from export business, followed by a maximum tax rate of 25 per cent.

(c) Primary Production

Income derived from the sale of primary production is exempt from tax in income years beginning 1 January 1975 and ending 31 December 1984. During the ensuing five years the producer may in calculating assessable income deduct an amount equal to 25 per cent of the increase in exports.

Depreciation Concessions

(a) Enterprises approved under the Enterprises Incentives Act

No concession. During the tax holiday period the enterprise is required to depreciate its assets in accordance with the normal rules and at the end of the tax holiday the written
down value of the assets is counted as the commencing value for computing further depreciation amounts.

(b) **Income Tax Act 1974**

Section 30 (3) of the Income Tax Act provides that for the purpose of encouraging the economic development of Western Samoa the Minister of Finance may allow depreciation at rates other than those usually allowed.

**Investment Allowance (Initial Depreciation)**

(a) Enterprises approved under the Enterprises Incentives Act

No concession.

(b) **Income Tax Act**

Section 30 (2) of the Income Tax Act empowers the Commissioner of Inland Revenue to allow in respect of business premises, such deduction, in addition to normal depreciation, as he thinks fit, except that the amount may not exceed 20 per cent of the cost of the premises and shall normally be claimed within four years.

Section 30 (3) of the Income Tax Act (already referred to above) provides that the Minister of Finance may, for the purpose of encouraging the economic development of Western Samoa, allow deductions additional both to normal allowances and to amounts allowed by the Commissioner under Section 30 (2).

**Export Incentives**

Western Samoa does not have any system of export incentives apart from that which will apply to primary products following the lifting in 1985 or the total exemption currently enjoyed by such products.
Carry Forward of Losses

(a) General

Business losses may generally be carried forward from year to year without limit, subject to the proviso that such relief must be made use of at the first opportunity.

(b) Enterprises approved under the Enterprises Incentives Act

Section 21 (6) of the Act provides that the balance of any losses incurred over the whole period of the tax holiday may be carried forward from that period as if they had been incurred in the last year of the tax holiday period.

INCOME TAX - OTHER INCOMES AND AVOIDANCE OF DOUBLE TAXATION

Individuals

The normal rate of income tax on individual incomes rises from 5 per cent on the first WS$1,000 of taxable income to a maximum rate of 50 per cent on such part of the taxable income as exceeds $10,000.

Interest and Dividends

A withholding tax is imposed on interest and dividend payments by Western Samoan companies. The rate of withholding tax is 5 per cent on payments to residents and 15 per cent on payments to non-residents. Dividends and interest received by individuals are assessable with credit being allowed for withholding tax.

Dividends paid by enterprises approved under the Enterprises Incentives Act, during the period of their tax holiday, or within the two years following shall not be taken into account in ascertaining the chargeable income or the rate of tax of such shareholders. This is subject to the limitation that the amount of such dividends must not exceed the total amount invested by the shareholder in the approved enterprises. Furthermore the concession does not apply to any shareholders who would as a result of the exemption become liable to tax on those profits in another country.
Avoidance of Double Taxation

Western Samoa does not have any double taxation agreements.

CUSTOMS DUTIES - EXCHANGE CONTROLS AND PROTECTION

The Tariff

The Western Samoan tariff provides for a duty of 42 per cent to be paid on the majority of items imported to Western Samoa. Lower rates are set for some essential items including basic foodstuffs e.g. flour, rice, sugar, 5 per cent; butter, vegetables, fish, 15 per cent; frozen mutton, 15-25 per cent; and frozen fish 25 per cent; and some materials and supplies for agriculture and construction materials 22 per cent. Rates somewhat higher than the normal 42 per cent are imposed on a wide range of items including most metal products. Still higher rates are imposed on luxury items including motor cars which are dutiable at from 115 to 135 per cent.

Relief from Customs Duty

(a) Enterprises approved under the Enterprises Incentives Act

In terms of Section 18 of the Act approved Enterprises are entitled, for the duration of their tax holiday period, to import free of duty capital items and raw materials specified in the approval order. In general imports of necessary capital equipment are allowed duty free along with limited imports of building materials where those are not manufactured locally. Motor vehicles are usually given only a partial exemption on the grounds that these are unlikely to be used only for business purposes. Where concessions are given on raw materials these are usually in the form of a reduction in the rate of duty on imports up to some specified total value.

(b) Industrial Free Zone Act

For approved enterprises exporting 95 per cent or more of their output the Industrial Free Zone Act provides for complete exemption from payment of import duties on raw materials and capital items. Investor interest has proved slight and this Act
has not been applied in practice. In this situation the Samoan authorities have preferred to develop the physical facilities of an industrial estate open to firms producing either for local or export markets but the act remains in force and could be applied.

(c) Duty drawback provisions

The Customs Act provides for the drawback of duty on imported material used in the production of exported goods.

Exchange Control

Foreign exchange transactions are controlled by the Exchange Control Regulations 1961 administered by the Monetary Authority of Western Samoa. Foreign exchange is scarce and imports are controlled by a system of exchange allocations. It is policy to allow repatriation of interest, dividends, and principal as required but the stringency of the present situation has led to delays in approval of some such transactions. Exchange controls are used in a way which accords quantitative protection to some producers for the local market. Basically exchange controls are operated on a four tier basis. A few basic items are free of control and a short list of other basic items are given relatively generous basic allocations. Beyond this licenses are allocated which can be used for the import of any commodities other than a nominated list of items which are produced locally. Although the immediate motivation for these restrictions is the conserving of foreign exchange, the system also provides direct quantitative protection for the listed items.

These are:-

- timber, roofing iron, paints, soap, jandals, beer, cigarettes, matches, salt, beef, sausages, ham and bacon, biscuits, cakes and pastries, fruit juices, soft drinks, twisties, ice cream, eggs, toilet rolls, fish and frozen fish. Motor vehicles are also specifically controlled.
Restrictions on Competing Local Production

There is no established system of local market protection but the Enterprises Incentives Act provides that the Director of Economic Development, in reporting on applications under the Act, and Cabinet in making its decision on such applications, shall satisfy themselves, that the new venture will not unduly affect any existing efficient enterprise producing a similar product.

OTHER FORMS OF ASSISTANCE

Industrial Estate

The Government of Western Samoa has developed a 60 acre industrial estate at Vaitele close to Apia. The approval of the Department of Economic Development is required before firms establish on the estate which is managed by the Western Samoa Trust Estates Corporation (WSTEC). Rentals are set at concessional rates which include no allowance for the capital value of the land. Leases are for an initial period of five years and are renewable.
INTRODUCTION

Vanuatu's situation is unique. Although its development objectives are similar to those of other SPEC countries its fiscal systems are radically different. Vanuatu has no system of income tax, is an established international tax haven, and has no formal system of development incentives. These features derive from the legacy of the Condominium but have all been reaffirmed as part of the policies of the new state. From 1975 to 1979 the Condominium did operate an Investment Code, under Joint Regulation No. 2 of 1975. The Regulation provided for total or partial exemption from:

- import duties on materials and equipment
- added value tax on subdivisions of land
- export duties for the first five years of production.

Exemption could be granted by the Resident Commissioners to approved enterprises in fishing, food processing, hotels and tourism, transport and industrial undertakings. When this code lapsed in 1979 consideration was given to introduction of a new code. It was however felt that the old Joint Regulation had not significantly contributed to development and a new draft code was rejected on the grounds that its administrative procedures seemed likely to offset the positive effect of its incentive clauses.

Although Vanuatu does not operate a formal system of incentives its customs tariff provides the minister with authority to remit duties and this power is used to assist new enterprises. In dealing with applications the minister can refer to draft statements of departmental requirements prepared by the major policy departments. Beyond this the absence of income tax and the presence of the tax haven are thought to offer some inducement to investors. The centrepiece of many countries' incentive systems is a temporary exemption from income tax so that permanent exemption can be argued to offer at least as strong an incentive. In addition the tax haven has encouraged the
development of a significant financial infrastructure in Vila and these unusually well developed services, for a Pacific Island country, are felt to provide a distinct incentive.

INCOME TAX - Not Applicable.

CUSTOMS DUTY - EXCHANGE CONTROL AND PROTECTION

The Tariff

The Vanuatu tariff is essentially a revenue tariff. The tariff generally provides for a 15 per cent customs duty plus a 2 per cent customs service tax and a 2 per cent customs surcharge. The basic rate of customs duty is modified in a number of areas. Some basic foodstuffs and essential items are free of duty. A wide range of less essential items are dutiable at 20 or 25 per cent. Motor vehicle are dutiable from 25 to 45 per cent.

Relief from Customs Duty

Schedule III to the Customs Tariff provides for the exemption from import duties of goods ordered for approved development schemes. In practice it is usual to exempt capital items (including building materials) from payment of duty but imports of second hand machinery are dutied, at half the usual rate. Imports of raw materials may be free of duty for one year at which point the situation is reviewed.

Schedule III also provides for the exemption from import duties of imports of capital equipment for the cattle and poultry industries and of imports of agricultural equipment in general.

Duty Drawback Provisions

The Customs Tariff does not provide for drawback of duties on imported materials used in the production of exported goods. Schedule III does however provide for the duty free import of goods which are due to be exported within six months.

Exchange Control

Vanuatu has no system of exchange control.
THE SYSTEM OF INCENTIVES - TONGA

INTRODUCTION

The Tongan system of incentives is centred on the Industrial Development Incentives Act of 1978 and the Industrial Development Incentives Regulations of 1977. The Act requires any person desiring to establish or expand a manufacturing enterprise or to create or expand a prime facility to the visitor industry to apply for a development licence. Firms granted a licence shall be entitled to exemption from payment of income tax for a period of up to five years, for exemption from payment of customs duty on capital goods for a period of two years, and for up to six months exemption from customs duty on raw materials for trial runs, on a draw back basis.

Development licenses are issued by the Minister of Labour Commerce and Industries following recommendation on the proposal by a Committee established under regulation. This Committee, which is chaired by the Minister, comprises, the Secretary of Labour Commerce and Industries (who acts as Secretary of the Committee), the Secretary of Finance, the Chief Planning Officer, and the Managing Director of the Tonga Development Bank.

The Act applies only to enterprises in processing industries, manufacturing industries, assembly industries, including packaging, or in providing approved prime facilities to the visitor industry, including hotels, motels, cruising vessels and tourist attractions.

In considering proposals the Committee is required to determine whether they will bring positive, substantial and continuing benefits to Tonga, with reference to a range of characteristics, including, processing of local resources and contribution to local value added, employment, exports, import substitution, and the degree to which the enterprise brings capital and managerial and technical skills.
A late 1980 survey of firms licensed under the Act suggested current employment of just under 600 persons in firms operating under license with about another 400 persons expected to be employed in plants which were under construction but not yet operating. This latter figure included 300 persons expected to be employed in a new public sector dessicated coconut mill financed under Australian aid. In the manufacturing sector most approvals related to small scale import substituting operations but there were also several firms engaged in leather goods and timberwear production for export markets. Total projected employment in approved tourist facilities was something less than 200.

INCOME TAX - COMPANIES

Normal Company Tax Rates

Non-resident 37\(\frac{1}{2}\) per cent but 42\(\frac{1}{2}\) per cent on that part of taxable income in excess of $50,000.

Resident 25 per cent but 37\(\frac{1}{2}\) per cent on that part of taxable income in excess of $100,000.

Depreciation Rates

Examples of normal depreciation rates, which are calculated on a diminishing value basis, are:

- Buildings 5 per cent
- Industrial Machinery 10 - 20 per cent
- Vehicles 25 per cent

Income Related Tax Concessions

(a) Enterprises approved under the Industrial Development Incentive Act

Every approved enterprise is entitled to exemption from payment of any income tax for up to five years as determined by the Minister. For companies this exemption may be extended up to a further five years in exceptional circumstances by the Privy Council.
(b) **Special Provision for Large Projects**

In terms of a Privy Council decision in April 1978 the Ministers of Commerce and Finance are instructed "to consider as an incentive the exemption from income tax of any investment in the Kingdom of T$3,000,000 or more for a period of 25 years. Such incentives should in principle be reserved for investment in building and other substantial projects approved by the Privy Council". These provisions have not been applied to date.

**Depreciation Concessions**

**Concession under the Industrial Development Incentives Act**

An approved industrial enterprise may depreciate its assets after the expiration of its tax holiday on the original value of the assets. Normal rates then apply.

An approved industrial enterprise may opt for accelerated depreciation of its assets within five years in lieu of its five year tax holiday.

**Investment Allowance (Initial Depreciation)**

The Industrial Development Incentives Act contains no provision for an investment allowance.

**Export Incentives**

Tonga does not operate any direct form of export incentive.

**Carry Forward of Losses**

(a) **General**

The Income Tax Act 1976 does not provide for the carry forward of losses but does provide in Section 6 (1) that losses incurred in a business may be offset against the tax payer's gross assessable income in the same year.
(b) Concession under the Industrial Development Incentives Act

Net losses incurred by approved industrial enterprises may be carried forward and set off against future losses without limit except that such relief must be availed at the first opportunity.

INCOME TAX - OTHER INCOMES AND AVOIDANCE OF DOUBLE TAXATION

Individuals

The normal rate of income tax rises from 5 per cent on chargeable incomes between $600 and $1,600 to a maximum rate of 40 per cent on such part of the chargeable income as exceeds $7,600.

Interest and Dividends

Section 71 of the Income Tax Act imposes a withholding tax on interest and dividends derived from the Kingdom of Tonga. The rate of withholding tax is 5 per cent on payments to residents and 15 per cent on payments to non-residents. Interest and dividends are generally assessable in the hands of residents with a credit being allowed for withholding tax paid. For non-residents the withholding tax is final.

Concessions under the Industrial Development Incentives Act

Section 7 (3) of the Industrial Development Incentives Act provides that shareholders in approved enterprises shall be exempt from payment of income tax on dividends relating to the tax holiday period of the enterprise provided the dividend is paid not later than two years after the expiry of that period.

Section 8 (1) of the Act frees dividends paid to non-resident shareholders (including non-resident companies) from payment of withholding tax on income relating to the initial tax holiday. This exemption is not available for payments from income during any extended period of tax holiday.
Avoidance of Double Taxation

Tonga is not party to any double taxation agreements.

CUSTOMS DUTY, EXCHANGE CONTROL AND PROTECTION

The Tariff

Since 1978 Tonga has operated a single column tariff in which the majority of items are dutiable at 15 per cent. A large number of items which could be characterised as less essential or luxury items, or which in a few cases would be imported in competition with local production, are dutiable at 20 to 25 per cent. Motor vehicles are dutiable at 45 per cent. A significant number of items is admitted duty free. This group includes basic foodstuffs such as meat, butter and eggs and a wide range of other products. Importers are also required to pay a Port and Service Tax of 12½ per cent on all imports.

Relief from Customs Duty

The Industrial Development Incentives Act provides that approved industrial enterprises may import capital goods free from customs duty for a period at two years from the date of issue of the development licence. (Section 12 (1) ). Furthermore the enterprise may be entitled to a refund of customs duty on raw material imports, including fuels, imported for use during a trial run period of up to six months as approved. (Section 12 (5) ). Port and Service Tax is levied at a 50 per cent concessional rate on capital goods imported by approved enterprises. (Section 13 (1) ).

Duty Drawback

The Customs Duties Act 1978 does not provide for drawback of duties paid on materials used in the manufacture of exported goods. This deficiency is made good, for approved enterprises, by Sections 12 (4) and 13 (2) of the Industrial Development Incentives Act which provides for drawback of import duties and port and service tax paid on raw materials, including
semi-finished products and packaging, used in the production of export goods.

Exchange Control

Foreign exchange transactions are controlled under the Foreign Exchange Control Act and Regulations. Foreign exchange is available on application for normal transactions and Section 15 of the Industrial Development Incentives Act provides that approved enterprises shall be entitled to remit dividends, profits, gains, interest and capital. Such remittances will be subject to usual procedures and the guarantee given is limited in three ways:

i) there is no entitlement to remit profits accruing on locally raised capital
ii) remittances of capital are limited to the amount originally brought in
iii) expatriate salaries may be remitted up to the amount on which income tax has been paid.

The Exchange Control Regulations are not used to provide protection to local industries.

Quantitative Control of Imports

Tonga does not operate a general system of import controls but Section 16 (3) of the Industrial Development Incentives Act provides that the Minister of Finance, if he considers it expedient, may, on application by an approved enterprise wholly prohibit or quantitatively restrict under the Foreign Exchange Control Regulations, the importation of any goods into Tonga. This power has not been used to date although it may well be used in the near future.

Restrictions on Competing Local Production

The Industrial Development Incentives Act provides a comprehensive system of industrial licensing. Ministerial approval is a pre-condition of setting up an industrial enterprise in Tonga.
Section 16 (1) of the Act reaches beyond this and declares that it shall be unlawful for any person to establish or expand any manufacturing, processing or assembly operation or create or expand tourist facilities in Tonga without the approval of the Minister, on penalty of a fine of T$1,000.

OTHER FORMS OF ASSISTANCE

**Industrial Estate**

Tonga has, with assistance from the Asian Development Bank, established a Small Industries Centre on a 12 acre site at Ma'ufanga 2.5 kilometres from Nuku'alofa and 1 Kilometre from the wharf. The Centre has five factory sheds, ten small scale industrial units (103 m² each) and 19 industry plots. The site has room for expansion and is fully serviced by roads, water, electricity, telephone and sewage. Leases are for 50 years and rentals are calculated so as to recover all operating costs plus repayment of capital over a 40 year period. The rates are concessional to the extent that no interest is payable on that capital.
THE SYSTEM OF INCENTIVES - THE FEDERATED STATES OF MICRONESIA

INTRODUCTION

The investment and incentive laws of the Federated States of Micronesia (FSM) are in a state of transition. The main tax and revenue laws are those inherited from the Trust Territory of the Pacific Islands (TTPI). A bill intended to establish a progressive income tax in the FSM was introduced to Congress in 1980 but, as at March 1981, had not been passed. Its future was uncertain. A new Foreign Investment Act came into operation in 1980 replacing the foreign investment laws and regulations of the TTPI. An Investment Incentives Bill, introduced in 1980, had not been approved by Congress by March 1981 and its future was uncertain.

The FSM has very low rates of taxation and little in the way of incentive legislation. Businesses are taxed on gross revenue rather than profits at a rate of $80 plus 3 per cent of revenue over $10,000. Import duties are levied only on goods intended for resale so that raw material and capital goods imports are free of duty.

The Investment Incentives Bill, which remains before Congress, proposed the granting of five year tax holidays from gross revenue tax and import duties and offered the possibility of tariff protection. The Foreign Investment Act requires foreign investors to obtain a permit before setting up a business in the FSM. Applications are considered by a Foreign Investment Board comprising the Secretary of Resources and Development, the National Planner and a third member appointed by the Speaker of Congress. The Board investigates the proposal and consults with the state governments. The final decision, which requires Presidential approval, is to be made taking a range of factors into account, including, economic, social, and environmental factors, resource depletion, exports and imports, employment, training and local participation.
INCOME TAX

Rate of Business Tax

Businesses are taxable on gross revenue rather than net revenue or profits. The rate of tax is $80 plus 3 per cent of revenue over $10,000. The tax is a composite tax half of which is levied by and accrues to the federal government and half of which is levied by and accrues to the four state governments.

Concessions

There is at present no provision for exemption from gross revenue tax but the Investment Incentives Bill proposes that exemption should be available for a period of four years to approved enterprises having a local added value greater than 35 per cent.

Depreciation

As taxes are levied on gross rather than net business incomes the question of tax allowable depreciation provision does not arise.

INCOME TAX - OTHER INCOMES AND AVOIDANCE OF DOUBLE TAXATION

Individuals

Wages and salaries are taxable at a rate of 6 per cent on the first $11,000 and 10 per cent on amounts in excess of $11,000. This is a composite tax which is shared equally between federal and state authorities. Individuals are also liable to pay gross revenue tax on gross receipts received as compensation for personal services not in the form of salaries and wages.

Interest and Dividends

Interest and dividends are taxable as gross revenue in the hands of the recipient and there are no provisions for exemption of such income.
CUSTOMS DUTY - EXCHANGE CONTROL AND PROTECTION

The Tariff

Import taxes are levied on all products imported into the FSM for resale. Foodstuffs for human consumption are dutiable at 1 per cent and general merchandise at 3 per cent. Higher rates of duty (either ad valorem or specific) are set on perfumery and cosmetics, soft drinks, alcoholic beverages and fuels. As to protective use of the tariff, the draft incentives act proposes empowering the President, with the concurrence of the Board, to increase by not more than 100 per cent the level of import duty on any article.

Concessions

As the import tax is imposed only on items imported for resale it does not apply to raw materials imported for use in local manufacture or to import of capital equipment by the investing firm.

Exchange Controls

The FSM is part of the US currency area and is serviced by a branch of the Bank of Hawaii. There are no local exchange controls or restrictions on remittance of dividends, interest and related fees.

OTHER INCENTIVES

Industrial Estates

The FSM does not have any developed industrial estates. Public land is however generally available for lease at rentals calculated at 7 per cent of the assessed value of the land. Some use has been made of the concept of small industries centres where government provides ongoing advisory services to small enterprise initially established on a publicly owned building.
INTRODUCTION

The Kiribati system of incentives depends upon the exercise of ministerial powers conferred under three laws. The Income Tax Act provides for up to five years exemption from income tax for approved pioneer companies. General provisions of the Customs Act enable exemptions to be given from import duty. Finally the Protected Industries Ordinance empowers the Minister to limit activity in particular industries to approved firms.

In considering applications from foreign investors the Minister of Trade, Industry and Labour is assisted by an Foreign Investment Advisory Committee. Chaired by the Secretary of Trade, Industry and Labour this Committee also comprises, the Assistant Secretary of the Ministry, as Secretary, the Secretary of Finance, the Secretary of Natural Resources and Development, the Planning Officer Ministry of Finance, the Executive Secretary of the National Loans Board, the Chief Lands officer and three members of the public nominated by the Minister. Tax concessions are subject to final decision by the Minister of Finance.

The Government of Kiribati welcomes foreign investment in all sectors, provided it brings lasting benefits and considers that the greatest scope for such investment is in marine resources and, to a lesser extent, tourism. Foreign investors are offered guarantees against nationalization or expropriation and of the right to remit earnings and capital abroad.

INCOME TAX - COMPANIES

Normal Company Tax Rate

Resident and Non-resident 25 per cent
Period and Extent of Income Tax Concession

Pioneer Companies

The Minister of Finance may declare any company a pioneer company where he considers this in the public interest, having regard to the economic and other benefits likely to accrue to Kiribati. Such companies are accorded total exemption from income tax for a period of five years from a ministerially specified "date of production".

Depreciation

Depreciation is calculated on a diminishing value basis with provision for a higher than usual deduction in the year of purchase. The allowable rates are:

<table>
<thead>
<tr>
<th></th>
<th>Year of Purchase</th>
<th>Subsequent Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buildings</td>
<td>25</td>
<td>10</td>
</tr>
<tr>
<td>Machinery and Plant (including motor vehicles)</td>
<td>50</td>
<td>25</td>
</tr>
<tr>
<td>Ships</td>
<td>50</td>
<td>10</td>
</tr>
</tbody>
</table>

Concessions

The normal rates listed above are themselves concessionary in that they provide for accelerated depreciation. There are no provisions for further concessions to any particular class of firms.

Investment Allowance (Additional Depreciation)

Kiribati does not offer any concessions by way of additional depreciation.

Export Incentives

Kiribati does not operate any form of export incentive.

Carry Forward of Losses

Losses may be carried forward without restriction as to time.
INCOME TAX - OTHER INCOMES AND AVOIDANCE OF DOUBLE TAXATION

Individuals

The normal rate of income tax on individual incomes rises from 9 per cent on the first $500 of chargeable income to a maximum rate of 50 per cent on such part of chargeable income as exceeds $6,000.

Interest and Dividends

The Kiribati law on taxation of dividends and interest is somewhat complex. Dividends and interest derived from Kiribati are assessable in the hands of the recipient. Dividend payments are not subject to a withholding tax but resident companies are entitled (although not required) to deduct from the gross amount of any dividend, tax at the rate at which the company is liable to pay tax on its profits. In such cases the company is required to supply relevant details to the shareholder who is entitled to set off the tax deducted against his own tax liability. Pioneer companies are entitled to a tax-free distribution, by way of dividend, of profits earned during their tax concession period provided that the distribution is made within two years of the end of that period and does not exceed the share capital of the company. Interest payments made to non-residents are subject to a withholding tax calculated at normal income tax rates.

Avoidance of Double Taxation

Kiribati has a double taxation agreement with the United Kingdom which is extended to include Sweden, Denmark and Norway.

CUSTOMS DUTY - EXCHANGE CONTROLS AND PROTECTION

The Tariff

The Kiribati tariff is a revenue tariff with a wide range of duty rates. Variations are largely explicable in terms of essentiality coupled with a desire to divert spending to local rather than imported
products. For foods, for example, duty rates range from free, for butter and cheese, coarse cereals and a wide range of miscellaneous products, through 10 per cent for most vegetables, 15 per cent for fresh and canned meat, 20 per cent for dried and preserved fruits, oil seeds and macaroni, 30 per cent for spices, 40 per cent for coffee, tea and cocoa, and 60 per cent for fresh and canned fish. Industrial materials and machinery are generally either free of duty or dutiable at low rates. Duty rates on manufactured items vary widely, again primarily, but not always, in terms of essentiality. Joinery and made-up articles of wood are dutiable at 20 per cent, clothing and footwear at 50 per cent, and motor cars at 60 to 80 per cent.

Relief from Customs Duty

(a) General Provisions

There is no specific incentive legislation relating to customs duty. However, Section 8 of the Customs Ordinance gives the Minister of Finance power in his discretion to exempt in whole or in part any duty prescribed in the ordinance and this may be used as an incentive.

(b) Duty Drawback Provisions

The Customs Ordinance provides for the draw back of duty on imported materials used in the production of exported goods.

Exchange Control

Kiribati uses the Australian dollar as its own currency and operates no more than a rudimentary level of exchange control. The Bank of New South Wales, which operates the only trading bank in Kiribati, is required to notify all transactions of more than $50,000 but, given the size of the economy, most such transactions are on government account. Although Kiribati uses Australian currency the Australian authorities do not regard Kiribati as part of the Australian currency area and payments from Australia to Kiribati are subject to the normal Australian controls. The official brochure "Investment in the Gilbert Islands" indicates that the government will offer to foreign investors guarantees on remittance of funds but these
guarantees are not formally incorporated in any law. The foreign exchange control system is not used to provide protection to local producers.

**Restrictions on Competing Local Production**

The Protected Industries Ordinance empowers the Minister to declare an industry protected where he considers this necessary and in the public interest. In such cases it becomes an offence to carry on a business without a licence. Orders are reviewable after five years and thereafter at intervals of not more than two years. Licensed firms are subject to various reporting requirements, and may have conditions imposed on prices to be paid for local raw materials, and maximum selling prices set for goods manufactured by the protected firm. The ordinance has recently been applied to protect an overseas venture which has pioneered the aerial collection, processing, and export of crayfish and similar products.

**OTHER INCENTIVES**

**Industrial Estate**

Kiribati does not have an industrial estate.
THE SYSTEM OF INCENTIVES - COOK ISLANDS

INTRODUCTION


The Development Investment Act and the Investment Code are concerned with the regulation of foreign investment and the provision of incentives to encourage investment in priority areas. The Act established a Development Investment Council whose membership comprises the Secretary of Trade, Industry, Labour and Commerce as chairman, the industrial development officer from the department as Secretary, the Director of the Development Planning Unit and the Collector of Inland Revenue. In addition the Minister may appoint up to three other members who are not members of the Cook Islands public service.

The Development Investment Council is responsible for reviewing and making recommendations through its Minister to Cabinet, both on applications for the granting of incentives, and on applications from foreign firms for registration under the Act. In recommending on these matters the Council is guided by the Investment Code as approved by Cabinet from time to time. This Code established three basic schedules.

(a) A schedule of activities which the government sees as desirable for the economic development of the Cook Islands.

(b) A schedule of activities which are eligible for incentives and concessions (this is a sub-set of (a)).

(c) A schedule, graded in much finer detail, of activities which will be reserved primarily for local rather than foreign investors. This schedule includes some activities which are eligible for incentives.
The schedule of activities eligible for incentives includes commercial agriculture, livestock production and fishing, the processing of such products, other marine and agro based industries, production of stockfoods, commercial handicraft production, tourist support facilities, manufacture for export or for import substitution, and manufacture of products for the home building industry.

Approved enterprises may, at Cabinet's discretion, be entitled to special tariff protection, partial or full exemption from import duties on raw materials and capital items an income tax holiday of up to five years (with the possibility of a five year extension in special circumstances), special tax deductions in respect of overseas recruitment of local persons and training of counterpart staff and provision for accelerated depreciation and investment allowances.

The 1980 tax changes revolved around a shift in emphasis from taxation of the net income of companies to taxation of business turnovers. The Turnover Tax Act imposed a turnover tax on most sales of goods services and property.

For registered wholesalers the rate of tax is 1 per cent and for most other transactions including retail sales, it is 4 per cent. The Use Tax Act provides for a 5 per cent tax to be imposed on important goods. The Income Tax Amendment (No.2) Act provided for a 15 per cent reduction in the rate of company income tax and introduced a special provision for development industries. This provides that the Minister of Finance having consulted Cabinet, may, where he is satisfied that a "development industry" will contribute significantly to the economic development of the Cook Islands, lower the income tax for the company to 5 per cent, implicitly without limit as to time. Finally, the Cook Islands Customs Tariff was revised in 1980.
INCOME TAX - COMPANIES

Normal Company Tax Rates

<table>
<thead>
<tr>
<th></th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-Resident</td>
<td>27¼%</td>
</tr>
<tr>
<td>Resident</td>
<td>20%</td>
</tr>
</tbody>
</table>

Depreciation

The Cook Islands has traditionally used the depreciation rates provided under the New Zealand law. Examples of such rates, calculated on a straight line basis for buildings and a diminishing value basis for plant are:

<table>
<thead>
<tr>
<th>Year of Purchase</th>
<th>Subsequent years</th>
</tr>
</thead>
<tbody>
<tr>
<td>concrete building</td>
<td>1</td>
</tr>
<tr>
<td>industrial machinery (lathe)</td>
<td>20</td>
</tr>
<tr>
<td>motor vehicle (motor car)</td>
<td>20</td>
</tr>
</tbody>
</table>

Income Related Tax Concessions

(a) Enterprises approved under the Development Investment Act

Approved enterprises may be granted full or partial exemption from income tax for up to five years with the possibility of an extension for a further five years in special circumstances.

(b) Income Tax Amendment (No.2) 1980

Any new or existing company engaged in manufacturing, primary production, export industry or import substitution may be declared by the Minister of Finance to be liable to pay company tax at the rate of 5% per cent, if he is satisfied that the business will contribute significantly to the economic development of the Cook Islands. The Minister may impose conditions on an approved company but the Act does not provide for any time limit.

Depreciation Concessions

Accelerated Depreciation and Investment Allowance Concessions for Firms approved under the Development Investment Act

The Act provides for various combinations of accelerated depreciation and investment allowances. These are described in
parallel in the following table:

<table>
<thead>
<tr>
<th>Project Description</th>
<th>Depreciation Allowance</th>
<th>Investment Allowance</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Commercial, agricultural, livestock and fishing projects</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) Capital expenditure greater than $20,000</td>
<td>as per usual schedules</td>
<td>55 per cent allowance; may be claimed in any year until full amount claimed.</td>
</tr>
<tr>
<td>(ii) Capital expenditure $20,000 or less</td>
<td>accelerated depreciation at discretion of firm</td>
<td>no investment allowance</td>
</tr>
<tr>
<td>(b) Other projects having capital expenditure greater than $5,000 excluding land.</td>
<td>accelerated depreciation at discretion of firm</td>
<td>100 per cent investment allowance at discretion of firm</td>
</tr>
</tbody>
</table>

Briefly the concessions provide for accelerated depreciation for agricultural and similar projects having a capital value of less than $20,000 and for all non-agricultural projects having a capital value of $5,000 or more. An investment allowance of 55 per cent is accorded to large scale agricultural projects and a 100 per cent investment allowance is available for non-agricultural projects where capital expenditure exclusive of land, is more than $5,000.

### Recruitment and Training Incentives

The Development Investment Act provides for extra deductions to be allowed in respect of certain employee costs incurred by approved enterprises. These are:

(a) a 120 per cent deduction of allowable expenditures on recruitment of an employee who is a local person ordinarily residing overseas.
(b) a 200 per cent deduction of approved training costs incurred in training a local person to replace an expatriate.

Carry Forward of Losses

Business losses may generally be carried forward without limit provided that such relief shall be availed at the first opportunity. The Development Investment Act contains no additional provisions on this matter.

INCOME TAX - OTHER INCOMES AND AVOIDANCE OF DOUBLE TAXATION

Individuals

The normal rate of income tax on individuals rises progressively from a rate of 5 per cent on the first $2,000 of taxable income to a maximum rate of 45 per cent on such part of income as exceeds $12,000.

Interest and Dividends

A withholding tax is imposed on interest and dividend payments made by enterprises operating in the Cook Islands. The rate of withholding tax is 5 per cent on payments to residents and 15 per cent on payment to non-residents. Interest and dividends are taxable in the hands of residents with credit for withholding tax deductions made in the Cook Islands. For non-residents the withholding tax is final.

Avoidance of Double Taxation

The Cook Islands is not party to any double - taxation agreement although they have a working relationship with the New Zealand income tax authorities and benefit from a special tax sparing provision under New Zealand law. The New Zealand Income Tax Act provides in section 62 (2) that where the income of a New Zealand company is derived principally from an enterprise declared to be a development project in the Cook Islands shall be exempted from income tax in New Zealand. Thirteen companies are currently so listed under New Zealand Orders in Council.
IMPORT DUTIES, EXCHANGE CONTROL AND PROTECTION

The Tariff

The Cook Islands Customs Tariff imposes two parallel rates of taxes, an Import Duty and an Import Levy. The import duty is not applicable to imports from New Zealand, but the import levy is. Common rates for duty are zero, 5 and 10 per cent and for levy: 10 per cent or some higher rate. Many items have import levy rates from 15 to 25 per cent and very much higher rates of duty or levy are applied in some cases. Examples include coconuts, canned pineapple and fruit juices - duty 25 per cent, levy 75 per cent; woven fabrics containing wool, duty 45 per cent, levy 10 per cent; and motor cars, duty 55 per cent, levy 20 per cent. In general the Tariff is a revenue rather than a protective tariff with higher rates generally being reserved for less essential or luxury goods. There are some times where rates have been set with protective intent.

Duty Concessions

The Development Investment Act provides that approved firms may be granted full or partial exemption from importy duty and/or levy on both capital and raw material items. For capital items the exemption shall not extend for more than 3 years while for raw materials the exemption may be for any specified period of time. To date about 15 to 20 firms have received concessions. It is usual for such firms to be accorded exemptions from both duty and levy on capital goods imports. Exemptions in respect of raw materials are less usual and have typically, but not exclusively, been applied in respect of materials for use in production of export items.

Drawback of Duty

The Cook Islands operates normal duty drawback provisions.

Provision of Protective Duties

The Development Incentives Act provides that import duties and levies may be increased to protect an approved activity where

- the activity is import substituting
- protection is essential for initial survival
- where there is a threat of excessive or unreasonable competition from a foreign exporter.

**Exchange Control**

The Cook Islands is part of the New Zealand currency area and for many years its overseas exchange and import licensing procedures closely followed those of New Zealand. Recently the Cook Islands has adapted its systems to meet its own needs although its freedom of action is limited by a need to remain within the boundaries of the New Zealand system. Furthermore, the fact that the Cook Islands is part of the New Zealand system means that the Cook Islands cannot use exchange controls or import licensing to protect its producers against New Zealand competition. In practice exchange is allocated on application, subject to a one per cent licence remittance fee, provided that the application is within the traders traditional line of business.

Approval will normally be given for remittance of profits and capital and in terms of the Development Investment Act registered foreign investors are guaranteed the right to remit earnings and repatriate capital subject to the laws of the Cook Islands.
THE SYSTEM OF INCENTIVES - TUVALU

INTRODUCTION

It has not proved possible to gather the information needed to support a detailed statement of the Tuvalu system of incentives. The main features of the Tuvalu system are very similar to those of Kiribati as until independence the two countries were subject to the same laws. In particular the pre-independence Income Tax, Customs and Protected Industries Ordinances applied to the two countries and, as in the case of Kiribati, have been translated directly into Tuvalu law. An overview of the Tuvalu system can thus be formed by reference of the appendix on Kiribati.

Known differences between the systems of the two countries are set out below.

In Tuvalu questions on investment incentives are overseen by the Foreign Investment/Business Advisory Committee.

The Tuvalu Customs Tariff has been revised since independence.

Tuvalu has its own national bank. This is a joint venture between the Tuvalu Government and Barclays Bank International. The Australian Dollar is the main currency but a local coinage circulates domestically at par with Australia. There is no formal reporting procedure for foreign exchange transactions but as all major transactions are made by either the government or the Co-operative Society these are easily monitored. The Exchange Control Ordinance is being revised.
THE SYSTEM OF INCENTIVES - NIUE

INTRODUCTION

In May 1981 the Niue Cabinet adopted a statement of its investment policies based upon principles developed in the Niue National Development Plan for 1980-85. These policies are intended to support Niue's objective of providing several hundred private sector job opportunities in agriculture, agro-based industries and light manufacture. The concessions which are offered are given under various statutory powers.

INCOME TAX - COMPANIES

Normal Company Tax Rate

Resident and non-resident companies 30 per cent.

Depreciation Rates

Normal depreciation rates are:
- Buildings 1 - 24 per cent, straight line
- Plant, machinery 20 per cent, diminishing value

Income Related Tax Concessions

Section 50 of the Income Tax Ordinance 1961 provides for exemptions in respect of industries contributing to economic development. The section empowers the Cabinet of Ministers, after reference to the Niue Assembly, to exempt the income of enterprises which will contribute substantially to the economic development of Niue. The exemption may be in whole or in part or by way of special deductions and shall apply for a specified period. In practice the usual form of concession has been a full tax holiday for five years.
Depreciation Concessions

Niue does not offer accelerated depreciation as an incentive although Section 50 of the Income Tax Ordinance would enable such a concession to be granted.

Investment Allowance (Additional Depreciation)

Niue does not offer any form of investment allowance additional to normal depreciation.

Export Incentives

Niue does not operate any form of export incentive.

Carry Forward of Losses

Losses may be carried forward for up to six years. Section 50 of the Income Tax Ordinance enables the granting of an extended carry forward to concession firms.

INCOME TAX - OTHER INCOMES AND AVOIDANCE OF DOUBLE TAXATION

Individuals

The normal rate of tax on individual incomes rises from 10 per cent on income up to $4,200 to a maximum rate of 41 per cent on such part of income as is in excess of $6,800. These rates reflect the combined action of two taxes, first a flat tax imposed on all incomes by the Aid to Revenue Ordinance and second the progressive rate scale imposed by the Income Tax Ordinance.
Avoidance of Double Taxation

Niue is not party to any agreement for the avoidance of double taxation. Niue does however benefit from a unilateral tax sparing provision in New Zealand law which enables income derived from particular enterprises in Niue to be exempted by Order in Council from income tax that would otherwise be payable in New Zealand.

CUSTOMS DUTY - EXCHANGE CONTROLS AND PROTECTION

The Tariff

The Niue tariff is currently under review and is expected to be operational in 1992. The Cabinet is prepared, where it deems fit, to review the level of tariff protection for Niue industries producing for the domestic market.

Relief from Customs Duty

The Niue Cabinet has agreed that capital goods for approved business undertakings should be given duty free or concessional entry into Niue for a specified period of time or for a particular quantity of items. Concessions are granted in terms of general ministerial powers contained in the New Zealand Customs Act which has effect in Niue. This also provides for drawback of duty on imported materials used in the production of exported goods.

Exchange Control

Niue is part of the New Zealand currency area and the Niuean Treasury is responsible for exchange control and in the absence of a trading bank directly handles exchange transactions. Niue is no longer subject to a fixed exchange quota from New Zealand because of its relatively small requirements by international standards. However, the Niue Treasury does exercise
some control over the availability of foreign exchange by approving allocations to importers and others on an annual basis as requested. Repatriation of capital and profits within the New Zealand currency area is permitted without restriction but repatriation beyond this area is examined by Cabinet on a case by case basis.

Quantitative Control of Imports

The National Development Plan states a preparedness to use quotas as a means of encouragement to local industry. Quotas are currently applied to protect the market of the local soft drink producer whilst still leaving room for some competing imports.

Restrictions on Competing Local Production

There is no established system of local market protection in Niue but only permanent residents are permitted to engage in wholesaling, retailing, taxi and hire car services and public bus operation.

OTHER FORMS OF ASSISTANCE

Industrial Estate

A small industries centre is being established on 18 acres of crown land for both industrial and commercial activities. Two factory shells are planned and will be made available at subsidized rentals.

Rebate on Government Charges

Cabinet will, where it deems fit, approve a rebate on government charges to Niue businesses.
On-the-job Training

Cabinet will consider, on a case by case basis, the merits of sponsoring initial on-the-job training of employees in newly established or expanding businesses.