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STUDY ON AN EXPORT PROCESSING ZONE
AS A POLICY OPTION FOR TONGA

NC/TON/92/064

TONGA

Report

Prepared for the Government of Tonga
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SUMMARY

Existing Situation

Tonga has already in place all the necessary elements of an EPZ package. An investor can under present regulations and procedures (i) establish a factory on an industrial estate in Nuku'alofa or anywhere else in the Kingdom; (ii) import materials and equipment free of duties and taxes (and without any major delays) process the materials and export the finished product; and (iii) avail of a 10-15 year tax holiday.

Very few existing manufacturers can take advantage of the EPZ type facilities on offer because most of the 158 units classified as manufacturing are very small (employing less than 10 people), producing a range of "non-exportable" products - bakeries, concrete products, other building products, furniture etc. Only 27 firms have export-oriented status. These companies are concentrated in the clothing, leather and jewellery sectors. Most of them are small scale (20-30 employees). With few exceptions they find it difficult to mount a sustained export drive in overseas markets. An analysis of manufactured exports over the period 1984-92 shows total manufactured exports growing from 0.886 M T $ in 1984 to 2.173 M T $ in 1988 and fluctuating between 2 and 2.5 M in recent years. Machinery and transport (mainly excavators and boats) was important in the mid 1980's but subsequently declined. Exports of leather products expanded significantly in more recent years (1988-91) but declined somewhat in 1992. Knitwear exports achieved a sustained growth in the period 1984-90 due to the efforts of one company but declined in the last few years. Exports of shirts were important in 1992.

Within the manufacturing sector there has been no sustained long term growth in any product line. An explanation with which many have agreed is that existing companies (with few exceptions) are too small and lack the overseas connections, especially in relation to marketing and design, to maintain a sustained export drive over a number of years.

If Tonga is to achieve a sustained growth of manufactured exports, it will be necessary to attract a steady flow of medium sized overseas investors with strong marketing connections in export markets and the ability and resources to manage a subsidiary operation in Tonga. In general, this would mean companies with a few hundred employees and a turnover in excess of 5 M $ motivated (by profits) and locating in Tonga to increase profits.

To date this type of company has not invested in Tonga on a significant scale. Most foreign investors are small-scale business people with limited financial resources who have invested for a number of non-economic reasons, e.g. a liking for the Tongan people or lifestyle, or a desire to do something for the country.

Investment Promotion

Tonga to date has invested very little in trying to attract investors to the country. The budget for investment promotion last year was reported to be under 1000$.

There are no major obstacles to investment in Tonga, except perhaps its remoteness and small size. As a result, international transport and domestic support services (e.g. repair and maintenance) are limited. However, the telecommunications service is good. The workforce is well educated and industrial relations are good. People with industrial skills are in short supply. Labour costs could be classed as average for the region and low in comparison with New Zealand and Australia. Industrial estate facilities are available - which might be improved to respond quickly to investor requirements.

The industrial estate at Nuku'alofa is 20 acres in size or 80,000 sq. m. The area of plots is 52,478 sq. m. or 66% of total. This is the normal ratio of plot size to total area. The ratio of built over area to plot size is very low. Buildings occupy on average 22% of the plot area. The normal ratio is above 50%. The estate is making a loss at present when depreciation expenses are included. The Ministry is short of funds to develop the rest of the estate. There is however, an application for funds with the Asian Development Bank. There is a need to review the operation of the estate to (i) achieve a higher ratio of built over area within plots and (ii) a better balance between revenue and expenditure i.e. commercialize the estate or operate it on commercial principles as a separate profit centre, possibly within the responsibility of the proposed Development Corporation. (There is a proposal to establish a Development Corporation in Tonga and it is understood that a consultant will review the proposal later in the year).

Australia and New Zealand are the best sources of investment in the short/medium term because of the traditional trade, transport and political links and geographic proximity. In addition, there are established promotion offices in both countries - the South Pacific Trade Commission (SPTC) in Sydney, and the South Pacific Trade Office (SPTO) in Auckland, and Tongan tourism representatives which can be used to promote investment. The East Asia and the West Coast of the United States could be targeted for promotion in the medium term.

The general reaction of the SPTC in Australia and the SPTO in New Zealand, as well as tourism representatives in both countries and diplomatic representatives, is that with a sustained and highly focused promotion effort it should be possible to attract a number of medium sized investors to Tonga. At present very little is known about Tonga in Australia or New Zealand.

A figure of 3-4 investors per annum employing 50-100 people each was considered "achievable". The promotion effort would require 150-200,000 T $ annually. The Tongan government would have to finance a percentage of the total - about 20%. Indications are that Australia, New Zealand or the EC would fund the balance. The EC is currently financing part of the operation of the Fiji Trade and Investment Board (FTIB).

Organizational Structures

In order to attract investment, strengthening of investment promotion unit as described below will be important. In addition, an EPZ law should be drafted which would set out clearly the relationship between the investors and government and outline the operating conditions for investors. (See Annex I).

The investment promotion unit should be separate from the Ministry of Labour, Commerce and Industry (MLCI) with its own budget and Board of Directors. A study on the establishment of a Development Corporation is due to commence later in the year. There is a good argument for including the investment promotion unit within the Development Corporation as well as the trade promotion efforts of the MLCI and the management of the industrial estate. The organization would be modest in scale and could be modelled on MEDIA - the Mauritius Export Development and Investment Authority - which has responsibility for trade and investment promotion and industrial estate development.

Responsibility for project evaluation, approval and the licensing of EPZ or export-oriented projects would remain with the MLCI as is the case in Mauritius. This would allow a clear separation of the promotion/commercial aspects of EPZ development on one hand and the evaluation, licensing and regulatory aspects on the other.

The Investment Promotion Unit should at all times work with and on behalf of the investor - persuading him first of all to invest in Tonga, then progressing his application through the Ministry, assisting and working with the investor in the establishment and operating stages - providing factory buildings and supporting him with trade promotion activities.

In progressing the application through the Ministry, the Investment Promotion Unit would have the responsibility of ensuring that each application is acknowledged and processed quickly. There have been some complaints about the speed of processing investment applications in the past and the lack of acknowledgment of applications. The Ministry of

Labour, Commerce and Industry would have the responsibility of ensuring that potential investors will:

(i) make a positive contribution to the development of the Tongan economy (employment and exports); and

(ii) that suitable arrangements are in place to transfer production skills to Tongans before licenses are issued - the evaluation process.

The Ministry should ensure that the necessary permits (building, labour, immigration) follow automatically once the project is approved. In addition, the Ministry would be responsible for ensuring that the investor adheres to the conditions of the license.

BACKGROUND INFORMATION ON EXISTING SITUATION

Industry policy

The Industrial Development Policy announced in 1977 aims at developing private sector by encouraging:

(i) investment by local entrepreneurs and

(ii) foreign investments which bring continuing and real benefits to the people of Tonga. Foreign investments with the following characteristics are encouraged:

- requiring substantial amount of risk capital;
- processing of local resources;
- substantial contribution to local value added;
- access to managerial and marketing skills;
- modern technology and technical expertise;
- labour intensive, with a medium to high labour to capital ratio;
- having export potential to augment the country's foreign exchange earnings;
- import substitution resulting in conservation and saving of foreign exchange;

- a reasonable level of local equity participation;
- having a multiplier effect providing base for the establishment and growth of ancillary industries;
- likely to bring complementary benefits to other manufactures or producers in Tonga.

The fiscal aspects of the policy were legislated in the Industrial Development Incentives Act of 1978. In accordance with the provisions of the Act, regulations were also made for administration of the Act.

The fiscal incentives include: income tax holiday for five years, extendable by another five years in case of exceptional circumstance by His Majesty in Council; in case of expansion, income tax holiday for five years; tax exemption on dividends during the tax holiday period; withholding tax exemption for non-resident shareholders/entrepreneurs; carry forward of losses without time or monitory limit; depreciation to commence after the tax holiday period; in case tax holiday is not availed, accelerated depreciation was to be allowed; moratorium on income tax after tax holiday, on specific requests, if it is to the long term advantage of the Kingdom; full exemption from customs duty on import of capital equipment and exemption of 50% Port and Services Tax for five years; facility of drawback of Customs duty and Port and Service Tax on import of raw materials and semi-finished products if the end products are exported; facility of repatriation of funds as per Section 15 of the IDI Act.

The non-fiscal incentives include repatriation of funds generated on foreign investments; lease of serviced industrial plots and built up factory buildings on long lease, entrepreneur visas, and provision of business advisory and promotion services.

The following amendments to the IDI Act were made after 1978:

- export-oriented industries were exempted to pay customs duty and port and services tax on import of raw material/semi-finished product at the time of import. Earlier the duty was paid and reimbursement allowed after actual imports.

- for the trial run (for maximum six months), exemption on payment of customs duty and port and services tax was allowed at the time of first imports. Earlier only reimbursement was allowed.
- tax holiday was allowed from the date of production instead of date of issue of Development License.
- exemption of withholding tax was also allowed for non-residents entrepreneurs;
- provision was made to procure duty free equipment from government stores;
- building materials for construction of factory buildings were included under the capital equipment for exemption of customs duty and partial exemption of port and service tax;
- import of duty free vehicle as part of capital equipment was allowed with specific approval of the Minister;
- the scope of the IDI Act was enlarged with the introduction of an enabling clause to declare any industry under the IDI Act;
- service-oriented industries such as automobile repair enterprises were included under the purview of the IDI Act in 1983 (most of these enterprises are owned by Tongans);
- tax holiday was increased up to 15 years. The duration for tax holiday which could be considered is as follows:

* Traditional industries in Tongatapu (service industries like automobile repair shops, furniture and joinery, small tourist facilities, etc.)	5 years
* Industries in outer islands	7 years
* Export-oriented industries	10 years
* Processing of agricultural and marine products	10 years
* Import substitute industries with capital investment of over two million pa'anga	10 years
* Industries and tourism prime facilities with a capital investment of over five million pa'anga	15 years

(No Development License has been issued with 15 year tax holiday)

- construction of factory buildings for renting to approved industries is included under the purview of the IDI Act for grant of incentives;
- also commercial farming for export and commercial fishing for exports are included under the purview of the IDI Act.

Specific amendments relating to export-oriented industries: the definition of export-oriented manufacturing industry is specified as one which exports 90% of its annual sales. Export proceeds are required to be brought back to Tonga within 12 months of exports. Full exemption on payment of port and services tax on capital equipment (including motor vehicle) is allowed within two years of the issue of Development License. Earlier only 50% was allowed.

Other developments relating to export enterprises: the Tongan currency pa'anga, which was at par with Australian dollar until February 1991, is now pegged to the basket of currencies. Export Finance Liquidity Scheme was introduced by the National Reserve Bank of Tonga (NRBT) in 1990 to overcome liquidity problems of the two banks in Tonga. The Scheme which originally covered merchandising exports has now been extended to tourism. There is possibility of the same being extended to the export manufacturers. Under the Scheme, the promissory notes originally discounted by the two financial institutions are rediscounted by the NRBT.

The following incentives were withdrawn in the end of 1992: facility of depreciation to commence after the tax holiday period; tax holiday for expansion programmes; carry forward of losses, irrespective of monitory or time limit; moratorium on payment of income tax.

Status of industries in operation

Over one-hundred-eighty industries were in operation in 1991, 26 were operating as "export-oriented industries". The products exported by these industries include woollen knitwear, shirts, patchwork items, spectacle accessories, leather garments, ladies handbags, processed root crops, coconut oil and processed vanilla beans. The output of all the industries in operation in 1991 was estimated at T$ 25 million with an employment of 2,500 workers.

The industrial sector, though small in terms of its contribution to the GDP, is growing steadily. The Asian Development Bank in its report "Asian Development Outlook 1991" has estimated contribution of manufacturing sector at 10% during 1990 with 30% exports. The manufactured exports are increasing and are substituting coconut-related export trade.

Licensed manufacturing establishments in 1992

	In operation	Closed	Total
- Food Processing/Bakery/Beverages	46	24	70
- Clothing/Apparel	23	13	36
- Jewellery	4	1	5
- Leather Products	8	5	13
- Furniture and Wood Products	31	15	46
- Building Material	10	4	14
- Printing (publishing)	5	3	8
- Non-metallic Products	2	4	6
- Chemical Products	6	2	8
- Fabricated Metal Products	8	2	10
- Other Transport Products	2	7	9
- General Engineering	4	13	17
- Spectacles and Accessories	2	1	3
- Photo Processing	1	2	3
- Building Material	10	4	14
- Miscellaneous	4	4	8
- Auto Repair	39	15	54
- Electrical/Electronic Repair	18	5	23
- Dry Cleaning	3	2	5
TOTAL:	216	121	337

Note: Figures do not include 58 service-oriented industries, workshops such as automobile repair, electrical repair enterprises.

Institutional arrangements

Under the IDI Act, for any industry to be set up in Tonga a Development License is necessary. The authority to approve the Development License vests with the Minister of Labour, Commerce and Industries, who is advised by a Standing Advisory Committee (SAC) on Industrial Licensing.

The application for issuance of a Development License is submitted to the Secretary of the Ministry of Labour, Commerce and Industries (MLCI). The same is appraised by the Industrial Promotion Unit of the Ministry, and then submitted to the SAC constituted under the IDI regulations. The SAC is chaired by the Minister. Other members are the Secretary of the MLCI, who is also the Secretary of the Committee, the Secretary of Ministry of Finance, the Managing Director of Tonga Development Bank, the Chief General Manager of Bank of Tonga, the Director of the Ministry of Agriculture and Forestry, and the Director of Central Planning Department. All applications are required to be submitted to the SAC which makes specific recommendations to the Minister (MLCI) about the proposal and incentives.

Following the recommendations of the SAC, the Minister approves the issuance of license. The approval is conveyed by the Secretary of the Ministry through a Letter of Intent. The actual license is issued when the enterprise is about to be launched, so that maximum benefit is availed by the promoters.

The incentives granted are indicated on the body of the license. Copies of all Development Licenses are sent to the Customs Department, Immigration, Electric Power Board, Secretary of Finance, etc. For facilitating exemption from custom duty and port and service tax, the enterprises are required to submit the details to the MLCI which verifies the same and sends it to the Customs Department. The enterprises are advised to inform the MLCI about their six monthly requirements in advance, so that the same is verified by the IPU and sent to the Customs Department.

Most of the approvals for setting up industries are provided/processed by the MLCI and the investors are not required to go to different departments. These include grant of Development License, lease of factory building/serviced industrial plots, registration of companies, issue of trading license, assistance in undertaking market research, provision of business advisory services, etc. As such, the MLCI has now emerged as a One-Stop Shop for local and overseas investors.

Although, under the IDI regulations, the Minister is empowered to reserve industries for local entrepreneurs, no such reservation has been made as yet.

Potential investor interest

Tonga has favourable conditions for attracting foreign investment. These include concessional entry of Tongan products through special trade and economic agreements (SPARTECA) to the markets of New Zealand and Australia and through GSP to the USA and Europe; political stability; industrial harmony; near universal literacy; easy bureaucracy (one-stop service).

Industries which have scope in view of the existing natural resources, demand, skills and specific entrepreneur interest, include: cassava products (chips, starch, alchohal); papain from paw paw; fruit processing (mango, guava); spices processing (red chili and black pepper); vanilla extract; pumpkin squash powder; processing of special type of mushrooms; bio gas; coconut products (refining of existing crude oil, improvement of existing coconut soap, coir products); marine-based products (fish frozen and processed); garment industries; leather products; electronic sub-assemblies; artificial flowers for exports; flour mill with imported wheat; shipway for repair of small ships.

Although Tonga has not been very active in overseas investment promotion measures, it has been able to attract a few foreign investments. Of the manufacturing enterprises in operation in 1991, about 20% have overseas interests, either as joint venture or wholly foreign owned. The maximum number of investments have come from New Zealand, followed by Australia and USA.

Favourable schemes like Pacific Islands Industrial Development Scheme (PIIDS) and trade agreements like South Pacific Trade and Economic Agreement (SPARTECA) have attracted investments from these countries. On the other hand, Tonga has not been able to take advantage of the Australian Joint Venture Scheme or the Overseas Private Investment Corporation of USA (OPIC).

Country	Number of Joint Venture/ Overseas Investments
New Zealand	15
Australia	9
USA	5
Germany	2
Sweden	2
Fiji/India	2
Canada	1
Denmark	1
Total:	37

Support infrastructure

The thrust of the objectives of the Industry Sector for the Sixth Development Plan are to support the establishment of export-oriented industries. One of the prerequisites for the same is the provision of readily available built up factory space for export production. The objectives of the Industry Sector as enunciated in the Sixth Development Plan include the following:

- to promote entrepreneurship in viable manufacturing activities with domestic supply linkages in order to create local value added and employment, and generate foreign exchange earnings;
- to encourage the development of export-oriented industries, particularly those involving local resources, in order to diversify sources of foreign exchange earnings.

There is only one industrial estate, the Small Industries Centre (SIC) on Tongatapu, which operates under the MLCI. It has been developed in stages with loans from the Asian Development Bank. The facility has proven to be an important industrial infrastructure in attracting investments. Twenty-eight enterprises are located at the Centre, involving entrepreneurs from several countries besides Tongan. This facility has been developed in phases over a period of ten years. A similar centre has been established at Vava'u in 1990 and two factories are in operation. The production of the industries located in these two centres increased from T$ 6.5 million in 1991 to T$ 8.3 million in 1992. The export sales were 30% of total sales.

The development of the industrial estate at Vava'u consisted of site preparation, development of industrial infrastructural facilities (such as roads, water, power and telecommunication supplies, and the construction of one factory shed of 343 m^2). The outlay for the second SIC development at Popua was estimated at T$ 937,800 (excluding contingency) under the Fourth Multi Project Loan. This comprised mainly provision of infrastructure at the new site.

In view of the pressing demand for built up sheds, the ADB has approved to allocate funds for construction of three factory buildings at the Maufanga SIC, as a substitute project under the Fourth Multi Project Loan.

For the purposes of grant of incentives, whole of Tonga is treated as export processing zone. However, because of land regulations (land cannot be bought in Tonga by foreigners, it can only be leased), establishment of EPZ is likely to attract investments. The EPZ is also expected to be a marketing tool for promoting Tonga for investments from overseas and is likely to have favourable impact on the economic development of Tonga.

Detailed information on present physical infrastructure (including electric power, transport, telecommunications), labour force and support services (banking) is given in Annex II.

CHAPTER I

REVIEW OF EXISTING GOVERNMENT POLICY AND INSTITUTIONAL SETTING

The policy of the Tongan Government and the arrangements for promoting industrial development have been reviewed in the first part of this report. Tables 1.1 - 1.8 provide some additional information on the Tongan economy. The main points arising from these tables are:

- the small size of Tongan industry is highlighted in Table 1.5;
- the failure rate does not vary significantly between industry sectors or between domestic and export industry;
- as might be expected, the failure rate among older firms is higher (see Table 1.4);
- the composition of the export manufacturing sector fluctuates and changes with time (Table 1.6). Excavators according to the official statistics were exported to Scandinavia;
- food is the major export earner (see Table 1.7). The major growth in 1991 and 1992 is due to squash pumpkin sales to Japan - valued at zero in 1990, growing to 12.445 M T$ in 1991 and 8.674 M T$ in 1992. Prospects for 1993 are also good. Other major export products are fish (1.141 M T$ in 1992 down from 2.295 M T$ in 1988), and vanilla (2.083 M T$ up from 1.349 M T$ in 1988);
- the trade imbalance is large and growing - 67.695 M T$ in 1992 - (see Table 1.8);
- the trade imbalance is financed largely by emigrants remittances (mainly Tongans resident in New Zealand and Australia) and official aid (mostly from Australia, New Zealand and the EC). The balance on transfers amounted to 51.4 M T$ in 1991/92.

TABLE 1.1 - LICENSED MANUFACTURING ESTABLISHMENTS 1992

	Food	Clothing	Jewellery	Leather	Furniture	Concrete	Other	Total
In operation	46	23	4	8	27	9	41	158
Closed	24	10	1	5	9	6	39	94
Total	70	33	5	13	36	15	80	252

<u>Source</u>: Ministry of Labour, Commerce and Industry.

TABLE 1.2 - LICENSED EXPORT-ORIENTED MANUFACTURERS

	Food	Clothing	Jewellery	Leather	Other	Total
In operation	6	10	4	5	2	27
Closed	4	4	-	2	8	18
Total	10	14	4	7	10	45

<u>Source</u>: Ditto.

TABLE 1.3 - LICENSED DOMESTIC MANUFACTURERS

	Food	Clothing	Jewellery	Leather	Furniture	Concrete	Other	Total
In operation	40	13	-	3	27	9	39	131
Closed	20	6	1	3	9	6	31	76
Total	60	19	1	6	36	15	70	207

Source: Ditto

TABLE 1.4 - ANALYSIS BY AGE

	Export				Domestic				Total			
	78/85	86/90	91+	Total	78/85	86/90	91+	Total	78/85	86/90	91+	Total
In operation	7	13	7	27	39	56	36	131	46	69	43	158
Closed	13	5	-	18	52	21	3	76	65	26	3	94
Total	20	18	7	45	91	77	39	207	111	95	46	252

Source: Ditto

TABLE 1.5 - MANUFACTURING SECTOR 1992
OUTPUT AND EMPLOYMENT

Sector	No. of Units	Output in M T $	Employment	Employees per Unit
Food/Beverage	21	7.3	349	16.6
Textiles	6	0.5	128	21.3
Wearing Apparel	11	1.0	98	8.9
Leather	6	0.9	109	18.2
Wood	2	0.3	22	11.0
Printing	4	1.1	117	29.3
Chemicals	3	2.3	15	5.0
Non metallic	8	0.7	51	6.4
Minerals	11	1.2	47	4.3
Machinery	2	0.07	13	6.5
Motor Assembly	3	-	5	1.7
Other transport	6	0.6	33	5.6
Furniture/Other	25	1.4	138	5.5
Total	108	17.2M	1125	10.4

Source: Dept. of Statistics

NOTE: This table is not directly comparable with tables 1-1 and 1-4. This survey covers only the island of Tongatapu and excludes service-oriented workshops and industries located in outer islands - Vava'u, Ha'apai, 'Eua and Niuatoputapu, and Niuafo'ou.

TABLE 1.6 - EXPORT MANUFACTURING IN 000's T.$
SECTION 4 - 8 OF INTERNATIONAL TRADE STATISTICS

	Year	1984	1986	1988	1991	1992
4)	Oils/fats	5013	2010	1173	418	437
5)	Chemicals	-	-	-	129	33
	Paint	-	-	-	-	26
	Aloe Vera	-	-	-	-	7
6)	M/fred Articles	4	53	446	1450	1159
	of which					
	Handbags	-	5	6	401	268
	Leather Jackets				571	485
	Spec. Cases		11	409	306	226
	Other Leather				128	129
	Other textiles				42	
	Bottles/Cans			287	12	34
7)	Machinery/ Transport	318	286	222	1	39
	of which					
	Excavators	318	128	1	-	-
	Boats	-	-	89	-	-
	Electrical	-	-	31	-	-
8)	Misc.	564	957	1505	861	912
	Shirts/Other	-	37	2	-	310
	Knitted	172	519	733	480	377
	Footwear	-	44	186	105	-
	Handicrafts	16	5	54	91	20
	Tapa	11	16	102	50	68
	Sports	228	162	51	-	-
	Mats	3	7	50	65	162
Total 4 - 8		5899	3306	3346	2730	2580
Total 5 - 8		886	1296	2173	2441	2143

Source: Dept. of Statistics.

TABLE 1.7 - EXPORTS

	Year	1984	1986	1988	1991	1992
0)	Food	3941	5115	5658	17675	13895
1)	Beverages	-	-	18	-	-
2)	Crude Materials	91	250	94	38	84
3)	Fuels	-	-	-	-	-
4)	Oil/Fats	5013	2010	1173	418	437
5)	Chemicals	-	-	-	129	33
6)	Mfred. Articles	38	53	705	1450	1159
7)	Machinery	318	286	222	1	39
8)	Misc. Mfred. Articles	564	957	1505	861	912
9)	Other	30	40	127	40	18
	TOTAL	9996	8711	9503	20611	16576

Source: Dept. of Statistics.

TABLE 1.8 - IMPORTS IN 000's TONGAN $

	Year	1984	1986	1988	1991	1992
0)	Food	10967	13566	17741	16520	18172
1)	Beverages/ Tobacco	2614	3476	3203	3123	3248
2)	Crude Materials	2947	2084	2635	3618	4032
3)	Fuels	6528	7340	6843	12147	10756
4)	Oil/Fats	72	127	178	186	196
5)	Chemicals	2794	5186	4603	6224	5204
6)	Mfred. Articles	9306	13904	13453	11905	19163
7)	Machinery/ Transport	6356	9135	15472	14641	16230
8)	Miscellaneous	4813	4679	6028	8056	6951
9)	Other	215	116	520	396	319
	TOTAL	46614	59616	70689	76817	84271
	Trade Balance	36618	50905	61186	56206	67695

Source: Dept. of Statistics.

CHAPTER II

SUPPORT INFRASTRUCTURE

The Small Industry Centre (SIC) is run by the MLCI as part of a government department. Rental prices for plots and buildings are not necessarily related to the cost. The area of the estate is 20 ac. of which 12 ac. is developed. The remaining 8 ac. at the back of the estate is being set aside for development as an EPZ.

The area of the SIC devoted to plots (52,478 sq. m. out of a total area of 80,000 sq. m. or 66%) is in line with standard ratios for industrial estate development. The building density is, however, well below standard norms. In plots which have buildings (38,317 sq. m. of plots) the built over area is 8,593 sq. m. or 22% of the total. In most industrial estates the guidelines for built over area is 50% of the plot. <u>The Ministry should examine the existing design and layout of the estate with a view to achieving a larger area of buildings per ac.</u>

The cost of some of the existing buildings seems to be high. It was not part of the terms of reference to review building costs in detail, however, well designed low cost buildings will help to attract investors. <u>It is recommended therefore that the Ministry (MLCI) review the design and construction costs as part of the total effort to develop a successful EPZ</u>.

The SIC made a steadily increasing operating loss in the 5 years 1986/7 to 1990/1 when depreciation figures are included. The debtor figure has also increased steadily. As with the design and layout of the SIC, the terms of reference of this study did not include detailed assessment of the commercial viability of the SIC or existing arrangements for managing the centre. A commercially viable SIC with high standards of maintenance is an important element in the development of a successful EPZ. A government department in Tonga or indeed any other country is not the most suitable agency for managing a commercial venture such as an industrial estate. <u>There is a strong argument for allocating the responsibility for the development and management of the SIC to the proposed development corporation and reviewing rental charges in the SIC with a view to generating sufficient revenue to cover operating expenditure, depreciation, maintenance and loan repayments.</u>

It was suggested by some Ministry officials that the demand for space at the SIC exceeds the supply and there are a number of potential tenants waiting for buildings at the centre. Application has been made to the Asian Development Bank for additional funding to construct buildings. In the context of EPZ development it is essential that the Tongan Government through the appropriate agency (probably the proposed Development Corporation) can respond immediately to EPZ investor demand for factory buildings. Otherwise the investor may be lost to some other Pacific Island country.

In summary, <u>there is a need to commercialize (if not privatize) the SIC so that buildings can be provided at the lowest possible cost and at a time when investors want them and at a rental charge which covers not only operating costs but depreciation charges, maintenance costs and loan repayments</u>.

TABLE 2.1 IN T$

FINANCIAL DETAILS OF THE SIC IN T$

Year	1990 /91	1989 /90	1988 /89	1987 /88	1986 /87
Revenue	124905	92590	85518	74401	68882
Operating Expenses	98691	80557	83126	74345	67263
Depreciation	86809	67497	50666	39339	37485
Loan Interest	16934	13866	8922	-	-
Operating Loss	60595	56104	49003	39478	36453
Debtors	44806	24483	23938	23507	12774

Source: Small Industries Centre - Annual Report 1990/91.

CHAPTER III

EXPORT PROCESSING ZONE DEVELOPMENT

Introduction

The free zone or export processing zone is a promotion concept which has been used over many centuries to promote international trade and investment. The character and nature of the free zone and even the terminology has evolved and changed over the years in line with changes in technology and business or commercial relationships.

A recent publication "The Challenge of Free Zones in Central and Eastern Europe - International Perspectives" published by the United Nations in 1991 contained a list of 23 terms used to describe free zones. Most of these terms have a slightly different meaning from each other. The most commonly used terms include (i) free trade zone or free port; (ii) industrial free zone or export processing zone; (iii) foreign trade zone; (iv) special economic zone and (v) free zone.

Free Trade Zone or Free Port

This is the oldest term used. It refers to the concept which existed in Gibraltar from 1705 onwards or Aden, Singapore or Hong Kong. It also covers the concept developed in Northern Europe around the end of the 19th Century in Stockholm, Malmo, Copenhagen, Hamburg, Bremerhaven, and Bremen. In these ports areas were set aside where goods could be stored without the payment of duty in a secure warehouse under Customs control. The goods in question could be repacked and then exported.

Manufacturing activity was normally prohibited. The emphasis was on trading, warehousing and distribution.

Most of the zones were established in or near port areas. Zones were also established at other major transport intersections e.g. major rail terminals.

The zones were usually managed and developed by the Port Authority or warehousing group. The Director of Customs usually had the authority to approve the establishment of free trade zones and responsibility to supervise their operation. The degree of supervision depended on the level of customs duties, the type of goods stored in the zone and the risk of illegal diversion of goods on to the domestic market. In the case of Hong Kong and Singapore where duties were very low or non-existent, the level of supervision was minimal. In Europe where duty rates of 40% or more prevailed, supervision was much more intense.

Foreign Trade Zones

This term applies mainly to zones established in the United States under the 1934 Foreign Trade Zones Act. The first such zone was established in Statten Island, New York in 1937 followed by New Orleans 1946, Seattle and San Francisco in the late 1940's. Today there are 200 such zones spread throughout the United States. Goods can be stored in such zones without the payment of duty. Manufacturing or processing activity is permitted. Most (75% or more) of the goods passing through U.S. zones are destined for the United States domestic market. They are primarily import processing zones.

Industrial Free Zone or Export Processing Zone

This term refers to an idea which began at Shannon in 1959 and spread to Taiwan (Kaoshiung 1965), Korea (Masan 1971), Malaysia (Penang 1971), Philippines (Bataan 1971) and later to many more countries in Asia, Africa, Central and South America, the Pacific Islands and Europe including Cyprus (1975), the United Kingdom (1984) and France (1980).

With the development of international transport, communications and production technology on one hand and the reduction in tariffs on the other, off-shore production became a possibility. GATT was formed in 1947 and the average tariff level fell from 40% in 1947 to about 5% in 1990.

Companies operating in certain sectors of industry (garments, light engineering, electronics) could shift part of the production process to low cost locations (mainly lower labour costs). The gains from lower labour costs more than offset any additional transport costs. Materials were shipped to the low cost locations for processing and re-export. It was essential of course that the materials were (i) not subject to customs or other duties in low cost locations; and (ii) were not delayed by bureaucratic procedures. Ireland, Singapore and Hong Kong had the necessary cost conditions (low labour costs, infrastructure, reasonable international transport services), political stability, and an administrative framework to accommodate this type of off-shore processing. Thus the export processing zone or industrial free zone came into operation. The export processing zone differs from the older free trade zones in a number of respects. The free trade zone is a warehousing and distribution centre usually located at a port or transport intersection.

The EPZ is first of all a manufacturing centre. Warehousing distribution and more recently international service activity may be also accommodated in an EPZ. The export processing zone is an industrial estate and ideally should be located close to a population centre and industrial services (water, electricity and sewerage). Reasonable proximity to good international transport services is also essential. The economic impact of a free trade zone is limited in terms of value added and employment. The EPZ will generate greater value added, employment and exports. The EPZ may also result in the transfer of some technology or managerial/marketing know how from foreign investors to the host country.

Export Processing Zone Definition

An export processing zone as it developed in the 1960's at Shannon, Taiwan and Korea was a fenced in area of 20 to 100 hectares in size with a 2 to 3 meter chain link fence surrounding the area. It was developed as an industrial estate for light industry. Machinery and raw materials could be imported free of all duties, taxes and trade restrictions, processed, manufactured, stored, warehoused, packed and exported. Domestic sales were usually prohibited. There was a high degree of customs surveillance in and around the zone to prevent the illegal diversion of duty free goods on to the domestic market. Investors usually benefitted from tax holidays (5 to 10 years), high standards of infrastructure, good international transport and telecommunications and streamlined procedures for clearing goods through customs (ideally under 24 hours). The bureaucracy was streamlined. Projects were approved normally in 2 to 6 weeks and special arrangements existed for securing the necessary permits to start a business (building permits, work permits, emigration permits, health permits etc.).

In 1970 the Mauritian government expanded the EPZ concept by deciding that any land, area, or building could be declared an export processing zone by the appropriate authority (the Minister for Industry). In effect the whole island became an export processing zone in that it was possible in Mauritius to establish an EPZ enterprise anywhere on the island. This course of action was possible in Mauritius because of its small size. The risk of a legal diversion of duty free goods on to the domestic market was small. The Mauritians wanted (i) to spread the benefits of EPZ development around the island rather than concentrate activity in any one location and (b) to maximize the use of existing facilities (buildings and industrial estates) by allowing EPZ enterprises to use them, rather than confining EPZ activity to a particular industrial estate.

Today an export processing zone can be defined as an area of land or building (i) which is declared by the competent authority (usually the Minister for Industry) to be an export processing zone; (ii) where approved or licensed export-oriented manufacturing, trading, or service activity can be undertaken; and (iii) where equipment and materials can be imported free of all taxes, duties, levies and trade restrictions, processed and exported.

Requirements for Successful EPZ Development

Attracting export-oriented investment is a very competitive business worldwide. This is particularly true of "good quality" investment. A free zone or EPZ, especially in the early stages of development, helps to improve the image of a country from a foreign investor viewpoint. It is a particularly useful instrument where a major bureaucracy is controlling imports. The type of industry that will benefit most from a free zone situation is that which requires regular (weekly) supplies of materials from overseas. Examples include clothing, textiles, leather, plastic, sports goods, consumer durables, light engineering and electronics. The designation of an area as a free zone or EPZ does not automatically make an area attractive as a location for foreign exported industry. The basic conditions for attracting foreign investment must exist, otherwise the investment will be of a lower quality than expected, or worse the investment will not materialize. In this respect the key considerations are:

i) Political and economic stability: for most investors this is a very important consideration. Essentially what investors look for is a consistent economic policy favouring private enterprise, foreign investment and export development and a politically stable environment.

ii) Good transport and communications facilities: for most free zone industries e.g. electronics, light engineering and clothing, good air connections are important. This means adequate air cargo capacity and services to all major destinations. For international service activities good communications facilities are very important.

iii) Good physical environment: most free zone investors are international companies with a good reputation. As such they will look for a pollution free environment and high standards of physical planning.

iv) Reliable infrastructure: a reliable water and electricity supply is important.

v) Market Access: preferential access to a major market is an advantage e.g. South Pacific country vis-à-vis Australia and New Zealand, Caribbean countries vis-à-vis the United States and Canada and ACP countries vis-à-vis the EC.

vi) Support Services: basic support services such as banking and freight forwarding are essential in all zones. If a zone is seeking high skilled engineering or electronics activities, the existence of good quality contractors and spare parts suppliers is an advantage.

vii) Labour: the cost and productivity of labour and the range of skills will more than anything else determine the type of industry which will be attracted to the zone.

viii) Good Organization: an organization which (a) can interact with investors in a businesslike manner, (b) deal efficiently and quickly with investors queries and applications; and (c) assist investors once approved during the establishment phase is important. Very often the difference between two locations is marginal and the location decision will hinge on minor considerations. The overall impression made by the organization responsible for promoting and developing the zone on the investor can in such circumstances be decisive.

CHAPTER IV

COMPETITION AND INVESTOR INTEREST

Introduction

Competition for export-oriented investment in Tonga will come primarily from other South Pacific island nations. Tonga's ability to compete with other islands for investment depends on the relative quality and cost of inputs and support services required by investors.

The cost of labour is an important factor for most export-oriented investors in the South Pacific. Other important factors are the cost and quality of international transport and communications services and the reliability and quality of basic infrastructure (water, electricity, sewerage, roads).

Table 4.1 below sets out the area, population and per capita income of the nine largest South Pacific island nations. American Samoa, French Polynesia and New Caledonia with their relatively high per capita incomes and consequently, relatively high wage costs will be uncompetitive in attracting labour intensive manufacturing activity. Papua New Guinea and the Solomon Islands are large, resource rich countries with a relatively under developed infrastructure. Both also suffer from a degree of political instability.

TABLE 4

	Size (area in sq. km.)	Population in 000's	GNP per Capita
American Samoa	195	380	5,410
Fiji	18,274	717	1,540
French Polynesia	4,000	189	7,840
New Caledonia	19,013	154	5,760
Papua New Guinea	462,840	3,561	2,240
Solomon Islands	27,556	299	430
Tongan Islands	748	95	800
Vanuatu	12,190	150	820
Western Samoa	2,831	159	580

Source: World Yearbook 1991

Fiji, Vanuatu and Western Samoa are the most competitive. Fiji is well established and well known in the South Pacific region as a free zone location, partly because of its size. Western Samoa has export processing zone legislation since 1974. It was amended in 1989. An industrial zone corporation was established under the Free Zone Act and a hundred acre industrial estate in Vaitela near the capital Apia has been developed. The country has attracted a number of investors. The most notable is a Japanese factory producing components for the motor industry and employing in excess of 1000 people.

Fiji

Fiji's tax free factory programme began in 1988. Progress in the first 3 years of operation was good, due in part to the fact that a number of Fijian business people were waiting to apply for tax free factory (TFF) status. Since 1990 however, progress has been slow, partly due to the world recession of recent years and the slowdown in investment. The overseas image of Fiji as a place of civil strife was possibly a factor also in the slowdown. There is a heavy concentration on the garment sector activity. 84 out of 119 TFF projects in 1992 (or 71%) and an even higher percentage of total employment (11,166 out of a total of 11,877, or 85%) belong to the garment sector.

A significant number of projects are of Fijian origin. 64 out of 119 (or 54%) are 100% Fijian and a further 19 (or 16%) have Fijian joint venture partners. As might be expected, the Australians and New Zealanders are the most important overseas investors - although East Asian investors have increased in importance in recent years.

The situation in Fiji is in line with that in many of the EPZ's around the world and Mauritius in particular. A heavy concentration on the garment sector, a significant local investment and the majority of overseas investors are those with whom the country has strong trade, business and cultural links e.g. France, the U.K. and Hong Kong in the case of Mauritius.

New Zealand

New Zealand was the most important overseas investor in the Fijian TFF programme up to 1990 in terms of projects, volume of investment and employment generated, followed by Australia. In the last 2 years (1991 and 1992), New Zealand has been surpassed by Australia in terms of number of projects and by Singapore in terms of the number of employees. In Tonga New Zealand tops the list of overseas investors with 15 projects, followed by Australia with 9.

In an attempt to evaluate (i) the awareness of Tonga among New Zealanders; (ii) the level of interest in Tonga as an investment location, interviews were conducted with a number of New Zealand personnel in Tonga and Auckland who are familiar with and sympathetic to Tonga.

TABLE 4.1 - TAX FREE FACTORIES IN FIJI

Year		1988	1989	1990	1991	1992
Number of Factories						
Garments		27	53	78	79	84
Other		16	30	36	31	35
	Total	43	83	114	110	119
Employment						
Garments		3,022	6,434	7,829	8,745	10,066
Other		1,185	1,501	1,674	1,441	1,811
	Total	4,207	7,935	9,503	10,186	11,877
Investment in M Fijian $						
Garments		5.8	23.6	37.3	36.0	44.8
Other		7.9	10.2	16.2	20.3	25.3
	Total	13.7	34.3	53.5	56.3	70.1

TABLE 4.2 - ORIGIN OF TAX FREE FACTORIES

	1990 Number	1990 Employed	1991 Number	1991 Employed	1992 Number	1992 Employed
Fiji	58	4,528	61	4,349	64	4,988
Australia	13	620	11	838	12	1,059
New Zealand	16	830	12	594	9	502
Singapore	3	693	4	1,524	4	1,950
Hong Kong	-	-	3	824	5	918
Other foreign	4	771	5	649	6	741
Fiji/Australia	6	173	6	622	8	602
Fiji/New Zealand	8	1,050	6	460	6	518
Other joint ventures	6	838	2	326	5	599
Total:	114	9,503	110	10,186	119	11,877

There was a consensus among those interviewed that Tonga as an investment location is not widely known in New Zealand. In fact, knowledge generally about Tonga in New Zealand is extremely limited. There is little point in trying to promote Tonga as an export processing zone location among the wider public. It would be an expensive exercise which would yield few results.

However, those interviewed believe that a number of medium sized manufacturers could be persuaded to invest in Tonga. Persuading for such investors would require a well organized promotion effort over a period of time. It was suggested that in the past sourcing information from Tonga on investment issues has not always been easy. Sometimes, it was suggested, application forms were not acknowledged.

A number of suggestions were made for promoting New Zealand investment in Tonga: a good information system including a detailed investors kit is important. There should be continuous personal contact - ideally there should be somebody based in New Zealand (preferably in Auckland where most of the New Zealand investors are located) with responsibility for making initial and regular contact with investors. He should be supported by a good backup organization in Tonga. A time limit on investment applications would help to give applicants the confidence that applications would be handled with speed and efficiency. This confidence does not always exist at present. Whether this is due to misunderstandings or some other reason is difficult to say. The South Pacific Trade Office should be used to assist in promoting investment. The office in Auckland is willing to assist in the investment promotion effort. It is recognized that investment promotion is necessary in order to promote trade. An article in the Pacific Islands Monthly, April 1992/93 on changing a growth path - Page 9 - makes this very point "finding overseas markets will require in many cases inviting overseas investment".

New Zealand manufacturing output in 1991 was 36 BNZ$ or 22% of GNP. Import duty and quotas have been abolished on about 90% of imports. Employment in the apparel, leather and footwear sectors has fallen from about 30,000 to 24,000 in the last 7 years. A number of manufacturers in these sectors could possibly be persuaded to relocate part of their production in Tonga, availing of the lower labour costs in order to make them more competitive on the New Zealand market.

Australia

Australia is the second most important country after New Zealand as an investor in Tonga. In Fiji, Australia has replaced New Zealand as the most important investor, both in terms of number of projects and the volume of investment.

The reaction in Australia to investing in Tonga was similar to that in New Zealand. Tonga is generally unknown as an investment location. General knowledge of Tonga in any sense is limited. However, there was a confidence among those interviewed that some Australian investors could be persuaded to locate in Tonga. Investors need to be sure about the rules and regulations e.g. that immigration and work permits will be forthcoming once projects are approved. The promotion effort to persuade investors needs to be well organized and consistent. This means well targeted promotion campaigns, good brochures and promotion materials, efficient response to requests for information and regular contact with potential investors.

The South Pacific Trade Commission (SPTC) in Sydney are willing to assist in the promotion effort. The commission has recently organized two investment promotion seminars on Tonga - one in Sydney and one in Melbourne. The seminars took place in August 1993.

Other Investment Sources

Japan is one of the world's leading centres of outward investment. Most of this investment is concentrated in other East Asian countries and the developed countries of Europe and North America. Cumulative investment in Oceania up to the end of 1990 was 18b$. Most (16b$) of this investment is concentrated in Australia, followed by New Zealand (1b$), the Northern Marianas (0.5b$) and Papua New Guinea (0.25b$) account for most of the remaining investment. The Japanese investment in Australia and New Zealand is mainly in property and tourist projects. Investment in Papua New Guinea is in natural resources. Investment in Fiji (0.1b$) is concentrated in tourism. The investment in Vanuatu (0.1b$) is concentrated in offshore banking activity. Promoting investment out of Japan is a slow, difficult process which can be rewarding if successful. However, it is necessary to be able to sustain a promotion campaign without results for a number of years.

Taiwan is the most important outward investor in Asia after Japan. Most of the investment is concentrated in China via Hong Kong as well as in Europe and North America. There is a small amount of Taiwanese investment in Fiji. Korea, Hong Kong and Singapore are also emerging as significant investors on the world scene. Singapore and Hong Kong rank third and fourth after Australia and New Zealand as foreign investors in Fiji. Korean investment is concentrated in other North East Asian countries and in Europe and North America.

The Malaysian government is also encouraging some outward investment. In particular, it is offering inducements to garment manufacturers to move production facilities overseas and release labour for electronics and other high technology industries.

United States investment in the South Pacific up to the end of 1991 was about 20b$. Almost all of this investment was concentrated in Australia (16b$) and New Zealand (3b$). The remainder of the U.S. investment in Oceania is spread among a number of tourist and offshore banking projects in centres like Fiji and Vanuatu. There are few examples of U.S. investment in free zone facilities in the Pacific.

Investment Prospects

New Zealand and Australia are the best sources of investment in the short term for a number of reasons. They are already major investors in the South Pacific Island countries. They have the strongest trading links in the South Pacific Islands including Tonga. The best transport connections in the South Pacific are with Auckland and Sydney.

Singapore is an important investor in Fiji. Tonga has diplomatic relations with Taiwan. A new commercial bank - MBF Bank (Tonga) Ltd. - with connections in Hong Kong, Malaysia and Singapore has recently commenced operations in Tonga. Malaysian companies have shown a willingness to invest in distant overseas locations, e.g. Botswana. It should be noted that Botswana succeeded in attracting a number of Malaysian companies through persistent and well planned promotion efforts, political stability, reliable infrastructure and attractive incentives. Tonga should be able to build on these connections in the medium term and target these newly developing countries as investment sources. Investors in all of these countries make relatively quick investment decisions. Thus a well planned promotion campaign in these countries over one or two years could produce some worthwhile results. Promotion efforts, however, in Japan and to a lesser extent in the United States should be considered as long-term propositions and postponed for the moment.

CHAPTER V

IMPACT OF EPZ DEVELOPMENT

Potential for EPZ Development

Tonga compares well with key competitor locations as a base for export-oriented manufacturing, trading and international service activity in the South Pacific. Wage costs may be slightly higher (20%-30%) than in competing locations. However, high levels of productivity can counteract slightly higher wage costs. Expatriate investors in Tonga have admitted that with proper motivation and organization Tongan workers can achieve good levels of productivity.

Fiji has a better range of international transport services than other competing locations. Nevertheless, the transport services from Tonga to Australia and New Zealand are reasonable. Tonga probably has a stronger image than its competitors from the point of view of political stability - an important consideration for many investors.

Overall Tonga has sufficient attractions to make it an acceptable export processing zone location. It should be possible, therefore, to persuade a number of investors to choose Tonga as a location. Those interviewed in Sydney and Auckland who have an understanding of New Zealand and Australian industry and the South Pacific generally are convinced that a number of investors can be persuaded to move to Tonga.

In the period 1988-1992 the Fijian TFF Programme resulted in 119 projects employing nearly 12,000 people or 100 people per project. Fiji has a population of 717,000. Tonga has 95,000 people or 13% of the Fijian total. A possible target for the Tonga EPZ programme in its first 5 years of operation would be 1584 jobs in 16 projects (13.2% of the Fijian total). This would represent a target of 3-4 projects a year employing an average of about 100 people.

This sort of target was discussed at meetings in Auckland and Sydney. The general consensus was this type of target is achievable if (i) there is a coordinated and well planned promotion effort; (ii) the procedures in Tonga for responding to queries and accepting and processing applications are reliable and efficient; and (iii) the infrastructure is of a high standard.

It was suggested also that the ideal type of company to attract to Tonga would be a medium to large sized Australian or New Zealand company capable of supporting and managing a subsidiary company in Tonga employing 50 to 100 people with a turnover of half a million to one million $ and marketing the output of that company. Target companies in Australia and New Zealand should have a turnover of at least 5 M $.

Development Plan Targets

The Sixth Development Plan contains a number of labour force projections (Table 4.14 Page 171). The 1991-1996 projection for a growth in labour force ranges from 757 to 1940 or 151 to 388 annually depending on assumption about emigration and activity rates. The 1996 to 2001 projections range from 1,044 to 2,730 or 209 to 546 annually.

The 1991 labour force is in the order of 26,000 people. The expectation is that a decline in emigration and increased female participation rates will result in growth rates closer to the higher figure.

Agriculture, which is currently the major source of employment, accounts for about 36% of GNP and about one third of the total employment. Manufacturing accounts for 5% of GNP and a similar percentage of employment. There are some problems of definition when evaluating the contribution of the manufacturing sector. Some figures include small repair and maintenance facilities in garages. Other figures concentrate on a narrower definition of manufacturing.

In attempting to create employment opportunities for the increased labour force, tourism, fishing and the development of an export manufacturing sector are considered to be the most promising sectors.

Contribution to the Economy

An export manufacturing sector that generated 1,200 jobs over 5 years would represent a significant addition to the Tongan economy. As a general guideline, export manufacturing would generate a gross output of 10,000-12,000 T$ per person annually and added value in the economy of around 4,000$ assuming all materials are imported. Most of the value added would be wages paid to workers - at the rate of about 60$ per week per worker.

If the EPZ programme commences operation in 1994, by 1999 a total of 1,200 jobs could be created with gross output/exports of 12,000$ per worker annually and value added of about 4,000$ per worker annually. By 1999 therefore the contribution of the EPZ sector would be (i) 1,200 people employed; (ii) gross output/exports in 1999 of 14.4 M T$ in 1993 money terms; and (iii) value added of 4.32 MT$ in 1993 money terms. The manufacturing sector contributed 8.7 M $ in value added in 1992-93. Thus the EPZ sector properly planned and developed would result in a 50% increase in manufacturing output. Exports from Tonga were valued at 20.6 M $ in 1991 and 16.6 M $ in 1992, thus the EPZ sector would lead to a very substantial increase in gross exports within 5 years.

CHAPTER VI

LEGAL AND ADMINISTRATIVE ARRANGEMENTS FOR AN EPZ

Introduction

Tonga is a small country with a limited home market. It follows therefore that there are few incentives to dispose illegally on the domestic market of duty free equipment or materials imported for processing and export. The number of investors likely to be attracted to the Kingdom, or indeed the number of projects which the Kingdom can comfortably accommodate, are limited. Because of the above considerations it is not necessary to develop elaborate procedures to control the circulation of duty free equipment and materials e.g. 24 hour patrols of the EPZ. Such patrols would in relative terms be very costly and require an additional 8 to 10 staff to man the EPZ entrances/exits.

Small island countries who have implemented the EPZ concept (e.g. Fiji and Mauritius), have opted for an island or countrywide EPZ or more correctly an export processing regime. Such a regime would allow the establishment of export processing factories anywhere within the kingdom.

Industrial Estates

Such an arrangement (the declaration of the whole kingdom as an export processing zone) does not preclude the development of part of the kingdom as an export processing zone or an export processing industrial estate. It has been suggested that an 8 acre area towards the back of an existing 20 acre small industry centre at Ma'Ufanga on Tongatapu should be developed as an export processing zone or estate. The study team concurs with this suggestion and strongly recommends that the 8 acres at the back of the SIC be set aside for an export processing zone. This area is already partly fenced off from the rest of the SIC. There is no need, however, for the entrance to the EPZ to be manned or patrolled on a continuing basis by Customs officers.

There are both promotional and economic advantages in declaring a particular area (in this case 8 acres) to be an EPZ. From a promotional viewpoint investors can see clearly that: (i) the government of Tonga is serious about developing export-oriented industry; (ii) facilities exist (a well developed industrial estate - assuming of course that the area is properly developed as an industrial estate with suitable buildings for rent) where investors can establish export firms; and (iii) that the EPZ is a reality and not just an idea. From an economic viewpoint, there are obvious economies of scale in concentrating development in and around one area.

EPZ activities

In most export processing zones the dominant activity is manufacturing. This is to be expected as most zones are established to specifically promote the growth of export manufacturing. International trading and international service activities are permitted in a number of zones around the world. International trading activity contributes little (with few exceptions) in the way of employment, technology transfer or value added in the host country. However, international trading does create additional payload for transport companies (air/shipping) servicing the host country (Tonga in this case). Increased payload can in turn result in improved transport services, thereby enhancing the host country's attractiveness as an industrial location. International trading companies based in

Tonga, or indeed any other location, may in time increase the value added within the zone e.g. companies may establish repair/maintenance facilities within the zone and eventually evolve into assembly and manufacturing activity.

The site of the old airport building would be suitable for the storage and transhipment of airfreight products. Some people may not consider Tonga to be an ideal transhipment centre. Nevertheless, the Government of Tonga should explore with the various airlines ways and means of promoting trading and transhipment activity using existing facilities. Provisions should be made in the EPZ legislation to allow trading and transhipment activity to benefit from the facilities and incentives available under that legislation.

The port at Nuku'alofa might also be used, if only on a small scale for the development of transhipment activity. However, until such time as serious commercial proposals emerge for the development of such activity, no investment in facilities should be undertaken.

International service activity such as data entry and data processing can provide useful employment and value added in an economy. It is often an appropriate activity for a relatively isolated location (transportwise) with good telecommunications and a literate workforce. Provision should be made therefore in the EPZ Act to allow such activity to benefit from the incentives and facilities as available under the Act.

Existing Administrative Arrangements

The existing arrangements for promoting investment in the development of industry and tourism in Tonga are set out in the Industrial Development Incentives Act of 1988, the regulations associated with that Act and the subsequent amendments.

Section 3 of the Act defines an industrial enterprise and it covers manufacturing activity, prime tourist facilities, packaging activity and the construction of factory buildings for rent. Under Section 4 of the Act, any person who wants to establish an industrial project, including a prime tourist facility must apply to the Minister for Labour, Commerce and Industry (MLCI) for a development license. An approved enterprise may be granted exemption from income tax for a period of up to 15 years. The maximum tax holiday for different categories of industry is set out in Section 7.2b of the associated regulations. Export industries can gain a tax holiday of up to 10 years and projects with an investment of over 5 million pa'angas can have a maximum tax holiday of 15 years. A condition of the tax exemption is that the proceeds of any exports should be brought into the Kingdom within 12 months. Approved enterprises may import capital goods free of duty for a 2 year period from the date of issue of the Development License. Export-oriented enterprises as determined by the Minister may import raw materials and semi-finished products duty free, provided the final product is primarily for export. An export-oriented enterprise means an enterprise which exports at least 90% of its annual sales. (Section 2 Amendment November 1992). Export-oriented enterprises are also exempt from the port and service taxes. Section 14 of the main Act provides that industrial enterprises are exempt from any export levy. Section 10 of the associated regulations provides that a license holder must keep satisfactory records, i.e. records which are satisfactory from the point of view of the controller of customs, of the commissioner for inland revenue in consultation with the Minister of Labour, Commerce and Industry.

The procedure for making an application for a Development License is set out in the associated regulations. There is a prescribed form which each applicant must complete. Additional information or documentation may be requested by the Minister or the Secretary to the Ministry to complete the evaluation of the project. There is an advisory committee which "shall scrutinize all applications .... and make appropriate recommendations to the Minister on the issue of a Development License and conditions and incentives which should apply". This Advisory Committee is chaired by the Minister and includes the Secretary of the Ministry for Labour, Commerce and Industry who is also Secretary to the committee, the Secretary to the Ministry of Finance, the Managing Director of the Tonga Development Bank, the General Manager of the Bank of Tonga and the Directors of the Ministry of Agriculture and Central Planning Departments. The Minister issues a Development License on receipt of the committee's recommendations. No license may be transferred from one person to another without the written consent of the Minister. Under Article 18 of the Act the Minister, the Commissioner or the Controller shall have power to revoke, cancel or modify any license or order issued under this Act.

In summary, export processing zone conditions already exist in Tonga as a result of the Industrial Development Incentives Act. Any approved export-oriented (90% or more exports) enterprise may import materials, packaging and equipment free of customs duties, taxes and service charges, process the raw materials and export the finished product. The enterprise will qualify for a tax holiday of up to 10 years (or 15 years if the investment exceeds 5 million pa'angas). The enterprise faces no serious bureaucratic obstacles during the process of importing, manufacturing and exporting.

The Need/Desirability for Export Processing Legislation

The EPZ is primarily a promotional concept. When a country proclaims that it offers EPZ facilities to investors it is stating or implying that (i) domestic and foreign investors are welcome to establish export-oriented business activity; (ii) that investors will be allowed to import equipment and materials free of duties, taxes and quantitive restrictions and bureaucratic procedures; (iii) that there will be a good standard of infrastructure and the necessary ancillary facilities (international transport and telecommunications) to support international trade. As with many products, the EPZ in reality may be different and less attractive than what is implied in the name or brochures. Nevertheless, many investors instinctively look at or enquire about a location when the term EPZ is used.

Tonga is hoping to attract an increased number of foreign export-oriented investors. A declaration that the Kingdom is an export processing zone will help in the promotion effort. The export processing zone can be compared with a wrapping or packaging on a product. The wrapping or packaging will attract consumer interest and may generate some initial sales. However, if the product itself has no merit or consumer appeal it will not succeed. It is similar with an EPZ. Unless there is substance to the export processing zone idea i.e. a well managed industrial estate and infrastructure, together with good transport, communications and banking services, investors will not be attracted.

In summary, the declaration of the Kingdom as an export processing zone will help to generate interest in Tonga among the investment community, especially in Australia and New Zealand. It will also ease the task of those trying to promote export industry in Tonga. However, the conversion of investor interest into actual projects in Tonga will require a continuing promotion/selling effort as well as good facilities on the ground in Tonga.

The first step in declaring the kingdom to be an export processing zone is the drafting of suitable export processing zone legislation. The EPZ law should set out the nature of the Tongan EPZ, who will be responsible for the EPZ (i.e. which minister within the government), how it will operate, the terms and conditions and incentives which investors may expect to find in the EPZ and the powers and responsibilities of the various agencies involved in or associated with EPZ development.

Export Processing Zone Legislation

Existing arrangements under the Industrial Development Incentives Act have proved satisfactory from the point of view of the administrators and the investors. The EPZ legislation should therefore follow closely on the procedures and practices set out in the Industrial Development Incentives Act. By following similar procedures and practices in both acts, the possibility of confusion and misunderstanding is minimized. The Industrial Development Incentives Act is divided into four parts (i) preliminary; (ii)

Development License; (iii) development incentives; and (iv) miscellaneous. These four sections are also included in the proposed EPZ legislation and in so far as possible, the same wording is used. An additional section is included in the EPZ legislation dealing with the establishment of an export processing zone, customs controls of the zone and the disposal of duty free goods.

With the increased circulation of duty free goods within the Kingdom arising from the development of an EPZ, the customs authorities need more power than is provided for in the Industrial Development Incentives Act, to ensure that such goods (duty free) are not illegally disposed of within the Kingdom. In particular, customs officers should have the power to (i) specify the form in which stock accounts are kept by EPZ investors; (ii) decide the length of time for which accounts should be kept; (iii) inspect those accounts and all relevant documentation relating to the accounts at all reasonable times. The customs should also be empowered to decide where and how duty free goods should be stored. In addition, the controller of customs should be empowered to demand duty liable on any duty free goods which are missing or not properly accounted for, in addition to any fines or penalties which might be imposed. The customs authorities should be consulted prior to the issue of any EPZ license. Finally, the customs authorities should be able to request the Minister to revoke or cancel a license when the holder is convicted of any offence against the customs acts or contravenes a condition attached to the license. A draft EPZ law is set out in Annex 1.

CHAPTER VII

INVESTMENT PROMOTION

Attracting foreign Investment

Throughout the world competition for foreign investment is becoming more intense each year. There is an increasing interest in understanding the investors decision-making process and factors which influence such decisions. Analogies have been drawn with firms competing for market share. The product can be defined as the positive and negative features attached to a particular country (or area within a country) as an industrial or investment location. The price is the cost of establishing and operating in a particular area.

Price (cost of production) and marketing variables (promotion efforts) were found to have little or no impact on decisions by investors to establish facilities which are geared to supplying the domestic market. The product itself is the key factor. i.e. investors focusing on the domestic market are persuaded by conditions in that market such as market size and level of competition. Cash grants, tax breaks or promotion efforts have very little impact on such decisions.

In the case of export-oriented investors, price and marketing variables were found to have a very significant influence. Export-oriented investors, according to studies undertaken, react positively to incentives such as tax holidays and cash grants. Export-oriented investors are also influenced to "a very significant degree" in making decisions by the approaches and efforts of investment promotion agencies.

There are many examples around the world of companies who never considered investing overseas until they were approached by investment promotion agencies. One of the best known is the Apple Computer Company. In 1978 it had not considered investing overseas. However, it responded to a series of visits by investment promotion agencies by establishing plants in Ireland and in Singapore by 1980.

Institutional Requirements

The way in which a free zone is organized and promoted i.e. the institutional arrangements, is a key factor in free zone development. Increasingly, economists are taking the view that the institutional framework (or the administrative competence of government) is a major variable in explaining why some economies (or free zones) achieve high levels of prosperity. A study of 115 market economies concluded that the institutional framework had "a significant and large affect" on the growth rate.

The organization responsible for promoting the proposed EPZ in Tonga and the development of the industrial estate must be able to relate to investors in a business or developmental context. A government ministry or department is not the ideal structure to handle investment or trade promotion or industrial development initiatives (for industrial estate development). Business issues such as profit and loss and efficiency are not usually major considerations in government departments. The emphasis is more on budgeting and spending in line with rules and regulations.

Most countries have overcome this problem by establishing para-statal organizations (e.g. development corporations) to undertake development initiatives such as trade and investment promotion. The FTIB in Fiji and MEDIA in Mauritius are two models which Tonga could follow in promoting investment (including EPZ investment) and industrial estate development.

Organization Structure

The organization responsible for promoting the proposed export processing zone and the development of the related industrial estate should be small and flexible and make use of existing personnel and facilities in so far as this is possible.

The organization could be headed by a small Board of Directors (maximum 5 people). Ideally, the Chairman and one or two of the Board members would be drawn from the private sector. The remaining members could include a representative of the Ministry or Labour, Commerce and Industry and another government official. The organization would be divided into 3 main sections - (i) investment promotion; (ii) trade promotion; and (iii) industrial estate development. This report is concerned only with the investment promotion and industrial estate aspects of the organization. A separate study is proposed later on in the year dealing with the establishment of a development corporation.

The Investment Promotion Division should appoint the Tongan tourism representatives in Auckland and Sydney to promote investment as well as tourism. These representatives would work closely with the SPTO in New Zealand and SPTC in Sydney in promoting investment. Both representatives as well as the SPTO and SPTC have expressed a keen interest in promoting EPZ investment in Tonga. Such an arrangement would give Tonga representatives in two key investment markets at very little expense. A fee of about 10,000$ in each case plus about 20,000$ each in expenses would probably suffice. The promotion efforts in Australia and New Zealand would of course be supervised by an Investment Promotion Manager and one or two staff. The Investment Promotion Manager will be responsible for the overall promotion effort, including the production of brochures and promotion material, the arrangement of investment visits to Tonga in co-operation with the field representatives, maintaining via the field representatives contact with potential investors, assisting investors in processing investment proposals and EPZ license applications through the Ministry of Labour, Commerce and Industry, assisting investors during the establishment phase and monitoring progress through the operating phase. The Investment Promotion Division would also be responsible for public relations and publicity associated with export processing zone development, both in Tonga and overseas.

The Industrial Estates Division would be responsible for the planning, development and management of the proposed export processing zone area in an efficient and businesslike manner, advising potential investors on all issues in relation to physical development, including where necessary assisting investors to secure suitable sites or buildings.

Financing Investment Promotion

The New Zealand, Australian and EC missions have all indicated a willingness to assist in funding the investment promotion effort associated with the development of the proposed export processing zone. The European Community has already assisted the

Fijian Trade & Investment Board with a number of investment promotion missions. The Ministry of Finance has also expressed a willingness to fund part of the promotion effort. A promotion budget of about 200,000$ annually over 5 years should be more than adequate to achieve an employment target of 1200 jobs. An expenditure breakdown and suggested source of funds is set out in the following table.

TABLE 7.1 - PROMOTION EXPENSES

Overseas Offices (Sydney/Auckland)	60,000	Tongan $
Travel/Entertainment	30,000	"
Salaries/Wages	50,000	"
Brochures/Promotion Materials	30,000	"
Other Expenses	30,000	"
Total:	200,000	"

Source of Funding

Tongan Government	40,000	"
EC/Australia/New Zealand	160,000	"
Total:	200,000	"

A N N E X 1

EXPORT PROCESSING ZONES ACT

An act to actively encourage Tongan and foreign investors to establish export-oriented manufacturing, trading, and service activity in Tonga through a system of granting relief from import duties and taxes, port and service taxes and income taxes.

Short title: 1. This Act may be cited as the Export Processing Zones Act 1993.

Part 1 - Preliminary

Interpretation 2. In this Act and any Regulations made hereunder unless the context otherwise requires-

"Approved Enterprise" means an enterprise belonging to any of the categories as defined in section 3 of this Act in respect of which an Export Processing Zone Licens has been issued by the Minister under section 13 of this Act;

"Commissioner" means the Commissioner of Inland Revenue as defined in the Income Tax Act;

"Controller" means the Controller of Customs;

"Company" means any corporate body whether registered under the Companies Act or not and any partnership consisting of more than 7 persons;

"Customs Duty" means the tariff or import duty as set out in Schedule 1 to the Customs and Excise Act;

"Customs and Excise Act" means the Customs and Excise Act of the Kingdom as amended from time to time and the regulations framed thereunder;
"Export Levy" means any duty or tax payable by any person under any enactment for the time being in force relating to the levy of such duty or tax on exports of product(s);

"Export Processing Zone License" means a license issued by the Minister under Section 13 of this Act;

"Income Tax Act" means the income tax as defined, imposed and payable under the Income Tax Act;

"Kingdom" means the Kingdom of Tonga;

"Minister" means the Minister of Labour, Commerce and Industries or such Minister whom Privy Council may appoint to be responsible for the time being for the performance of the duties under this Act;

"Port and Service Tax" means the tax liable to be collected and paid on all goods imported into the Kingdom as specified in Section 26 of the Port and Services Tax Act;

"Tax Holiday" means an exemption from payment of income tax for any specified period.

Enterprise

3.1 In this Act, the term "enterprise" means -

(a) any "company";
(b) statutory bodies established under any Act or Ordinance;
(c) co-operative societies registered under the Co-operative Societies Act;
(d) private entrepreneurship be it a sole proprietorship concern or a partnership firm comprising of not more than 7 partners, Tongan or foreign;
(e) any other industry or enterprise deemed by his Majesty in Council to be an Industrial Enterprise engaged in or desirous of engaging in any processing industry, manufacturing industry, assembly industry including packaging industry and/or any international trading or service activity set out in Schedule 1 attached to this Act.

3.2 Schedule 1 of Section 3.1 of this Act may be amended by the Minister at any time.

Exports

4. All enterprises approved under Section 13 of this Act shall export all of their output unless permission is granted under Section 5 of this Act by the Minister to sell a specified volume or percentage of their output on the Tongan market.

Domestic Sales

5. The Minister may approve an application from an enterprise to sell part of its output on the Tongan market. In granting permission the Minister shall have regard to (i) the possible damage such sales might cause for domestic enterprises; (ii) the extent to which such sales would replace imports; (iii) the benefits in terms of employment and import substitution to the Tongan economy; and (iv) the benefits to the enterprise concerned. In granting permission for domestic sales, the Minister shall specify the volume of domestic sales permitted and the time limit in which those sales can be made.

Explanatory Note: The purpose of Articles 4 and 5 is to restrict domestic sales and avoid damage to established or new domestic industries. At present an export company is defined as 90% export. However, a large EPZ company selling 10% of the domestic market could seriously damage a small domestic company. Hence it is better to restrict domestic sales to situations in which Tongans will benefit e.g. if there is no comparable product made in Tonga it makes sense to buy from an EPZ company (thus retaining some of the benefits of Tonga) rather than import the product directly from some other country.

Part 2 - Establishment and Operation of Export Processing Zones

Establishment of Export Processing Zones

6.1 The Minister may by order declare that on or after a specified date the land and/or buildings enclosed within the limits defined by the order shall be an export processing zone for the purposes of this Act.

6.2 The Minister may amend the order under Section 6.1 and vary and limits of the zone.

Explanatory Note: This section allows the Minister to declare any area of land or building to be an export processing zone and also allows the Minister to amend, expand or reduce the area.

6.3 No enterprise may commence operations within an Export Processing Zone without a license issued under Section 13 of this Act.

Non-Application of Import/Export Laws

7.1 The laws in force relating to imports and exports of goods shall not apply to goods brought into or out of an export processing zone from and to other countries or other zones within the Kingdom.

7.2 Imported goods of any description can be brought into the export processing zone free of all customs duties. port and service taxes and other forms of indirect taxation provided (i) such goods are part of the trade or business of a licensed enterprise; (ii) such goods are not prohibited for reasons of public order, security, public morality, public health, animal health or plant health.

7.3 Goods exported from an export processing zone shall be free of all taxes and duties and restrictions except goods whose export is restricted or prohibited by law.

Trade between the export processing zone and the Kingdom

8.1 Goods brought into an export processing zone from another part of the Kingdom not an export processing zone and not in transit to another destination shall be deemed to have been exported.

Explanatory Note: the purpose of this section is to allow goods made in Tonga to benefit from drawback of customs duties. In this way Tonga manufacturers can compete on equal terms with overseas suppliers (e.g. Fijian suppliers selling to Tongan EPZ enterprises will benefit from duty drawback in Fiji).

8.2 Goods brought into the Kingdom from an export processing zone (and not in transit to another destination) shall be deemed to have been imported.

8.3 The Minister in consultation with the Minister for Finance shall make regulations governing trade between the export processing zone and the Kingdom.

Explanatory Note: The Minister may decide that export processing zone goods should be subject to import duty on the imported raw material content of the product and not on the value of the finished product. This would give the export processing zone product a competitive advantage over a competing imported product. Alternatively, the Minister may if the circumstances warrant exempt the export processing zone product from the payment of any duty.

Customs Controls

9.1 The Minister may with the consent of the Controller of Customs and the Minister for Finance may make regulations (i) adapting or modifying for the purposes of this Act any of the provisions of the Customs & Excise Act or any statutory instrument relating to Customs operations; (ii) governing the movement of persons or vehicles into and out of an export processing zone; (iii) covering the keeping, storage and handling of goods in an export processing zone (iv) covering the keeping and preserving of accounts and records in specified form in respect of goods in an export processing zone; (v) relating to the provision of security by bond or otherwise as required by the Controller of Customs in respect of goods in transit between entry/exit points and export processing zones.

Explanatory Note: The purpose of this section is to give the Minister power to make regulations dealing with the control of duty free goods should such be necessary. At this point in time such regulations are not considered necessary expect perhaps regulations dealing with the storage of goods and maintenance of records. Each licensed enterprise should be obliged to lodge all duty free goods in a secure store and maintain records for at least 3 years in a prescribed manner. Customs officials should have access to such records and stored goods at all reasonable times including production schedules.

Consumption goods

10.1 Goods shall not be brought in to an export processing zone for personal use or consumption except under conditions set out in Section 10.2.

10.2 If goods referred to in Section 10.1 are liable to customs or excise duty this duty shall be paid before they are brought into the export processing zone and shall not be entitled to a drawback allowance.

Missing dutiable	11.1	If goods on which duty has not been goods paid or duty has been refunded by way of drawback or brought into an export processing zone and not removed lawfully from the zone are found to be missing or deficient without an acceptable explanation the Controller of Customs may demand from the licensee or other responsible person the duty in force at the time.
	11.2	If the licensee does not within X days pay the duty demanded he (the licensee) shall be liable for a fine not exceeding twice the duty demanded.
	11.3	In considering the volume of deficient goods the Customs Controller shall make due allowance for natural wastage, accidental destruction and similar causes.
	11.4	It shall be an offence to dispose irregularly of goods or to assist in the disposal of goods from the export processing zone when such goods have been brought into the zone without the payment of duty.

Part 3 - Export Processing Zone License

Application for an Export Processing Zone License	12.1	Any person planning to establish an export processing zone enterprise shall make an application to the Minister in such form and manner as may be prescribed by the Minister specifying the product or service to be provided and the equipment, machinery and raw materials to be used. The Minister may approve or refuse the application and no appeal shall lie against the decision of the Minister.
Development License	13.1	If the Minister approves an export processing zone license application referred to in Section 12 he shall issue the license or authorize any person under his administrative direction to issue the license in favour of the export processing zone enterprise approved by him. The license shall specify the products to be produced and/or services, activities to be performed.
	13.2	The license shall specify the development incentives available to the enterprise.

13.3 The Minister may attach any conditions he considers appropriate to the license.

Explanatory Note: It may be necessary to attach special conditions to particular licenses from time to time e.g. relating to the storage of duty free alcohol.

Transfer of License

14.1 No license issued under this Act shall be transferable without the prior written approval of the Minister. A license issued under this Act shall not exempt the holder from obtaining any other license required in connection with the approved enterprise under any other Act.

Part 4 - Development Incentives

Tax Holiday

15.1 An approved export processing zone enterprise will be granted exemption from payment of any income tax in respect of any assessable income earned by the said enterprise derived from approved export processing zone activity from the date of commencement of that activity for 10 consecutive years.

15.2 The Minister may extend the period of exemption from income tax for particular categories of enterprise if he considers it appropriate.

15.3 Every shareholder of a company approved as an export processing zone enterprise for the purpose of this Act shall be entitled to exemption from payment of any income tax on the income derived by him or his nominee as a dividend on his shareholding in the said enterprise relating to the tax holiday period specified in sub Sections 1 and 2 provided further that such dividends have actually been received by him not later than 2 years after the expiry of the said tax holiday period.

15.4 Every tax exemption is conditional on the net proceeds of exports being brought into the Kingdom within 12 months of the date of invoice.

Explanatory Note: It is better from a promotional viewpoint that the Act states clearly that a tax holiday will be granted for a specified number of years rather than that a tax holiday may be granted by the Minister. In Section 15.4 the date of invoice rather than the date of shipment is used as this covers service as well as manufacturing activity.

Part 5 - Miscellaneous

Power of the Minister, the Commissioner and the Controller

16.1 It shall be lawful for the Minister, the Commissioner, the Controller or any other person authorized by any of them (a) to enter the premises of an export processing zone enterprise approved or otherwise with the express intent of inspecting all aspects of the business being carried on therein to himself collect, scrutinize, take or acquire the production of any document material as a sample or any information orally or in writing if in the opinion of the Minister the Commissioner or the Controller it is expedient to do so for the purposes of this Act.

16.2 No person shall (a) obstruct the Minister the Commissioner or the Controller or any authorized person in the exercise of their powers and duties under subsection 1 of the Section; (b) wilfully fail to give information or to produce any documents or samples required of him; and (c) knowingly give false information relating to any matter relating to this Act.

16.3 Any person who contravenes the provisions of this Section or any order issued thereunder shall be liable on conviction to a fine not exceeding X $ or ....

Revocation or variation of License

17.1 The Minister may at his discretion revoke a license if (i) he is satisfied that there has been a breach of condition attached to the License or (ii) the licensee is convicted of an offence against the Customs & Excise laws.

17.2 Before revoking a license the Minister shall give not less than 30 days notice of his intention to the licensee and shall consider any representations made to him by the licensee within that time.

Regulations

18.1 The Minister may with the consent of His Majesty in council from time to time make such regulations as are necessary or expedient for giving effect to the provisions of this Act and the due administration there·

18.2 All such regulations shall be duly published in the gazette.

Investors	19.1	Foreign investors can hold up to 100% of the shares in any export processing zone enterprise.
	19.2	Tongan investors can hold up to 100% of the shares of any export processing zone enterprise.
	19.3	Foreign and Tongan investors will have equal status within the export processing zone.
Repatriation of Profits	20.1	Foreign investors can repatriate profits from an enterprise without restriction provided an Auditor's certificate is produced certifying that the profits to be repatriated are the true profits accruing to a foreign investor as a result of a dividend being declared.
Repatriation of Capital	21.1	Foreign investors may repatriate capital without restriction provided (i) the capital has been brought in to Tonga from overseas; (ii) the capital to be repatriated is realized from the sale of physical assets or shares and (iii) the proceeds from the sale represent the true value of the assets in question.
Regulations arising from Export Processing Zone Act	22.1	The regulations arising from the Export Processing Zone Act can be modelled on the regulations made under the Industrial Development Incentives Act. The composition of the standing advisory committee for the Export Processing Zone Act would be very similar to that set out in regulation 5(i) of the principle regulations of the IDI Act as amended in August 1990. Under this regulation the committee is made up of the Minister who is chairman, the Secretary of the Ministry who is the member secretary of the committee, the Secretary for Finance, the Director of Planning, the Managing Director of the Tonga Development Bank, the Director of Agriculture, Fishery and Forests and the General Manager of the Bank of Tonga.

ANNEX 2

PRESENT PHYSICAL INFRASTRUCTURE

ELECTRIC POWER:

The total installed capacity in Tonga is as follows:

Location	Installed Capacity	Peak Demand
Tongatapu	5.90 MW	4.40 MW
Vava'u	0.60 MW	0.57 MW
Ha'apai	0.24 MW	0.28 MW
'Eua	0.20 MW	0.11 MW

The generation is by diesel. The tariff is about T$ 0.36 per KWH. There is no special tariff for commercial or industrial consumers. The electric supply is 240 volts, 50 cycle single phase and 415 volts, three phases AC supply. Of the total of 13,100 consumers on Tongatapu, about 2% were industrial consumers during the year 1991.

The transmission voltage is 11 kv on Tongatapu and 6.6 kv on outer islands.

In the Sixth Development Plan (1991-1995) an additional investment of T$ 4 million has been indicated to overhaul generators and to upgrade transmission and distribution lines.

ROAD TRANSPORT:

Functional inventory of roads

1988	Highway	Trunk	Feeder	Access	Total
Tongatapu	64.6	188.5	248.0	487.0	988.1
Vava'u	9.3	93.3	123.0	97.0	322.6
Ha'apai	7.0	31.1	145.0	55.0	238.1
'Eua	.6	20.8	85.0	40.0	146.4
Niuas	-	29.3	65.0	-	94.3
Total	81.5	363.0	666.0	679.0	1,789.5

Number of registered vehicles:

Vehicles	1985	1990
Cars & light trucks	1,823	3,010
Heavy trucks	495	966
Taxis	277	1,032
Buses	111	118
Motorcycles	392	501

86% of the registered vehicles are at Tongatapu.

AIR TRANSPORT - INTERNATIONAL AIR SERVICES:

The following air connections are available from Tonga:

Route (from Fua'motu on Tongatapu)	Airline	Aircraft	Frequency
Apia (Western Samoa)	Air New Zealand	B737	1/week
	Polynesian Airlines	B737	1/week
Auckland (New Zealand)	Air New Zealand	B737	2/week
	Royal Tongan Airline *)	B737	1/week
Australia	Polynesian Airline	B737	1/week
Nandi (Fiji)	Air Pacific	B737	2/week
	Royal Tongan Airline	B737	1/week
Honolulu (Hawaii)	Polynesian Airline	B737	1/week
	Air New Zealand	B737	1/week
Suva (Fiji)	Air Pacific	B737	1/week

*) National carrier

Most manufactured exports (except coconut oil and processed root crops) are exported by air. However, raw materials are imported by sea.

Constraints: High international airfares from Tonga. Insufficient air services. Hawaiian airlines, which was a link to the West coast of the USA through Hawaii, has withdrawn after operating for more than 10 years. Inadequate cargo space. Relatively high international airfares.

SEA TRANSPORT - SHIPPING SERVICES:

The following shipping lines operate in Tonga:

Country	Shipping	Main Port
Australia	PFL	Sydney, Brisbane
Fiji	PFL	Suva, Lautoka
New Zealand	PFL, LINK	Auckland, Lyttleton
Western Samoa	PFL, REEF	Apia
United States	BS, SPI	Loos Bay, San Francisco, Los Angeles, Hawaii, Pago Pago
New Caledonia	PFL	Noumea
Japan	BHL	Osaka, Kobe, Nagoya
Chile	-	Valparaiso
Cook Islands	REEF	Rarotonga
French Polynesia	REEF	Tahiti

Notes for Shipping Line Abbreviations:

PFL Pacific Forum Line (Government owned)
WP Warner Pacific
LINK Translink Line
BS Blue Star Line
SPI South Pacific Interline
BHL Bali Hai Line

The main wharf is Queen Salote Wharf at Nuku'alofa (Tongatapu):

No. 1 Berth		No. 2 Berth	
Length of Birth Face	93 m	Length of Berth Face	110 m
Water Depth	11.7 m	Water Depth	10.5 m
Ship Length	250 m	Ship Length	140 m
Orientation	90 degrees	Orientation	90 degrees

TELECOMMUNICATIONS:

Domestic telecommunications are operated by Tonga Telecommunications Commission, a public sector corporation.

International services (telephone, fax, telex) are operated by Multinational Cable and Wireless through an earth station on the INTELET system. Subscriber direct dialing facilities exist for most countries.

Of the 5,215 lines, about 700 are in outer islands and the rest at Tongatapu. All lines are occupied at present. However, the Tongatelecom has plans to double the capacity in the next five years.

The rates charged for a local call of three minutes is T$ 0.10. Rates for international calls per minute are as follows:

	Direct dialing	Operator assisted*)
Pacific region including New Zealand and Australia	T$ 1.50	T$ 1.60
USA and Asia	T$ 3.00	T$ 3.85

*) For operator assisted calls, T$ 3.00 is charged per call

US$ 1.00 = T$ 1.37

AVAILABILITY OF SKILLED LABOUR FORCE AND SUPPORT SERVICES:

The population of Tonga as per the last census (1986) was 94,535. The average annual growth rate for the period 1976 - 1986 was 0.49%.

Population size and growth rate

Census Year	Population	Period	Rate of growth
1956	56,838		
1966	77,429	1956-66	3.09%
1976	90,085	1966-76	1.51%
1986	94,649	1976-86	0.49%

Population and labour force

Population categories	1976		1986	
	Males	Females	Males	Females
Total population	**46,036**	**44,049**	**47,611**	**47,038**
Population of working age (15-64)	23,713	23,360	25,751	26,455
Labour Force (15+)	**18,077**	**3,358**	**19,119**	**5,055**
Employed	15,888	2,743	17,886	4,109
Unemployed	2,194	615	1,233	946

BANKING:

There is one commercial bank, Bank of Tonga, and one development bank, Tonga Development Bank.

Bank of Tonga, a joint venture between the Government of Tonga, Westpak and Bank of Hawaii, commenced operations in 1974.

Approval has been granted to two other commercial banks to operate in Tonga. Both banks, MBF and ANZ, are likely to set up operations by the end of 1993.

Bank of Tonga: composition of Loans and Advances

The lending portfolio of the Bank of Tonga was as follows:

in %	1985-86	1986-87	1987-88	1988-89
Agriculture	1.2	1.9	4.3	6.4
Manufacturing	1.7	2.5	2.0	5.6
Transport, storage and communications	3.5	4.9	6.6	6.1
Commercial wholesale and retail trade	11.0	10.3	9.4	7.8
Non-housing construction	0.6	1.3	1.2	3.9
Other services	4.1	4.3	6.2	4.8
Government and statutory bodies	29.1	14.4	13.7	9.7
Housing	33.7	42.8	40.4	37.3
Personal	13.4	15.1	15.0	16.2
Others	1.7	2.5	1.2	2.2

Tonga Development Bank (TDB)

The TDB was established in 1977. The loan portfolio of the TDB is as follows:

TDB Loan Approvals by Sector (1986 - 1990):

Sectors	in T$,000	% of sub-sector	% of total approvals
Manufacturing & processing	2,934	13 5	7.1
Mining & quarrying	739	3.4	1.8
Electricity & gas	407	1.9	1.0
Construction	1,032	4.8	2.5
Wholesale & retail trade	4,644	21.4	11.2
Hotels & restaurants	5,532	25.5	13.4
Transport	3,834	17.7	9.3
Finance & business	1,353	6.2	3.3
Community services	1,243	5.7	3.0
Sub-total non-primary sectors	21,718	100	52.5
Beverages & spices (vanilla)	5,812	29.5	14.0
Benin & other fruits	727	3.7	1.8
Vegetables & pumpkin	4,506	22.9	10.9
Fisheries	1,863	9.5	4.5
Root-crops	4,934	25.1	11.9
Livestock	947	4.8	2.3
Others	881	4.5	2.1
Sub-total primary sectors	19,670	100	47.5

A N N E X   III

PROMOTION OF MANUFACTURING FOR EXPORTS

-STUDY ON EXPORT PROCESSING ZONE AS A POLICY OPTION-

A. BACKGROUND

Over the past years the Government of Tonga has taken a number of steps with a view to promoting manufacturing, industrial development being chosen as a long-term objective to diversify the economy. Concrete measures were taken to that end, among which:

- the establishment of the Small Industries Centre;
- the introduction of an attractive Incentive Scheme package, spelling out fiscal incentives and other facilities provided by the Government to promote investments by both local and foreign entrepreneurs;
- the creation of an Industrial Promotion Unit and the strengthening of the Industrial and Business Advisory Unit within the Ministry of Labour, Commerce and Industries.

The establishment of an Export Processing Zone (EPZ) in Tonga could be an effective instrument in increasing exports, enhancing the inflow of capital investment, transferring skills and increasing employment. To promote investments in the country, the Government has already introduced the above-mentioned Incentive Scheme package. Given its political stability, excellent communication facilities, educated labour force, attractive incentives and preferential access to overseas markets, basic pre-conditions for the establishment of an EPZ appear to prevail in Tonga.

B. OBJECTIVE OF THE STUDY

The objective of the study is to provide the Government of Tonga with adequate techno-economic information on the viability of establishing an Export Processing Zone in Tonga as one of the instruments for export promotion and employment generation.

C. ACTIVITIES

The study to be undertaken will cover: (1) a detailed "stocktaking exercise" as a base for (2) recommendations on the viability of the EPZ concept in the context of Tonga. The above will encompass the following steps:

	Activities	Responsible person(s)
1.	To review and assess the Government's industrial policy and institutional environment, including incentives pertaining to investment/export promotion;	CTA DP/TON/86/002
2.	To determine the priority industrial subsectors/branches in which Tonga is expected to have a comparative advantage;	CTA DP/TON/86/002
3.	To assess potential investor interest (including eventual competition in this respect with other EPZs in the sub-region);	EPZ expert UNIDO s/m CTA DP/TON/86/002
4.	To assess the impact of the establishment of an EPZ on the economic development of Tonga, including expected impact on existing industrial enterprises;	CTA DP/TON/86/002 EPZ expert
5.	To assess the present physical infrastructure including transport facilities, telecommunications, utilities, etc.;	CTA DP/TON/86/002* EPZ expert
6.	To examine the availability of skilled labour, support services (efficient banking system, etc.);	CTA DP/TON/86/002* EPZ expert
7.	To analyze the administrative and legislative framework for the establishment of an EPZ;	EPZ expert
8.	To recommend appropriate incentives and other promotional and control measures for EPZ system;	EPZ expert UNIDO s/m
9.	To draft EPZ legislation;	EPZ expert

*) The responsibility of the CTA is to collate data on physical infrastructure utilities, transport, shipping, employment, that will be used as a basis for the final analysis/report by UNIDO.

10.	To prepare a comprehensive report on the above findings with detailed recommendations as regards the viability of the EPZ concept for Tonga; (in the affirmative) spelling out requirements for a successful EPZ in Tonga (type of EPZ regime, required legislation/incentives, type of management and organizational structure, infrastructural facilities, technical capabilities and environmental precautions required, estimate of financial implications to set up, promote and administer the zone programme etc.);	UNIDO s/m EPZ expert
11.	To present the study to the relevant authorities and private sector representatives (in the form of a local seminar);	EPZ expert
12.	To suggest an action plan to set up a pilot expert processing zone.	UNIDO s/m

D. **MODALITIES AND DURATION**

The study will be prepared under the overall responsibility of the Institutional Infrastructure Branch. The work to be carried out comprises:

UNIDO staff inputs 0.7 months

(including desk research prior to the fielding of the mission, analysis of the draft report and submission of the final report)

mission of consultant 1.3 months

(3 weeks in Tonga, including short visit to selected countries with potential investor interest (Australia, New Zealand, Fiji; 1.5 week briefing/debriefing in Vienna, including travel)