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## Impediments to Business and Government Policy Responses

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### A Framework for Policy Analysis

It is well recognized that, as in many other Pacific Island countries, private-sector development in Samoa is impeded by the small local market, high transportation costs to major markets, insecure property rights, extensive involvement of Government and public enterprises in the economy, and nontransparent and inappropriate regulation of business.

The nature and scale of the constraints means that investment will be attracted only where the basic features of the country create strong advantages. Access to fishing stocks, certain agriculture and agroprocessing such as kava, the natural beauty of the country, and preferential access to larger markets for certain manufactures constitute strong advantages.

To make the most of these advantages, the approach that is most likely to be successful is one that focuses on getting the basics right. This entails macroeconomic stability; generally low tariffs and taxes on inputs for all genuine business activity irrespective of the sector; the confinement of Government's role to core functions that match its capability; good public security; well-defined and well-enforced property rights and business laws; low transaction costs of doing business, especially with respect to interaction with Government; adequate and efficiently managed infrastructure; and a good general level of education and workforce skills.

In recent years, the Government has been successful in ensuring a stable macroeconomic regime and has made impressive progress with tariff and tax reform. Until recently there were major concerns about economic inefficiencies associated with the tariff and tax system and the investment incentives policy in Samoa. Tariffs on business inputs were generally too high and an extensive discretionary exemptions scheme was in place that was considered to be ineffective in attracting efficient

investment. As noted in Chapter 2, the recent tariff and tax reforms are generally considered to be effective, but there are still some important unresolved issues, particularly with respect to including commercial agriculture and fisheries in the tax system. The Government has also recognized the importance of redefining and refocusing its role to ensure that its core functions are performed effectively and that the involvement of Government in noncore activities is scaled back. Although progress has been modest, a good start has been made with the concept of performance budgeting. This is considered in more detail in Chapter 4. The degree of public security is also very good, reflecting one of the key advantages of the culture and social system, and this is an important aspect of a successful market economy.

To overcome the natural disadvantages associated with small size and distance from major markets, it is important to continue to give strong emphasis to economic efficiency and policies that harness the profit incentives of the private sector in a well-functioning competitive market. Insecure land tenure, inefficient public enterprises, and regulations that make it difficult to transact domestic and international business remain important constraints.

## **Key Constraints to Business Development**

### ***Land***

With respect to land tenure, the Statement of Economic Strategy (SES) 2000–2001 specifies that the Government will devise a strategy to improve the availability of land and the utilization of customary land as collateral. This will be a difficult exercise and there is little in the way of specific detail available at this stage. The situation with respect to the role of Government in facilitating access to land is considered in more detail in Chapter 8 on natural resources and some suggestions are made for reform options.

### ***Public Enterprises***

With respect to public enterprises, progress toward reform has been disappointing. The current SES notes that contracting out and corporatization/privatization will continue to be an important aspect of public-sector reform. An important development is a proposed new State-Owned Enterprise umbrella Act that should assist in improving accountability for performance. Public-enterprise reform is considered in more detail in Chapter 4, but it is relevant to note here a number of

key problems with the main public utilities: power, water, and telecommunications.

### ***Electricity***

In the case of electricity, a major concern is the frequency of power failures. Major enterprises such as hotels and factories need their own diesel-powered generators to ensure continuous supply. For example, the Yazaki factory runs its own generators during the day to avoid the disruption of power failures. This underlines the point that, in the current environment, any manufacturing for export will need either a major natural advantage or preferential entry to major markets to be successful.

**Table 3.1 Electricity Tariffs in Various Pacific Island Countries, 1997–1998**

	<b>Domestic</b>	<b>Commercial</b>
	sene/Kwh	sene/Kwh
American Samoa	43	41
Cook Islands	50	69
FSM	47	51
Fiji	33	34
Kiribati	62	75
Marshall Islands	35	47
PNG	28	28
Samoa	60 <sup>a</sup>	60 <sup>a</sup>
Solomon Islands	32	47
Tonga	77	77

*Note:* a. increased from 43 sene/Kwh in mid-1998.

*Source:* Kolone Vaai & Associates (1998).

Costs are also relatively high. In mid-1998, power prices were increased by 40 percent to well above levels in most other Pacific Island countries (Table 3.1). This tariff increase was the only increase since 1993 and was considered necessary to achieve a reasonable financial position of the Electric Power Corporation: in 1996 a loss of SAT\$6.6 million was incurred, followed by a loss of SAT\$7.9 million in 1997 and projected losses at the old tariff of over SAT\$10 million in each of the following two years. It is difficult to draw conclusions from comparing tariff rates without taking account of differences in operational efficiency and financial performance of different utilities. However, the comparison with neighboring countries does help to demonstrate the importance of ensuring that all public utilities are as efficient as possible and the difficulties for business where power is an important cost factor.

The flat rate tariff also entails a cross-subsidy from business to domestic consumers, particularly allowing for the higher cost of reticulation to villages. This entails a bias against business, although comparisons with neighboring countries suggest that this is a common practice. There are also no multipart or differential tariff structures, although there would be scope for achieving economic efficiency and more revenue through differential tariff structures for large users (Kolone Vaai & Associates 1998).

### ***Water***

As to water, the main concern of business is with the quality and reliability of supply, although some manufacturing businesses consider the cost too high. Metering is being introduced to provide better signals of resource costs and a major institutional strengthening project is underway, which should mean improved operational efficiency, providing the scope to lower charges.

### ***Communications***

In the telecommunications area, there are major concerns about cost, availability, and quality. International calls account for 75 percent of total telecommunications revenue; rates are SAT\$3 per minute to Australia, New Zealand, and other Pacific Island countries; SAT\$4.5 per minute to Europe and the United States (including Hawaii); and SAT\$6.0 per minute to South Africa and the Middle East. A three-minute minimum charge also applies. These rates are considered by the business community in Samoa to be expensive. There are also no off-peak rates which could assist in a more even and effective utilization. In contrast, local calls in Apia are only 10 sene and in rural areas 50 sene; calls to and from Apia are on a timed basis.

As to availability, the number of applicants awaiting telephone installation grew from less than 1,000 in 1988 to nearly 4,000 in 1997 (Government of Samoa 1998b). Even with the subsequent entry of a cellular telephone provider in mid-1997, there is still a substantial backlog of more than 2,000 applications waiting for connection. A working benchmark for a country with a GDP per capita of US\$1,200 is 10 lines per 100 people. With a population of 170,000 this suggests there should be 17,000 lines for Samoa, but there are at present only about 9,000 lines. There are also problems with connections for those with existing lines and with the quality and reliability of internet connections.

Another issue is that the new cellular provider was granted exclusive rights with respect to the provision of a mobile telephone service; this has raised concerns about whether the arrangements will be conducive to an economical and effective service for business.

The postal service is also considered to suffer from serious weaknesses in the reliability, security, and coverage of its service. An effective government postal service is particularly important in a developing country for both social and economic reasons.

In early 2000, a new communications sector policy was being formulated to improve the services for both telecommunications and the postal service. Accessibility, efficiency, and affordability are key objectives of the new policy. Effective implementation will be difficult and, in particular, is likely to require substantial subsidies in order to achieve access objectives.

The new communications sector policy also proposes an independent regulator to monitor its implementation. The independent regulator could also assess tariffs and trading practices, issue licenses, and arbitrate disputes. This is an important aspect of the policy and needs careful consideration to ensure the most effective model for Samoa. It is important to avoid a costly institutional structure based on models in larger countries, but it is also important to achieve independence, transparency, and competence in the determination of various matters that affect price, service, and competition. There is support for the concept of an independent and appropriately resourced regulator with these responsibilities, but further work is needed to develop an appropriate framework. The concept should also be extended to cover electricity, water, seaport and airport charges and services, and other matters relating to competition and monopoly power.

The world market is becoming highly interconnected via telecommunications. A modern and effective communications sector could provide major business opportunities for Samoa. There are many examples of large businesses shifting various administrative and telephone-call activities offshore to take advantage of lower costs. For example, the US has moved large segments of insurance processing business offshore, including to the Caribbean, and there are other examples of information, booking, and processing services that have been similarly shifted. Another example would be the provision of telephone directory assistance services for the Australian market. The prospects for such activity depend on high-quality, low-cost telecommunications and good-quality and low-cost labor with the ability to speak English, as well as time-zone advantages. Samoa has the capability to provide an effective workforce and has a time-zone advantage for the night-time in the United States, but it clearly lacks good quality telecommunications.

### ***Human Capital***

The level of education is not considered to be a critical constraint to business development at this stage, as there is a substantial segment of the population that is well educated and enough people with a reasonable education to provide a pool of adequate workforce skills. A recent positive development was that the Government relaxed its conditions for returning scholarship graduates to fulfill their bond obligations by recognizing their work in the private sector.

It is important to recognize that overseas communities of Samoans who have emigrated are an important source of skill and capital for the business sector in Samoa. There are many examples of Samoans returning to Samoa with improved skills and starting up successful businesses on their return, particularly in the service sector in restaurants, hotels, and distribution. It is suggested that, rather than viewing emigration as a possible problem, the Government should look more to the advantages that it provides and, in particular, should develop education policies that will maximize the ability of Samoans to work both in Samoa and overseas.

Although the level of human capital is relatively good, market inquiries in the manufacturing sector suggested that it takes much longer (usually more than twice as long) for Samoans to acquire the specific skills and productivity levels of workers in Asian countries. This again underlines the difficulties of establishing manufacturing activities unless there is a strong natural advantage specific to Samoa. Wage rates are also not considered to be a critical constraint. The present minimum adult wage is SAT\$1.40 per hour and employers such as Yazaki pay above the minimum wage.

### **The Transaction Costs of Doing Business**

Progress has also been made in reducing the transaction costs of doing business and in promoting foreign investment, but further efforts need to be made. In the case of foreign investment, policy is formally more open and effective promotional material has been prepared, but market inquiries confirmed that there was not enough emphasis on facilitation for genuine investors.

An institutional strengthening project to reinforce the capacity of the Trade and Investment Promotion Unit (TIPU) in the Department of Trade, Commerce and Industry began in early 1996 and has made an important contribution in providing information about the investment environment in Samoa. Inquiries confirmed that prior to recent changes,

Samoa had a very weak record with respect to the transparency of its investment regime. This also became apparent in the course of preparing the first National Investment Policy Statement, when it was established that a number of policies impacting on potential investors were not set out in information documents. The National Investment Policy Statement does not address policy or facilitation deficiencies, but it is considered to be a useful and up-to-date summary of all the policies, taxes, and regulations that would be of interest to foreign investors. At the time when this report was being prepared, TIPU was finalizing a national investment framework and supporting legislation to establish a more liberal and transparent investor environment in Samoa.

TIPU has also made good progress in researching, profiling, and promoting investment opportunities. Potential investors often lack knowledge and understanding of investment opportunities, regulations, and procedures in developing countries, particularly in smaller developing countries. For the individual investor, the transaction costs of acquiring the relevant information could prove prohibitive, but such information could be potentially very valuable to some investors and to Samoa if appropriate investment was undertaken. In these circumstances the transaction costs essentially lead to a market failure, so there is a legitimate and important role for Government in compiling all relevant information, attending to inquiries, and undertaking specific promotion of sectors where Samoa has a strong natural advantage.

The Department of Trade, Commerce and Industry is also promoting its services as a "one-stop shop" for investors. It has responsibility for facilitating leases, work permits, business licenses, and utility connections and other administrative requirements for new business. However, potential and actual investors complain of poor response times, indecision, and poor service. The Department has a policy of responding to all inquiries within 48 hours, but the perception is that the responses are not effective. There is a need to focus more attention on this aspect of investment facilitation and less on the preparation of investment profiles for specific projects. The former is an appropriate and critical role for Government, while the latter is essentially a role for the private sector.

A good example of government action to reduce the transaction costs of doing business is the area of business licenses. Prior to new arrangements in 1998, the process of obtaining and renewing a license involved clearance from numerous government departments and was a time-consuming and costly process. Under the new arrangements, all businesses apply to the Commissioner of Inland Revenue; an annual fee of SAT\$200 is charged for unincorporated businesses and SAT\$500 for incorporated businesses. The licensing arrangements were not raised

as a major issue by representatives of existing businesses, who confirmed that improvements had been made. However, a public interest test still applies and companies still have to be registered under the Companies Act as well as the Business Licenses Act. In addition, the business license requirement is an important disadvantage for small business, as technically any business, no matter how small and remotely located, is required to apply and pay the annual fee. A strong case can be made for initiating a threshold for the business license, similar to that for the VAGST.

Despite the improvements already made, there are other regulatory and administrative requirements and weaknesses that still have an important impact on the transaction costs of doing business. These include import/export documentation, quarantine requirements, exit permits for residents, work permits for expatriates, stamp duty, and the lack of a small claims court or tribunal.

For some time the trading community has been concerned about the complicated procedures and delays in processing imports and exports. At a minimum the clearance process requires visits to the Customs Department, a trading bank, the Port Authority for payment of wharfage charges, the Ministry of Agriculture for agricultural produce, and the Department of Trade, Commerce and Industry if investment incentives (which still remain under existing agreements) apply. Exporters must also present documents to the Central Bank for foreign exchange monitoring and statistical purposes. The Customs Department also insists on the presentation of original documents.

Another problem is that the Customs Department continues to query shipments where price varies relative to previous shipments (e.g., raw materials such as cement). This practice was probably necessary when duty rates were high and there were strong incentives to underrecord values so as to lower duty, but it is not necessary on a regular basis now, although spot checks could be a useful deterrence device. It is understood that many of these issues will be a priority in the next stage of public-sector reform.

With respect to quarantine requirements on imports, the private sector considers that the current arrangements are unreasonable and effectively prohibit imports that would be allowed in other countries with modern and effective quarantine systems. However, given the limited capability in Samoa to implement a modern risk-based quarantine system, it would seem that the Government would need to seek relevant technical assistance before undertaking any modernization.

It is difficult for residents to make travel arrangements at short notice because of a requirement for all residents (citizens and expatriates) over

18 years of age to obtain a permit to leave Samoa, whether the travel is business or personal. It is especially inconvenient for people outside Apia, as they must travel to the city to complete the necessary formalities during normal weekday office hours. The apparent rationale for the arrangements is to ensure that any debts owing to the Government are paid before departure. Rather than requiring an exit permit, it would be preferable to exercise such control at the border, by the computerized linking of records with relevant government agencies. Foreign workers, on the other hand, may be granted a multiple exit and reentry permit for the duration of their work or visitor's permit.

The employment of expatriate workers is subject to a relatively strict screening process. Any foreigner working in Samoa is required to have a valid work permit; spouses and dependents are required to have a valid visitor's permit. Permits are initially issued for six months and multiple extensions may be granted for up to three years. In order to obtain a work permit it is necessary to demonstrate that the particular skills required are not available locally. The requirement for some form of work permit for foreigners is reasonable, but consideration should be given to a more flexible system with respect to shareholders and managers of foreign investments. The Manufacturers Association and Chamber of Commerce have proposed a system where a business entity could apply for permits for key representatives and key posts for, say, a three-year period. At the time of application the permits would not apply to particular individuals but could be used by specific individuals at a later date provided they met the criteria of the permit as verified by the investor or company. These recommendations were based on a scheme operating in the Fiji Islands. It would also be useful to extend the scheme so that residents could obtain multiple exit permits.

Although not identified as a major issue, the restrictions on the ability of spouses to work may also be considered an unreasonable constraint; consideration should be given to relaxing them so that spouses can readily work in the occupation of their choice. The concept of displacing workers is based on a false assumption that there are a fixed number of jobs in an economy.

Another irritation to business is the requirement to pay stamp duty on various documents (loan agreements, guarantees, share transfers, memoranda of association, powers of attorney, lease documents, and all other deeds and contracts). With the exceptions of leases and transfers of shares, the stamp duties themselves are not expensive, but the transactions are seen as time-consuming, costly, and unnecessary. It is necessary to take the documents to the Treasury Department for stamping, but they are unable to stamp the documents on the spot, so each trans-

action requires two visits. Another concern was that it is normal practice to require a valuation of the property at the expense of the party responsible for the stamping. Many countries have done away with stamp duty on all transactions, as it has no place in an efficient taxation system designed to encourage private-sector development.

An effective legal system and dispute resolution process is an important feature of a well-functioning market-based economy. The lack of any formal arrangements to deal with small claims is seen by some business representatives as an impediment to the smooth conduct of business. The function of such arrangements would be to deal with small claims in a speedy and low-cost manner.

### **Legal Reforms to Facilitate Business Development**

At a broader level, it is important to recognize the critical role that an effective legal system plays in facilitating economic activity. Laws are important for defining property rights, generally reducing the transaction costs of business, and dealing with market failures. In a small country, it is especially important to ensure that the legal framework is clear and relatively simple and to keep in mind that it would be too costly to expect that laws and complementary institutions that are a feature of larger markets should apply in Samoa. For example, Australia's Trade Practice Acts and the Australian Competition and Consumer Commission, with their associated frameworks and procedures (court-based litigation and expert witnesses, etc.), are not likely to be an effective model for Samoa.

A comprehensive review of the legal and regulatory environment in Samoa that looked at these issues was recently completed (Kolone Vaai & Associates and Goddard 1999). The main conclusions are that with a few exceptions, the laws of Samoa are appropriate foundations for economic activity and that strengthening the institutions that administer those laws will generally produce greater dividends than altering the laws. Key exceptions are laws that unduly restrict competition or that are unduly restrictive with respect to various business transactions. The lack of clarity with respect to common law was also identified as an issue. Priority areas of reform include the following:

- Streamlining and updating company law and insolvency law;
- Streamlining stamp duty law;
- Streamlining dispute resolution arrangements;
- Reforming certain procedural aspects of land laws (also considered in Chapter 8 on Natural Resources);

- Reforming the law relating to security over property;
- Modifying the Fair Trading Act to repeal price control provisions or limit their application to remote areas, adding a provision to prevent price-fixing agreements and reforming various provisions relating to restrictive practices and market power that are not considered appropriate for Samoa;
- Removing legal barriers to competition, e.g., in such areas as electricity generation;
- Reviewing intellectual property laws to ensure compliance with obligations under WTO membership; and
- Ensuring that Samoa's laws do not impede use of electronic means to do business.

Most of the above recommendations have been endorsed by the private sector and were being considered by the Government at the time this report was prepared.

Another area where consideration will need to be given to new regulatory requirements is commercial fishing. As shown elsewhere in this report, the export fishing sector has grown very rapidly and there are numerous issues that require government action. In relation to regulation, these include safety and training, registration of vessels, and management of the fisheries. These issues are considered in more detail in Chapter 9.