



Asian Development Bank

Private Sector Assessment for Fiji Islands

“Promise Unfulfilled”

REVISED
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I. Executive Summary

1. The Fijian economy has performed poorly over the past 20 years, with annual growth rates averaging 2.3 per cent and investment averaging no more than 12 per cent of GDP¹. Fiji is a high cost business environment. Infrastructure is generally of poor quality; telecommunications charges are high; it is costly to fly to Fiji on business; port charges are high; there is extensive regulation; the legal and financial systems are costly to access and to use; and nominal tax rates on companies are significant (31 per cent). The government has announced that it will seek to improve growth performance by encouraging private sector development. Removing barriers that discourage investment and entrepreneurship has started in several of the areas. However, before meaningful reform can be achieved substantial progress remains to be made. The most important areas are outlined in the paragraphs that follow, and presented in a summary table of issues and recommended policy actions.

A. Incentive and Tax Issues

2. Fiji's investment policy is currently directed at offsetting the country's natural endowment disadvantages (such as its relatively small and remote market) as well as "man-made" investment barriers through the use of incentives in the form of tax holidays and accelerated depreciation allowances that put a significant portion of the economy outside the formal tax system. This arrangement leads to business decisions that do not allocate resources effectively for the development of the Fijian economy, with investment being dictated by the desire to avoid taxes rather than through obtaining the best before tax return on investment. The poor foreign investment and gross capital formation data suggest that the incentive regime has not been successful.

B. State Owned Enterprises and Infrastructure

3. The physical infrastructure necessary to foster economic development is weak and needs urgent attention. Basic services are by and large inefficiently delivered, and often at high cost. As a result, business input and transaction costs in Fiji are internationally

¹ Although in 2004, this rose to 16 per cent of GDP.

not competitive—exacerbating Fiji’s comparative disadvantage of being a relatively small and remote island state.

4. The State plays a large role in the ownership of assets in Fiji. It owns or has a significant shareholding in 29 enterprises – the capital employed in State owned enterprises (SOEs) is equivalent to around 25 per cent of GDP. These entities earn very low or negative rates of return on their assets, which shows the inefficiencies of their operation. It means that a substantial portion of the economy is not contributing to economic growth, putting an even greater burden on the private sector to generate growth. At the same time, the poor performance of a large part of the economy (the SOE sector) implies that it will be very difficult, if not impossible, to meet the economic growth targets needed to create jobs and opportunities. Recently, the government announced its intention to engage in further reform of SOE ownership, management, and corporate governance arrangements. This report endorses strongly the SOE reform initiative.

C. Land Issues

5. The land leasing framework in Fiji is far more advanced than it is in other countries in the Pacific Region but there are still many problems. Indigenous Fijians face difficulties in using land as collateral for bank loans, which limits their entrepreneurial opportunities. Fiji needs to develop a mechanism for Fijians to mobilize their land assets. The Agricultural Land Trustee Act (ALTA) creates strong negative incentives for agriculture because of uncertainties over lease renewal and the low rate of compensation for improvements to leased land. A single lease system in terms of which the government has a master lease with NLTB and collects rent from the lessees is an option worth considering. The NLTB needs to either reduce its fee or invest the funds to promote the workings of the land market. Land reform initiatives will take a long time, but need to be commenced immediately.

D. Legal and Regulatory Issues

6. Fiji’s commercial legal framework, is outdated and by and large ineffective in supporting modern business transactions. Fiji’s business laws require procedures that incur high transaction costs for business and increase the risk of enforcing business deals. The legal system requires a broad range of costly licenses and registrations, particularly at the local

level, that have no compensating public policy objective and severely raise uncertainty for investors. The problems of delays arising from investment approvals have been documented in several other ADB reports. Recently a joint World Bank/FIAS initiative has begun to tackle the problems of regulation and delays in investment approvals; this report strongly endorses the initiative. Furthermore, an ongoing ADB sponsored diagnosis of the legal and regulatory business environment is identifying priority reform areas for implementation over the short, medium, and long term; we recommend that this report should be widely discussed among key stakeholders, and the momentum be used to implement the prioritized reform agenda.

E. Financial Market Issues

7. There are a number of key issues hampering the financial sector's ability to finance investment and encourage savings. These are: (i) high interest rate spreads (7-8%); (ii) low levels of credit to the private sector (around 23% of GDP); (iii) low levels of investment (around 16% of GDP); (iv) low levels of foreign direct investment; and (v) poor intermediation of remittances.
8. Capital markets are underdeveloped, even though they are deeper than any of the other Pacific Region economies. The underdevelopment of the financial sector is connected to two underlying issues: lack of an adequate collateral framework for securing loans and the inability of native land owners to mortgage their land because of customary tenure. These elements impede access to affordable credit. A key reform issue is enabling movable property (chattels) to be used as collateral, which, under Fiji's current legislation, can only occur in a limited number of cases after going through a costly legal process. The report welcomes the ADB initiative to formulate a detailed reform implementation plan to improve the collateral system, thereby increasing affordable access to finance. The dominance of the Fiji National Provident Fund also seriously hinders financial deepening because it is a captive purchaser of government bonds.

F. Reform Implementation

9. Putting the private sector at the heart of Fiji's economy will require making some difficult choices. It will take courage, leadership, and political will to do so. However, these choices must be made if poverty is to be reduced and opportunities. One of the factors that has provided momentum to the recent reform efforts has been increased

dialogue between the government and the private sector. Continuation of this process is vital if the reform effort is to be sustained.

10. Government reform commitment, as articulated by the Prime Minister and senior government officials at various occasions, should manifest itself in directives for middle level government employees to ensure that any momentum generated does not founder on the rocks of bureaucratic inertia. It may be useful to identify counterparts outside government who will take on particular issues and push for change. For instance, the Law Society could become the counterpart with the Ministry of Justice to promote legal change, the CMDA could be the counterpart to promote financial market reform, the Chamber of Commerce could promote reform of the incentive environment, and so on. In addition, recently created advisory committees have substantial potential to promote reform over a wide range of issues.
11. The report makes suggestions on the timing and sequencing of the reform agenda. The last section contains a summary table with suggestions for how this might be achieved for some of the priority reform areas, how they could be sequenced, the government agencies that could be responsible, and the possible role of donors in the reform process. While the suggested sequencing and timing has been generally endorsed by various government key stakeholders, it represents only a first step towards preparing reform implementation. The reform recommendations cover a wide spectrum of economic and legal issues, which fall under the jurisdiction and purview of several government ministries and agencies. It is unrealistic to expect that any single ministry or department could encompass the range of issues that has been discussed. It is up to the government to work out more detailed implementation mechanisms, and possibly approach donors for support. “Champions” for change will need to be identified and nurtured.
12. Below is an overview of the issues and suggested reform actions to make Fiji a more business friendly environment. The report also contains a summary table of the main recommendations (issues, reform strategy, impact) on legal and regulatory reform issues.
13. ADB has expressed general commitment to support SOE reforms and public private partnerships, and to carry out diagnostic studies (including reform implementation plans) in the identified priority areas of legal and regulatory reform and collateral reform.

Summary of Issues and Policy Actions

Fiji needs a more dynamic private sector that will lead to:



Higher GDP Growth

The government goal is 5-8% growth per year. Current forecasts are below this target.



More Investment

Gross Capital Investment rising to 25% or more of GDP with at least 50% undertaken by the private sector.



More Job Creation

15,000 school leavers per year are entering the job market.



Better Human Development Indicators

Fiji has the opportunity to improve its current ranking.

The Private Sector Needs:

Less Political Uncertainty and More Policy Stability

- Social unrest, political uncertainty and governance and crime problems create uncertainty, risks and potential policy instability all of which shorten the private sector's time horizons and thereby damage entrepreneurship and efficiency.

Incentives that Encourage Efficient Resource Allocation

- The tax system is distortionary:
 - High company tax rates at the same time as tax holidays or accelerated depreciation for some businesses. Tax holidays and accelerated depreciation allowances encourage capital intensive investment, when job creation is needed.
- Natural resources (e.g. in the fishing industry) are not managed well which encourages exploitation.
- The current system unintentionally disadvantages native Fijians businesses:
 - They are often small service businesses, which do not qualify for the allowances.
 - They are often sole proprietorships, which do not qualify them for secured lending.
 - They cannot use their property as collateral the land leasing system provides negotiable leases to non-native Fijians only.
- Price controls that are still in place create distortions by adversely affecting agricultural productivity and quality.

Light Regulation that Promotes Entrepreneurship

- Fiji has many steps and licenses necessary to start and operate a business, which increases transactions costs and decreases the incentive to be formal.
- Many licenses have limited validity and are costly.

We Recommend:

Reduce Incentive Distortions

Action 1: Reduce the company tax rates sharply and eliminate all tax holidays, import duty holidays, and accelerated depreciation.

Action 2: Vigorously prosecute tax evasion.

Action 3: Remove price controls on agricultural products.

Reduce Legal and Regulatory Reform

Action 1: Implement the recommendations of the analysis of the legal framework for business. Electronic transactions, contract enforcement and collateral have been identified as priorities.

Action 2: Continue with the cataloguing and eliminate of the most redundant regulation.

Action 3: Remove investment rule disparities for foreign and domestic investors.

Rationalize State Involvement in the Economy

Action 1: Formulate and approve an SOE policy that increases private sector involvement through management contracts and other forms of private participation.

Action 2: Privatize or corporatise selected SOEs.

Action 3: Remove FNPF's control of ATH. Sell cellular licenses to increase competition and use the proceeds to compensate FNPF.

Less State Ownership, and More Private Sector Participation

- There are many inefficient and mismanaged State-owned companies that increase costs and crowd out the private sector. Rates of return on the assets of SOEs are low or negative.
- Public sector employment is very high, which adds to the fiscal deficit.

Financial Markets that Intermediate More Effectively

- Financial market inefficiencies are indicated by:
 - High interest rate margins.
 - Restricted access to credit.
 - The weak framework for pledging collateral, which limits lending secured by assets.
 - Sole proprietors, the bulk of Fiji businesses, cannot obtain funding.
- Dominant FNPF holds back financial market development:
 - FNPF is not allowed to invest elsewhere
 - FNPF directly controls all the funds that it manages.
 - As largest purchaser of government securities, FNPF strongly impacts on interest rates.

An Improved Legal System for Business

- The current legal system for business is based on outdated UK, Australian, and NZ laws.
- Complying with the provisions of the Companies Act and its administration raises costs with few corresponding economic benefits.
- Dispute resolution mechanisms are slow and costly.

Improved Infrastructure

- Infrastructure (e.g. electricity, transport, telecommunications) is poor, which imposes costs on firms and places them at a competitive disadvantage.

Improve Financial Market Intermediation

Action 1: Further relax exchange controls on FNPF investing overseas and increase substantially investment offshore. (This requires reconsideration of the fixed exchange rate policy.)

Action 2: Increase substantially the portion of the portfolio managed by Unit Trusts.

Reform the Secured Transactions Framework

Action 1: Participate in the upcoming ADB RETA on secured transactions.

Action 2: Set a timetable for legal and institutional change.

Strengthen Property Rights

Reform the Agricultural Land Trustee Act

Action 1: Ensure certainty around lease renewal.

Action 2: Increase the compensation for lessors.

Action 3: Consider a "block lease" system for agricultural land leases.

Improve Land Security for Native Fijians

Action 1: Analyse ways in which native Fijians can mobilize their land assets more effectively by allowing fully negotiable leases.

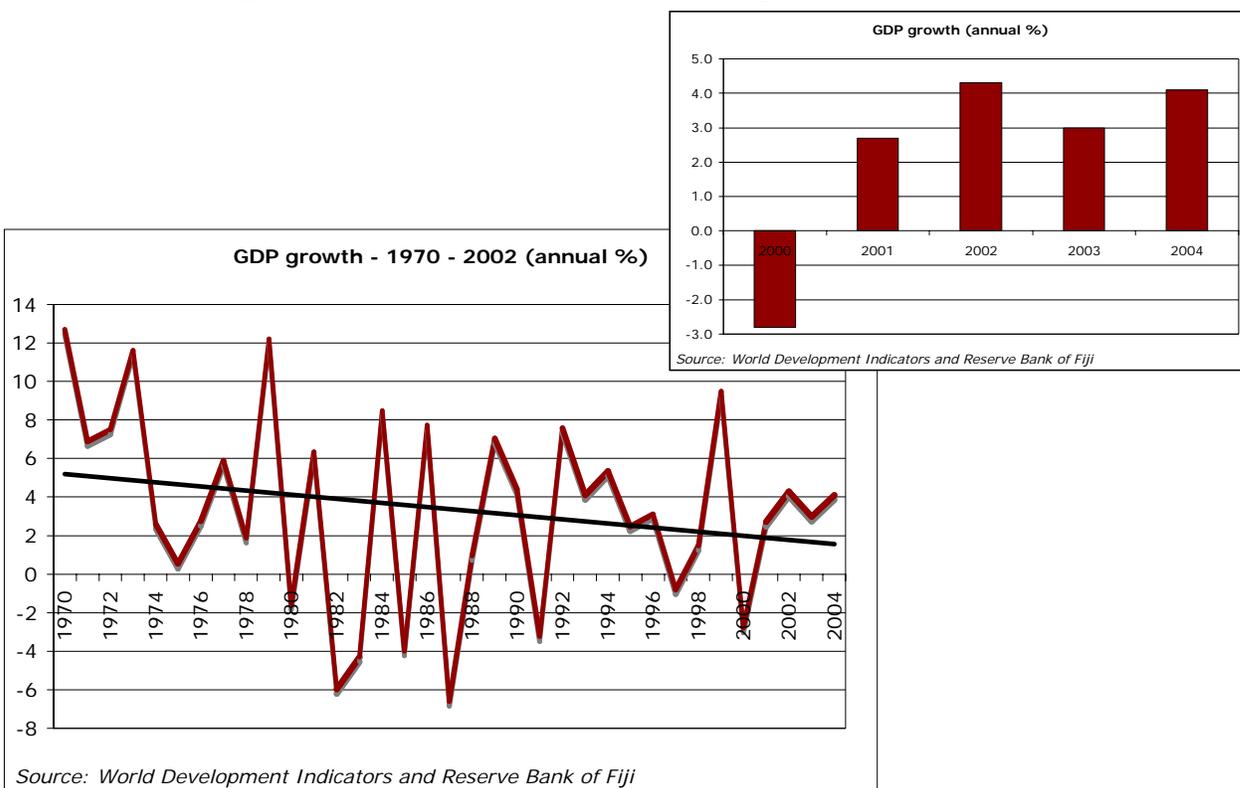
Upgrade Infrastructure to Reduce Business Costs

Action 1: In conjunction with SOE reforms, involve private sector operators and local communities in more infrastructure provision. This could require a review of budget allocations.

II. Introduction

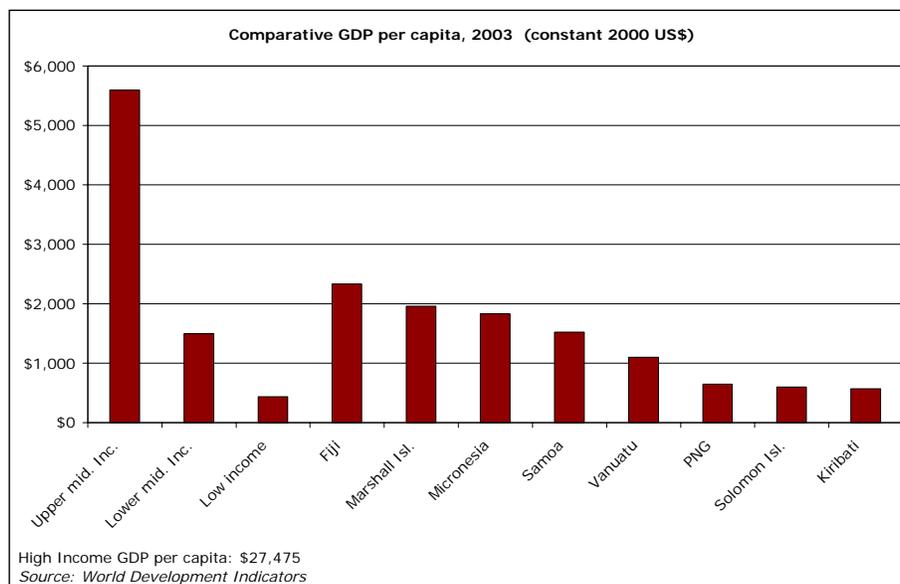
14. Fiji Islands (Fiji) is the largest and most prosperous Pacific Island economy. Whilst relatively isolated, it has rich natural resources, a tropical climate, and a vigorous tourist trade. Some might call it idyllic. But, it is a country that is not without problems. GDP growth over the last 3 decades has been volatile, a problem that has not been helped by political coups and natural disasters. Growth has improved more recently, registering, in 2001 and 2002, real GDP growth of around 4 percent annually, recovering from the negative effects of the 2000 coup, which caused a sharp decline in output. Estimates for 2003 indicate that output grew by close to 5 percent.

Figure 1. GDP Growth, annual percentage, 1970 - 2002



15. During the 1970s, the economy grew at an annual rate of close to 8 percent, above the average of small island economies but growth has been unstable and in general decline over the same period.

Figure 2. Comparative GDP per capita, 2003



16. The Government has recognized the importance of private sector development as the primary means to raise output growth. The National Plan established 5 percent growth as the target, and more recently, the prime minister² and several cabinet ministers have mentioned an eight percent growth rate for the economy as a goal. The government has taken a more proactive stance towards the private sector and is actively pursuing the identification of measures that will raise the investment rate to a level that will support higher growth rates.
17. This report is complementary to this process. It is being undertaken as part of the Asian Development Bank (ADB) private sector development strategy for the Pacific. This Private Sector Assessment (PSA) is the first stage of a possible initiative to identify and remove the obstacles to growth of the private sector in Fiji. The World Bank and FIAS are also analyzing the barriers to foreign investment.
18. Any analyst arriving in Fiji is immediately made aware that the country is suffering severely from consultant and donor “fatigue”. Government officials and private sector representatives recount the numerous meetings that they have had with consultants and representatives from multifarious aid agencies and donors. The disillusionment is especially strong in the private sector. Members of the business community describe the reports that have been written and the lack of follow-up, the fact that nothing changes,

² Speech by Laisenia Qarase, the Prime Minister of Fiji, to the Congress of the Fiji Institute of Accountants, May, 2004, reported in *Local Business News*, Suva, June 1, 2004

and the cynicism that this breeds. And they are right. Much has been written but it has led to no more than minimal reform.

19. Nevertheless, this situation is not a one way street. Recipient countries, Fiji included, cannot claim that all necessary reforms have been implemented. On the contrary, one of the conclusions of this report is that much remains to be achieved and Fiji is only at the beginning of meaningful reform of the business environment. It is, however, encouraging that the government has recognized the need for an improvement in the business environment and has initiated a process of reform. For example, government business councils have been established to advise the prime minister on appropriate measures to boost the role of the private sector in the economy. Both the government and the private sector recognize that much needs to be done.
20. A recent ADB publication pointed out that from the perspective of the private sector, most countries in the region are exacerbating the disadvantages of small size and remoteness by implementing policies that increase the undesirable impact of these factors on their economies³. Fiji is no exception and must bear the responsibility for these policies.
21. The aim of this document is to challenge the Government of Fiji, Fiji's private sector, the ADB, and other donors to cooperate to achieve the necessary reforms. Cooperation and a unified front are necessary to overcome the many vested interests that currently exist. It is common, for example, for private sector operators in Fiji to blame government bureaucrats for their failure to implement reform without admitting the extent to which entrenched private sector interests benefit from the distortions in the economy. Many also benefit from the extensive role of the state in the economy, from high public sector salaries to overstaffing of ministries and agencies. Reform implies that some beneficiaries of the status quo will have to make concessions in the short/medium term in order to improve the business environment. However, if the result is dynamism and entrepreneurship that leads to more investment and growth, all will benefit in the longer run.
22. Achieving a thriving business environment entails introducing competition where monopolies previously prevailed, implementing regulatory restraints where monopolies

³ See *Swimming Against the Tide? An Assessment of the Private Sector in the Pacific*, the Asian Development Bank, Manila, 2004

cannot be competed away, and realizing that the public sector exists to provide service to the whole population, not to entrench the interests of the employees of government or state-owned enterprises (SOEs). Deviations from the path of reform should be questioned, acknowledged, and corrected. And above all, it is necessary to have faith that the resourcefulness of Fijians will triumph if given the chance to succeed. In the past these abilities have been stifled by the heavy hand of a State that engages in business activities in which it has no expertise and yet fails to provide the essential elements of an environment in which private sector activities can succeed.

23. It is also our hope that the donor community will consider this report as a call to action and ensure that there is close coordination between them so that Fiji receives unified advice that is backed up by the funds and technical assistance necessary to initiate reforms.
24. This report is written at a time when a substantial number of initiatives are getting underway. The ADB has started on an analysis of the legal commercial framework for private sector development in three Pacific Region countries, one of which is Fiji. A summary of the initial analysis is contained in this report. The ADB is also about to examine the basis for collateralized lending in several countries in the Region, including Fiji. The World Bank/FIAS have begun to review foreign investment regulations and practices. These developments are all to be welcomed and are consonant with one of the messages of this work, namely that some of the problem areas require in depth analysis that will identify further reform initiatives. To complement these processes, the paper suggests some areas for closer examination that should occur as part of these activities that are getting started.
25. This report aims to be as succinct as is congruous with analyzing the issues. It presents the arguments and conclusions as briefly as is possible in making a case for change that will bring vibrancy to the private sector of the Fijian economy and set it on high growth trajectory. It identifies the most important factors that hinder private sector activity in the country. It does not aim to be encyclopedic, but rather to focus on the key issues in order to keep it within a manageable length. The structure of the document is as follows. Chapter II provides a summary view of the analysis and recommended course of action of the report. Chapter III is a discussion of the incentives and distortions faced by the private sector in Fiji. Chapter IV reviews the pervasive role of the State in

the economy. Chapter V discusses property rights and their impact on private sector development. Chapter VI is a discussion of the legal basis for business commerce. Chapter VII analyzes Fiji's financial markets, which do not finance investment effectively. The paper concludes with policy recommendations and activities that would improve the environment for private sector development and unleash Fiji's growth potential.

III. Costs of Conducting Business in Fiji

A. Introduction

26. There is increasing evidence that high transactions costs, weak property rights, and overly burdensome regulation creates distortions and harms growth and entrepreneurship. As a recent World Bank study of business indicators points out:

“Payoffs from reform appear large. A hypothetical improvement in all aspects of the Doing Business Indicators to reach the level of the top quartile of countries is associated with an estimated 1.4 to 2.2 percentage points in annual economic growth....How significant is the impact of regulatory reform? Very.”⁴

27. Both the interviews with entrepreneurs, as well as the recently published *Doing Business Indicators* of the World Bank reveal that constraints to private sector development exist in many areas in Fiji. Transactions costs are high; microeconomic incentives do not promote efficient allocation of resources; property rights are weak; financial markets do not fund investment and entrepreneurship effectively; the commercial legal system for private sector activity is outdated; there is pervasive government presence in many sectors that results in bureaucratic delays and onerous red tape; and the State has an ownership share in nearly 30 companies and public corporations.

28. A theme of earlier work by the authors is that the general approach to economic development in the economies of the Pacific Region has been unsuccessful. At the root of this issue is the low return on capital in most countries, Fiji included, that is frequently the result of governments’ interference in the regions economies. In addition the inefficient use of the capital by the public sector drags down the growth rate⁵. At the same time, the state is not providing the essential foundations of a well functioning

⁴ *Doing Business in 2005: Removing Obstacles to Growth*, The World Bank, Washington, DC 2005

⁵ A recent investigation of the determinants of economic growth across a large number of countries shows that the higher is public sector investment (including that of SOEs) in overall investment and the larger the share of the government in the economy, the lower the long run growth rate. Currently, public sector investment accounts for 75 per cent of total investment in Fiji. See: Determinants of Long-Term Growth: A Bayesian Averaging of Classical Estimates (BACE) Approach, By Xavier Sala-I-Martin, Gernot Doppelhofer, and Ronald I. Miller, *American Economic Review*, Sept 2004, pp. 813 - 835

business environment. In the pages that follow, these themes are developed at greater length. The chapter provides evidence on business environment issues that were identified through interviews with the private sector in Fiji and by recent World Bank data on business environment indicators. It then discusses some of the other important related issues and provides a set of possible reforms and action items that can be pursued to improve the business environment.

B. Fiji’s Costly Business Environment

29. Fiji is a costly place in which to conduct business. Starting and running businesses, enforcing contracts and closing businesses down are complex and time consuming processes for local entrepreneurs and even more so, for foreigners. It is an environment in which transactions costs are high and business faces many constraints.

1) The Costs of Business Start-up

30. Firstly, starting a business, although not costly in monetary terms, is a time consuming exercise that World Bank data indicate takes over 2 months, not counting the time during which the name of the business must be reserved. This compares with 2 days in some advanced economies. At the same time, the advantages of being formal are lower, which results in incentives for businesses not to formalize.

Figure 3. Comparative Data on the Number of Days to Start a Business

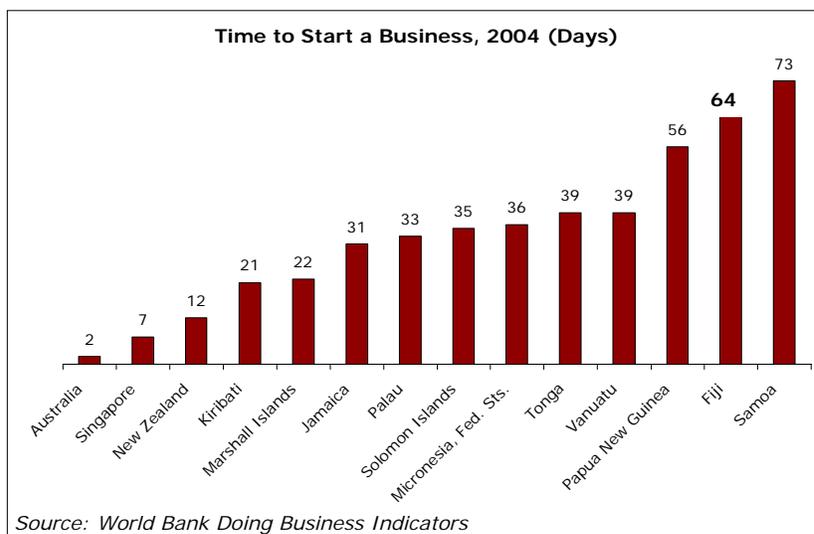
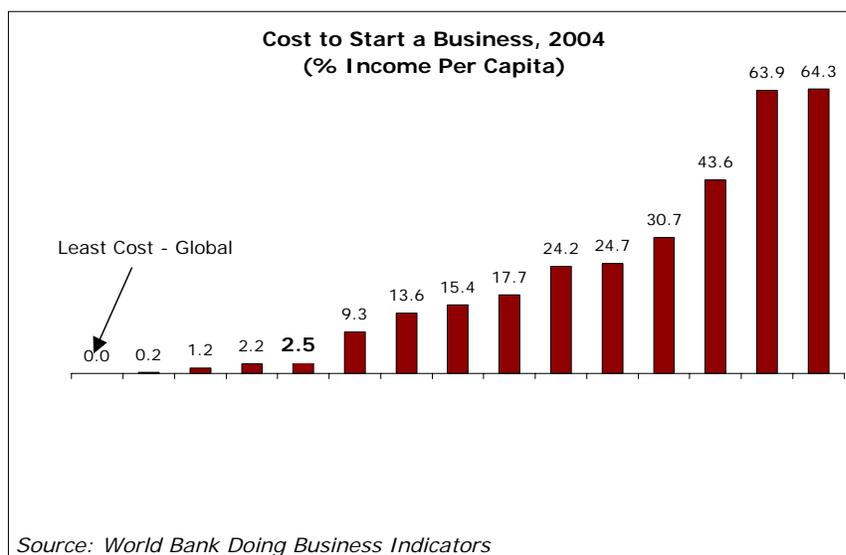


Figure 4. Comparative Cost to Start a Business



31. The steps that the World Bank analysis identifies for local businesses consist of:
- Checking the uniqueness of the proposed company name.
 - Registering the company with the Companies Registrar.
 - Registering for income tax and VAT.
 - Applying for a business license in each city town or province where the company carries on business.
 - Registering as an employer with the Fiji National Provident Fund (FNPF).
 - Opening a bank account.
32. In addition, analysis of company law reveals that there are stringent requirements for the appointment of directors, which appear to serve no economic purpose, but increase the difficulties of registering a business.
33. While each of these steps in itself is not onerous, they require visits to different offices and waiting on the approval of one agency before the next can be completed. Modern practice does not link one step with the completion of a prior requirement. The costs imposed by the registration procedures required by Fijian regulation include:

- *Direct Monetary Costs* arising from the fees and charges that are involved in the registration process. In Fiji, these are relatively modest, according to the World Bank Doing Business Indicators.
 - *Indirect Costs* that result from the administrative procedures involved as well as the foregone revenue resulting from the time not spent running the business. In Fiji, these indirect costs are substantial, especially for foreign investors. They arise from the need to employ lawyers and accountants to assist in the process.
 - *Additional Costs for Foreign Businesses.* In practice, most foreign investor applications are approved eventually. However, the tortuous path involved in going through such applications takes months or years – a representative of a foreign investor indicated that his client had been attempting to obtain permission for a very large tourism investment for nearly two years. The cost in terms of actual outlays and opportunities foregone was of the order of F\$10,000 per day and was starting to total in the millions. The investor was on the verge of withdrawing his application and going elsewhere, which would mean the loss of several thousand jobs that would have been created. It is also not only large investors that experience problems. Several of those interviewed recounted the anecdote of a New Zealand yachtsman who arrived in Fiji, liked what he saw and attempted to open a marina and slipway for yacht repair. After 12 months of going through the application process, he left in frustration. A small but significant investment was lost together with the creation of several dozen jobs.
34. A further problem is that in some government departments, the rules governing the approvals process are not written down in a way that an entrepreneur trying to establish a business can clearly see the necessary steps, how they link together, and the criteria determining how an application is evaluated. Instead, applications are moved within government departments in ways that are opaque to outsiders. One of the aims of the FIAS project is to document carefully the exact steps so they are available to investors.
35. Further complications exist in obtaining approvals for integrated tourist resorts. At the outset, the investor has to obtain town planning approval, a step which appears to be justified. However, even though subdivision may be part of the initial plan, and be

approved as part of the overall project, when the subdivision actually takes place, town planning regulations require that applications for subdividing be submitted again.

36. In practice, therefore, the regulations and procedures involved in starting a business in Fiji constitute a substantial constraint to investment in particular and private sector development more generally. If an entrepreneur wishes to incorporate rapidly, he or she must buy an off-the-shelf company from one of the major accounting or law firms, the cost of which is not insignificant.
37. Forcing potential entrepreneurs to navigate formidable administrative roadblocks pushes many smaller businesses into the informal economy or into becoming sole proprietorships. This type of business structure effectively excludes local business from bank borrowing because, as a later section of the paper points out, banks rarely lend to unincorporated businesses in Fiji. Furthermore, such procedures discourage first time entrepreneurs, the majority of whom are likely to be native Fijians. One of the themes of this report is that barriers to private sector development in Fiji impact indigenous peoples most heavily, which belies the official policies that are nominally directed towards encouraging local businesses.
38. One of the justifications of the process is the view that because Fiji is small, it cannot afford to allow businesses to start up that look as if they will fail. Therefore, the process includes vetting the reasons for the establishment of the company and its prospects for success. This view is mistaken on two grounds.
 - It is impossible for officials in the government departments vetting the application to know whether the prospects for the business are good, what the quality of the management is, and what its market niche is. Even investors and bankers, who are much closer to businesses, have great difficulty determining the likelihood of businesses succeeding.
 - The most dynamic economies are those where businesses are not only created in large numbers, but also fail in large numbers. Business failure is an essential part of the process that Schumpeter, the famous economist of the early 20th century labelled “creative destruction”. It is only through failure that entrepreneurs and markets learn what does and does not work. Small economies need flexibility

even more than large economies because they are subject to forces outside of their control to which they must adapt as quickly as possible if they are to be dynamic. Procedures that are currently being implemented in Fiji, are antithetical to business dynamism.

39. To reiterate the message of the preceding paragraphs, there is little to justify the current complexity of the process, nor the special rules that are applied to foreign investors. The FIAS initiative to review and streamline foreign investment procedures, which is being undertaken at the request of the Government, is most timely. Since it coincides with an analysis of the legal framework for private sector development in Fiji, there is abundant potential synergy between the two initiatives that have the potential to transform the process of business formation as well as the legal foundation for contracting. The more the reviews are extended to deal with local investors, the more beneficial they will be. There is no convincing rationale for distinguishing between different types of investors, whether they are local, foreign, indigenous or expatriate⁶. There is, therefore, a strong case for the investment and legal review processes to embrace all procedures and laws that apply to businesses more generally. A preliminary review of some aspects of the legal issues involved in investment procedures process appears in Chapter VI below.

2) The Costs of Running a Business

40. In all countries in the Pacific Region, it is costly to do business and Fiji is no exception. These high costs are usually attributed to the small size and remoteness of the countries. However, *Swimming Against the Tide* concluded that the impact of size and distance on the business environment are frequently exaggerated and public policy actions are the main contributors to high costs:

“In the Pacific, the effects of isolation and size are compounded by misguided government intervention that further pushes up costs and reduces competition...Utility services, telecommunications, and transportation in the Pacific are among the most costly in the world. Rather than ameliorating the problems of size and distance, the presence

⁶ Even in such areas as mining licenses and royalties, there is no reason to favor, or discriminate against investors on the basis of their nationality or origin.

of the state in the Pacific can be likened to a tax on development”.⁷

41. In this regard, Fiji is little different from other countries. Costs include:
- *Ongoing Monetary Expenses*, which arise in Fiji from the payment of taxes, permits, fiduciary insurance and social security payments as part of the process of operating the business.
 - *Ongoing Indirect Expenses* resulting from the costs of compliance with regulations and taxes, a part of running the business. In Fiji many of those interviewed complained, not about the complexity of these requirements, but rather about the delays involved in dealing with the bureaucracy. In particular, there were strong complaints about delays in VAT refunds.
42. Other costs that impact the running of business in Fiji are the costs of communication, and utilities. All of which greatly add to the expense of doing business.

a) Telephone Costs and Internet access

43. Fiji, like other Pacific Region countries is far from the nearest large markets, has a growing tourist industry, as well as nascent manufacturing industries that are oriented towards the export market. Yet, international telephone calls are among the highest in the world. While the costs of international calls in Fiji is lower than in some of the other Pacific countries, telephone communication costs remain a major expense to companies that are trying to do business outside the country. The main reason for the high cost of calls in Fiji is that the telecom company, Telecom Fiji Limited, (owned by Amalgamated Telecom Holdings (ATH)), has a monopoly on local land telephone communications. The lack of competition is compounded by ATH managing the government’s 51 percent holding in Fintel, the company that has the monopoly on international calls. The other 49 percent is owned by Cable and Wireless, a British company that also has interests in other Pacific Region and developing country telecom companies, in many of which tariffs happen to be extremely high.

⁷ *Swimming Against the Tide*, ibid. p. 6

Table 1. Telephone Costs

Country	Telephone Call To US (US\$/Minute)
Australia	~0.16 ^a
Micronesia	0.60 – 1.20 ^b
Tonga	0.75 – 0.80 ^c
Palau	1.15-1.50 ^d
Fiji	1.46^e
Vanuatu	1.56 – 2.00 ^f
Solomon Isl.	1.65 – 2.96 ^g
Samoa	1.74 ^h
Marshall Isl.	2.00 ⁱ
Cook Islands	2.06 ^j
Kiribati	2.42 – 3.03 ^k
Tuvalu	4.00 ^l

Notes: Rates are for October 2004, using the exchange rate on Nov. 4th, 2004 to convert to US Dollars. If a range is provided, it is for off-peak (weekends and evenings) and peak times. (Except for Tuvalu and Marshall Islands for which recent information was not readily available. See reference notes for those two countries.)

^a Source: Telstra http://www.telstra.com.au/phones/homeservices/distance_international.htm

^b Source: FSM Telecommunications Corporation <http://telecom.fm/phones/international.htm>

^c Source: Tonga Communications Corporation http://www.tcc.to/rates_new.html

^d Source: Palau National Communications Corporation http://www.palaunet.com/html/products_services/long_distance.html

^e Source: FINTEL http://www.fintelfiji.com/s_telephone.html

^f Source: Telecom Vanuatu Ltd <http://www.vanuatu.com.vu/english/telephoneCallingRates.htm>

^g Source: Solomon Telekom Company Ltd. Email correspondence with customer service

^h Source: SamoaTel Rates include 12.5% VAGST http://www.samoatel.ws/call_plan_international.asp

ⁱ Representative, converted to US\$ using the ave. exchange rate for 2001. Source: The World Bank. 2001.

^j Source: Telecom Cook Islands Ltd <http://www.telecom.co.ck/rates.htm>

^k Source: Telecom Services Kiribati Ltd <http://www.tskl.net.ki/idd.html>

^l Source: ADB, Tuvalu 2002 Economic and Public Sector Review

44. Many of those in the private sector who were interviewed as part of this work complained not only about the high cost of telephone service, but also about the quality (or lack thereof) of the service that they received – one interviewee said that she had been waiting for an additional line for several years.
45. The Fiji National Provident Fund (FNPF) owns the majority share of ATH, which it purchased for F\$300 million several years ago. This investment complicates the telecom monopoly issue. Part of the purchase included an exclusive operating license for Fiji Telecom until 2014. The purchase was controversial for several reasons, including FNPF having bought the company for a price that was substantially larger than the second rank bid (a phenomenon that is known as “The Winners Curse”). Determined to ensure that the investment is profitable, FNPF has defended the monopoly position of Telecom Fiji aggressively. The company has set high telephone charges that are consistent with its sole provider status⁸. Although rates have recently declined [October 2005], charges remain very high for a remote country that relies on its contacts with the

⁸ Encouragingly, however, the cross subsidization between local lines, business lines and international calls has recently been eliminated.

outside world for a major part of its trade and business. The result has been that ATH is the single most profitable investment of FNPF, having earned rates of return on equity that have averaged over 25 percent for the past 4 years.

46. Furthermore, through FINTEL, Fiji Telecom/ATH also controls Internet access, the rates for which are also high. New internet providers are beginning to be licensed, but the process is slow and charges remain high. The Chairman of ATH was quoted in 2004 as saying:

“...if you control the access, you control the business so we are not apprehensive of any future competition arriving in the country.”⁹

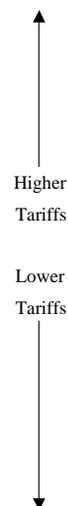
47. Little appears to be changing to broaden access substantially. FINTEL is said to be charging rates consistent with the recovery of the large sunk costs of access to Southern Cross Cable. This does not bode well for future reductions in charges through competition. Recent announcements regarding lower rates have been made. But the bottom line is that a vital communications link with the outside world, one on which the private sector in Fiji depends for its suppliers and its markets, adds greatly to the cost of doing business.

⁹ The Review. June 1, 2004. “A Bigger Giant. ATH and Cable and Wireless Bury the Hatchett.” Suva, Fiji.

b) Utility and Transport Costs

Table 2. Electricity Tariff Comparison Rates

UTILITY	DOMESTIC	UTILITY	COMMERCIAL	UTILITY	INDUSTRIAL
Vanuatu	0.2414	Tahiti	0.2700	Tahiti	0.2700
Tahiti	0.2156	Kirabati	0.2529	Kirabati	0.2529
Pohnpei FSM	0.2000	Vanuatu	0.2258	Cook Islands	0.1819
Kirabati	0.1991	Cook Islands	0.2228	Vanuatu	0.1817
Cook Islands	0.1864	Pohnpei FSM	0.2000	Tonga	0.1816
Tonga	0.1816	Solomon Islands	0.1875	Pohnpei FSM	0.1800
Samoa	0.1800	Tonga	0.1816	Pohnpei FSM	0.1800
American Samoa	0.1616	Samoa	0.1800	Kosrae FSM	0.1750
Kosrae FSM	0.1500	American Samoa	0.1790	Solomon Islands	0.1733
Solomon Islands	0.1496	Marshall Islands	0.1600	Marshall Islands	0.1600
Niue	0.1364	Saipan	0.1600	Saipan	0.1600
Marshall Islands	0.1200	Kosrae FSM	0.1500	American Samoa	0.1521
Saipan	0.1100	Niue	0.1364	Niue	0.1364
Fiji	0.0853	Palau	0.1200	Palau	0.1200
Palau	0.0800	Papua New Guinea	0.0865	Fiji	0.0859
Papua New Guinea	0.0462	Fiji	0.0859	Papua New Guinea	0.0460



48. Electricity costs, while they compare favourably in the region, are similarly high. The Fiji Electricity Authority (FEA) generates power. It is a wholly owned commercial statutory authority that has three strategic business units that separately manage power generation, the grid network, and the retailing of electricity. It is the largest commercial organization in Fiji with assets of some F\$500 million and over 1000 employees. It has a monopoly in power distribution, although it does allow private generators to supply excess power to the grid at a predetermined price. The Fiji business community complained of the unreliability of service, which forces those that depend on uninterrupted supplies of power to install costly generation facilities. Poultry breeders, for example, have had extremely high mortality rates as a result of power outages.
49. Similar issues exist with respect to port costs and airfreight costs. Moves are underway to sell Ports Terminal Limited to workers, which has the potential for the development of competition in stevedoring services but this outcome requires that exclusive handling rights not be part of the sales package.
50. To hold down the costs of monopoly services a regulatory body that is immune to regulatory capture is necessary, which can be a major issue in a small economy. Since it is likely that regulators and the regulated would meet not only in the course of business, but also socially, arms length decisions become more difficult. A way of dealing with

this situation would be to cede control to a regional regulator who would visit periodically to set rates in industries and sectors where monopolies exist. This arrangement does raise sovereignty issues. An alternative approach suggested by one of the authors of this report involves having a panel of outside regulatory experts hold regular hearings on rate setting for the various natural monopolies that exist in Fiji, both government and privately owned. The hearings and findings would be made public. The panel could make non-binding public recommendations and then leave it to public and political debate within Fiji to decide on the actual rates that are set¹⁰.

C. Incentive Issues

1) Introduction

51. When entrepreneurs and investors are left to identify and exploit business opportunities without interference or “guidance” from the State, resource allocation is most efficient and long run growth is maximized. In country after country, attempts to “pick winners” or promote specific sectors have led to misallocated resources and wasted investment. This observation applies not only to specific sectors or activities, but also the form in which investment takes place – investors themselves are the best judges of whether the investment should be capital intensive or labour intensive, or whether it should involve manufacturing, agriculture, or services. That is not to say that they will always be correct – in fact there is abundant evidence that a majority of start-up companies fail within the first five years of opening. This is not bad! The very process of attempting to invest in what appears to be business opportunities speeds up the identification of comparative advantage and promotes growth. This is not an area in which government employees, or development professionals have expertise.
52. Unfortunately there is now substantial evidence that governments’ attempts to promote incentives, or to encourage particular sectors leads to wasted resources, squandered opportunities and lower long run rates of economic growth. Such policies perpetuate the poverty that they are meant to alleviate.
53. Furthermore, there is no evidence that incentives promoting particular types of business activity, or sectors of the economy, have any impact on the overall volume of

¹⁰ Paul Holden, Address to Donors, FEMM Meetings, New Zealand, 2004.

investment. Nor is there evidence that offering general incentives has a long lasting effect. Such inducements run the risk of promoting competition with neighbouring countries, which leads to a “race to the bottom”, with each country bidding against others to attract investors, who can then play them off to obtain the maximum advantage.

54. There are a number of incentives that distort private sector behaviour and resource allocation in Fiji, the most important of which arise from tax holidays offered to investors.

2) Investment Incentives in Fiji

55. Fiji has a comprehensive set of tax holidays and accelerated depreciation allowances for new investment. These incentives give companies, primarily but not exclusively owned by foreign investors, extended tax holidays of up to 20 years for new investment. For many domestic companies, accelerated depreciation allowances permit investment to be written off over a much shorter life than the life of the capital. For example, the building industry can write off construction investment over 7 years. The result is that many of the larger businesses in Fiji pay little or no tax.
56. In the tourism industry, investments in excess of F\$40 million, qualify for a 20 year tax holiday plus 20 years of duty free imported inputs. Investments below F\$40 million qualify for a 10 year tax holiday and 10 years of duty free imports¹¹. It was reported that some investors have been able to obtain concessions that exceed these limits, but these claims could not be verified.
57. By contrast, many smaller businesses do not qualify for the allowances, either because the investment is too small or because they are sole proprietorships. Since the company tax rate is relatively high, it means that small businesses are placed at a disadvantage relative to larger companies. The incentives offered in Fiji also have a strong capital-intensive bias – investment in plant, equipment and buildings attracts more favourable treatment than investment in human capital or in service industries where the capital labour ratio is low. If a particular type of investment attracts lower tax rates than

¹¹ The Hotels Aid Act provides for these incentives

another – say a manufacturing plant over a service industry – then not only is the manufacturing investment favoured, the service investment is put at a disadvantage.

58. The question also arises as to whether incentives play any part in encouraging more investment. A comprehensive analysis of foreign direct investment linkages in small states implies that incentives as an instrument for attracting foreign direct investment (FDI) are liable to be ineffective¹². It also indicates that in a small economy like Fiji, the service sector is likely to be most attractive to foreign investors. Yet in Fiji, the most significant incentives are provided for manufacturing investment, precisely that which the same report indicates has the least flow-on impact. The wisdom of such measures is questioned in an analysis done for the Commonwealth Secretariat¹³.

“For manufacturing, on the other hand, the barriers look very high indeed, and if we wish such industries to develop, the leverage of any corrective policies will need to be correspondingly high. One common response is that since the costs of trading are so high, small countries need the right to protect their industries. This is completely misguided. The problem is not that that imports can get in too easily but the very opposite. Adding barriers to trade will exacerbate not relieve the problems of smallness. Even where local industries could be successfully established behind tariff walls there is nothing in the foregoing analysis to suggest that such an approach would be economically beneficial.[p31].”

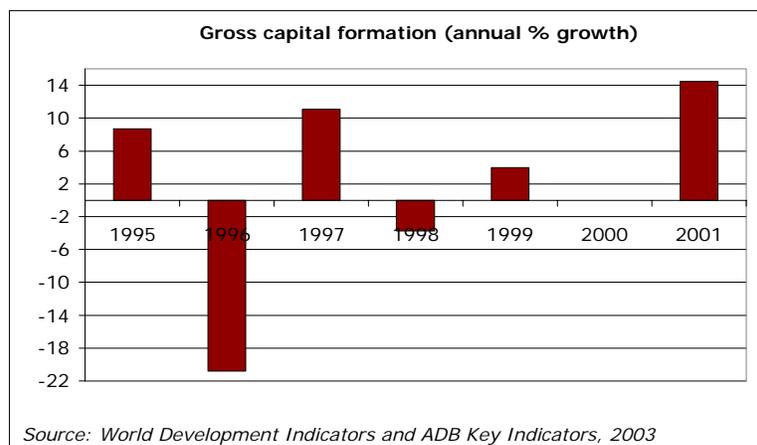
3) The Impact of Incentives on Investment

59. In spite of significant incentives, investment remains low – investment as a percentage of GDP averaged less than 15 percent in the 1990s, fell to around 10 percent as a result of the political uncertainty after the recent coup, and remains well below the level required to induce a long run growth rate consistent with high employment generation.

¹² *Linkages and Flow-on Impacts of Pacific Island Investments: Final Report*, Pacific Islands Forum Secretariat and Foreign Investment Advisory Service, 2004

¹³ L. Alan Winters and Pedro M.G. Martins, *When Comparative Advantage Doesn't Matter: Business Costs in Small Economies*, Commonwealth Secretariat, 2004.

Figure 5. Gross Capital Formation (annual % growth)



60. Rules of thumb (admittedly very approximate) indicate that a long run growth rate of 5 percent, requires gross capital formation of at least 25 percent of GDP, of which more than 50 percent should be private sector investment. Currently, private sector investment remains in the range of 4 – 6 percent of GDP. Levels that are much below what is needed.

a) Incentives, Tariffs, Price Controls, and Linkages

61. A further privilege received by investors who qualify for tax holidays is the right of duty free imports. This arrangement implies that imports are cheaper for this sector of the economy. While it might make sense for companies that are manufacturing for export, the impact is quite different in the tourism sector. In the course of this investigation, many pointed out that value added in the tourist sector was disappointing and that tourist resorts imported many of the foodstuffs that they use. This is not surprising, given the way that incentives are structured for the following reasons:
- There are price controls on the sale of food in Fiji. The effect of these controls is to push down the quality produced – high quality food is more expensive to produce but the prices are still controlled in the same way as for low quality food. In other words, there is a strong incentive not to produce high quality.
 - Since tourist operators with tax holidays pay no duty, imported food has a lower price relative to imports of food to other sectors or smaller operators.

62. The impact of the duty structure and price controls combined is therefore harmful to smaller tourist operators and to the development of the agricultural sector in Fiji, a vital part of the economy.
63. A further aspect of regulation is also harming the tourist sector. The tourism industry has a strong interest in having airfares as low as possible, something that might not be in the best interests of the airline industry that would naturally wish to limit competition and keep fares high. However, regulating flight arrivals in order to maintain the profitability of airlines damages the profitability of the rest of the tourist industry, which employs far larger numbers of people. It is noteworthy that in the Caribbean, the Dominican Republic is the only country that has an open skies policy that has resulted in airfares that are 25 per cent lower than the average of the other countries in the Caribbean Region and has the fastest growing tourist sector. Recently, there is a regional initiative to adopt an open skies policy. This report recommends strongly that Fiji join the initiative.

b) Options for Increasing Private Investment

I) EXPANDING THE SCOPE OF EXISTING INCENTIVES

64. Currently, substantial tax holiday investment incentives are granted for investments that are F\$10 million or more. Earlier sections described the effect on resource allocation and the capital intensity of investment of these and other investment incentives such as accelerated depreciation allowances. Since private sector investment remains low, however, one option for raising it would be to extend the scope of the incentives to encompass more categories or lower limits that would be required to qualify for benefits. However, the more extensive such incentives become, the closer they come to a zero company tax regime. Furthermore, unless the rates are reduced to zero, the advantages of lower tax rates are offset by the distortions that were outlined earlier. The implications of lower tax rates are discussed in the following sections.

II) CHANGING THE STRUCTURE OF INCENTIVES

65. Incentives work best when they are neutral across activities, something that is impossible under the current incentive scheme. The conclusions of this analysis are stark. Incentives designed to attract investment appear not to be successful in aggregate

as evidenced by the low investment rate, and in addition are discouraging the development of important sectors of the economy.

66. The incentives therefore do not appear to be a substantial factor in promoting a vibrant business climate. They also do not necessarily retain investment that was originally attracted by tax holidays - there have been cases of companies leaving Fiji once their tax advantage has expired. The recently announced move by Pacific Green to relocate its production elsewhere is a case in point. In addition, companies acquire value simply by virtue of having been granted a tax holiday without any of the actual investment having taken place. It is time to reconsider the strategy of offering tax incentives.
67. At the same time that tax holidays and accelerated depreciation allowances are granted, the company tax rate remains over 30 percent. Some argue that this is not high because it is lower than, for example, Australia. This is a false argument. First, tax collection from companies is relatively low. Second, this rate of tax is high enough to induce significant evasion, with many companies keeping two sets of accounts. In fact, many bankers, interviewed for this report, maintain that financially sound companies do not qualify for loans because of this situation – the banks cannot use the “unofficial” accounts as a basis for judging the soundness of a loan and if the banks see the unofficial accounts they are obliged to hand information to the tax authorities if asked. The third reason for questioning the company tax rate is that if the rate were substantially reduced, but applied impartially and vigorously across the board, it is likely that the tax revenue from company taxation would rise and the costs imposed by encouraging businesses to spend time and resources evading the tax would be removed. Finally, the question to ask is not what the tax rate in Australia or the United States is now, but what was it when these countries had the same per capita income as Fiji does now. For Australia in 1920, the sum of direct and indirect taxes amounted to 3.7 percent of GDP¹⁴!
68. So the question becomes, if this policy were to be implemented, what would the appropriate company tax rate be? Detailed analysis of the question requires investigation that is beyond the scope of this paper. However, some approximate calculations

¹⁴ Tanzi, V and L. Schuknecht. 2000. Public Spending in the 20th Century, A Global Perspective. New York, USA.

indicate the likely impact of changing the company tax rate on collections. Unfortunately, national income data, which show the share of profits in total income is not available for Fiji so any calculation requires some substantial assumptions. Nevertheless, some broad idea of magnitudes can be obtained.

69. In 2003, Company Tax collected was F\$116 million, approximately 14.5 percent of total tax collected. If, say, the company tax rate was reduced to 15 percent¹⁵ from its current level and no other changes occurred, total revenue would fall by some F\$61 million, or about 7.5 percent of the total tax take. However, tax concessions would also be abolished. How much would this add to tax revenue? There are no estimates of the cost of concessions, but foreign direct investment amounts to some 4 percent of GDP. Assume that 90 percent of FDI qualifies for investment incentives, investment that is the equivalent of 3.6 percent of GDP, and is not taxed. If the rate of return on this capital is 20 percent, then profits of 0.72 percent of GDP escapes taxation. Remembering that investment is a flow, and that the relevant tax calculation occurs on the stock of capital, we can assume that 5 years investment is not being taxed. This would amount to about 3.6 percent of GDP. At a tax rate of 15 percent, the current foregone tax from investment might be in the region of F\$19 million. This calculation is obviously very rough and ignores discounting issues. However, this rough estimate shows that if tax concessions were abolished and nothing else changed, there would be a net loss in revenue of about F\$42 million or about 5 percent of net revenue in 2002.
70. In addition, dynamic factors should also be taken into consideration. First, existing businesses who currently pay tax have greater incentive to expand, as their after tax rate of return would rise substantially. Second, existing businesses that evade the company tax would also have an incentive to formalize, particularly if this was combined with a reform of the collateral framework that would allow them to gain access to financing. Third, improving rates of return on capital would encourage additional investment that would raise growth rates and the overall tax take, not only from company tax but from other taxes in addition. Since distortions in resource allocation that exist under the current incentive system would be removed, there would be further stimulus to growth rates that would add to the tax take. Thus, it is highly unlikely that changing the tax rate

¹⁵ This tax rate is taken for illustrative purposes, and is not meant to be considered a policy recommendation.

to 15 percent would result in a significant revenue loss. Further careful analysis is obviously needed, but the success of other countries in improving their tax take as well as the improvement in resource allocation (see box) makes this an option worthy of consideration.

71. An additional issue, however, is the delay that many companies experience in obtaining VAT refunds. There are numerous complaints that these delays are stretching cash flow and reducing profitability. It is another example of how inefficiencies offset attempts to attract investors. Any reform of the tax system would need to be accompanied by improvements in refunds.

III) RAISING THE LONG RUN RATE OF RETURN ON CAPITAL

72. The third option to raise investment is reform that will increase the long run rate of return on capital in Fiji. This chapter and those that follow analyze the reasons why rates of return in Fiji are low.

Box 1. A Flat Tax – Some Examples From around the World

What is a “Flat Tax system”?

- A *flat tax system* is one where a single tax rate is levied on companies or individuals regardless of revenue or income. No exemptions or concessions are provided to companies or individuals.
- A flat tax system is compared to the more widely used *progressive tax rate system* where as income or revenue increases so do the tax rates. These systems generally make ample use of exemptions and concessions to make the system more palatable to businesses and citizenry and at times achieve often non-efficiency guided policy aims.

Flat taxes are not uncommon in most countries in one form or another (e.g. sales taxes).

Who has introduced a flat tax?

A number of countries around the world have implemented a flat tax on income and revenue. In the mid-1990s Latvia, Estonia, and Poland introduced a flat tax. Estonia saw its revenue double between 1993 and 1999¹⁶. More recently, Russia introduced a flat tax of 13% on income (2001) and a tax of 24% on companies (2002.) The system has been a success as real tax revenues have soared. (See graph). Ireland, the fastest growing country in the EU, introduced a flat corporate tax rate of 12.5%¹⁷. Given Russia and Ireland’s success, other countries have or will introduce a flat tax including the Ukraine, Belarus, and Slovakia (in 2002). China is also considering a flat tax.

How does a tax system effect an economy?

The tax system and taxation rates fundamentally impact behaviour. The higher the taxes the more economic activity is discouraged since after-tax rates of return on activities such as working, saving and investing, which are critical for economic growth, are reduced. In addition, higher taxes also create the incentive for tax evasion.

What is the aim of a tax system?

When it comes to a tax system, any country, large or small should be aiming for taxation that is - simple, efficient, and fair. For a tax system to be:

- *Simple*, it must be easy to understand and comply with and low cost.
- *Efficient*, it must not introduce distortions into the economy. Distortions are generally introduced through the use of exemptions and concessions.
- *Fair*, people or companies of similar circumstances should bear an equal burden.

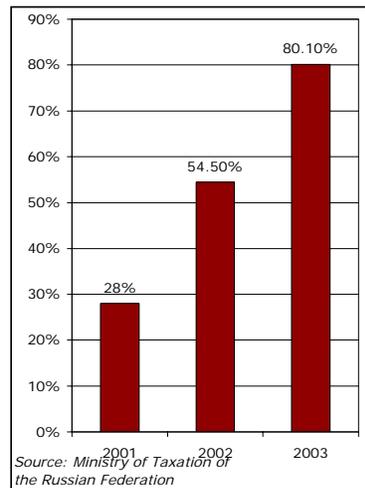
What are the traditional arguments against a flat income or company revenue tax?

- A flat tax allows big businesses and the rich to pay less than their “fair share” of taxes.
- By reducing the overall tax rate, the government’s tax revenue will fall.

Why are these arguments specious?

Few can argue that a flat tax system is not simple and efficient. Given the use of concessions and exemptions in progressive tax systems it has been shown that the large businesses end up paying less tax than they would under a flat tax system. This is because of first the concessions and exemptions they often receive, and second a more systematic process of tax evasion. Smaller businesses that do not have the same resources are not able to lobby for these concessions nor hire the professional “help” to avoid the taxes. Therefore, progressive tax systems prove to be less equitable and more distortionary. And government revenue often goes up rather than down, as was the case in Russia.

Russia's Increase in Tax Revenues Since Flat Tax Introduction (total since 2000)



¹⁶ The Economist. Mar 18th, 1999. “Estonia’s taxing dilemma.” London, United Kingdom

¹⁷ The Economist. Apr 15th 2004. “Dancing an Irish jig.” London, United Kingdom.

4) Other Incentive Distortions

a) Crisis in the Tuna Industry

73. The tuna industry, which accounts for some 3 percent of GDP, is in dire straits. The industry is in serious decline, with major operators indicating that they are considering closing down. Catches have fallen by over 25 percent over the past few years, a direct result of poor management of the industry. The Fisheries Ministry issued well over 200 fishing licenses in 2003 even though the Cabinet set an annual limit of 150. The criteria for obtaining licenses in Fiji are clearly defined but the allocation procedure is far from transparent - there have been accusations that corrupt practices were involved in the granting of licenses.
74. It is critical, therefore, that the government undertake the proper and rigorous enforcement of the legally defined license eligibility criteria and in so doing restore complete transparency in license allocation. Without these actions the Fijian tuna industry will have no hope of achieving some degree of sustainability and eliminating the rent-seeking opportunities.
75. In addition to the number of licenses substantially exceeding the authorized level, local fishing operators have to pay a higher charge for fuel than those who come from other countries. This situation gives offshore operators a substantial competitive advantage over local operators - local operators have to pay the tax while offshore operators do not¹⁸. Combined with the falling tuna catch this situation has placed the local operators in a dire position. Unfortunately, the FIAS foreign investment linkage study¹⁹ concluded that these are the very firms that have the greatest positive linkages in terms of direct employment effects, export earnings, and indirect local linkages. Thus, an absurd circumstance exists where one part of government is attempting to attract foreign investment through the provision of incentives, while another part is responsible for policies that threaten the existence of the firms that the incentives have attracted. The

¹⁸ Operators with a tax holiday pay a 25 per cent excise surcharge while those without the tax benefit pay 50 per cent. Boats who are not based in Fiji do not pay any surcharge at all.

¹⁹ *Linkages and flow on impact of foreign investment in the Pacific Island economies*. Foreign Investment Advisory Services, 2004

locally owned fishing companies are burdened and threatened because they have to pay the highest rate of excise tax on fuel²⁰ while some of their competitors pay none.

76. Restricting access of offshore-owned vessels to fuel would contravene Fiji's international treaty obligations. One option suggested by the FIAS study is to provide a rebate on fuel taxes paid in proportion to the percentage of the catch exported. This report endorses the recommendation.

b) Price and Rent Controls

77. Both price and rent controls exist in Fiji but their exact cost is difficult to ascertain without more detailed analysis. The earlier section outlined the damage that they do to the food producing part of the agricultural sector. The controls specify mark up on cost. Besides the paperwork involved in this, agricultural producers have little incentive to raise quality. There is no distinction in the price control legislation between high and low quality items. This situation encourages agricultural producers to focus on low quality production, because this costs less, and on sectors where price controls are less binding, which may not be those where demand is highest. As pointed out above, this also provides an incentive for the tourist industry to import food rather than to purchase it locally.
78. In other countries, both price and rent controls have been found to be extremely damaging. It is also ironic that Fiji applies price controls to goods such as foodstuffs, where there is competition, but not to telephone and electricity charges where there is none. As a general rule, neither price nor rent controls work in the way they are intended – where they are binding they restrict supply and when they are not they add an unnecessary layer of bureaucracy. As a result, it is advisable for Fiji to remove those controls that remain.

c) Exchange Control

79. The Reserve Bank of Fiji administers a comprehensive system of exchange controls in Fiji. Regulations apply to withdrawals of foreign direct investment, the amounts of profits that can be repatriated by foreign investments, offshore portfolio investments by

²⁰ According to the FIAS study, the largest local firm pays an additional F\$500,000 compared to an equivalent sized foreign firm.

Fijians, emigrant allowances, advance import payments and payments for merchandise imports. These controls also apply to the amounts that FNPF may invest offshore. These regulations serve to discourage foreign investment, distort resource allocation, increase risks for FNPF assets and artificially bolster the exchange rate. This report recommends that they be reviewed and abolished. Nevertheless, the question raises issues for exchange rate policy, which are discussed in more detail in the chapter on financial markets.

D. Communication Between the Government and the Private Sector

80. A recurring theme in discussions with the business community in Fiji was the lack of communication between the government and the private sector. Fortunately several recent initiatives are beginning to change this. In particular, the Prime Minister has appointed a “Brains Trust”, a committee of senior private sector business people to advise him and suggest ways to increase investment and raise the growth rate. In addition, Strategic Working Groups made up of the business community, civil society and government members meet to discuss economic and social issues and advise the government on policy. The National Development Council, on which business associations are also well represented, advise the government on inputs into the National Development Plan. These initiatives are most positive and are to be welcomed.
81. Nevertheless, problems remain. While senior government officials realize the importance of the private sector to the Fiji economy and are aware of many of the issues involved, such understanding does not extend to lower levels of the bureaucracy. This issue is especially pressing among middle level officials who are responsible for administering and implementing policies connected with business incentives and procedures. They appear to have little awareness of the costs involved in bureaucratic delays, complex administrative procedures, and the expense, both direct and indirect, of regulatory requirements.

E. Conclusions

82. Fiji is a high cost business environment, which is only partly the consequence of the size of the country and its isolation. Substantial distortions reduce the desirability of investing in the country both for local entrepreneurs as well as for foreign investors. The actions of the State raise business costs. There is misallocation of investment that arises not only from the inducements offered to foreigners to invest but also from the incentives faced by local entrepreneurs. These incentives tend to make investment more capital intensive than it would otherwise be as well as particularly weighing on local businesses. Coupled with problems with capital markets and business financing, which is discussed later in the report, it is not surprising that the rate of investment is low, nor that many local entrepreneurs prefer to emigrate rather than invest in Fiji. However, change can be achieved if the government and donors take action. It is action that will be difficult given the entrenched interests of the status quo. But it is action that has the potential to free Fiji's private sector from the burdens it currently faces, and provide conditions that could lead to unprecedented growth.

IV. State Ownership of Enterprise in Fiji

A. Introduction

83. In Fiji, the state is involved in a diverse range of business activities. These interests include power generation, air and sea port management, rice milling, cattle raising, a more general agricultural company engaged in crop production and aquaculture, significant shareholdings in telecoms, and a newspaper. The state also exerts considerable control over important industries such as sugar milling and fish processing. In all, the state has shareholdings in 29 entities that encompass nearly all of the important sectors of the economy (Appendix B).

B. SOE Characteristics

1) Poor SOE Performance

84. State owned enterprises (SOEs) suffer from the usual array of difficulties associated with government ownership. As is typical in many other countries, they are characterized by poor financial health and substandard service provision. While each of the SOEs has its own board of directors, the large majority of those directors are drawn from the public sector. So commercially oriented oversight is weak. Poor financial performance results from management difficulties, over-staffing, government interference and, often, poor service standards. In many instances, the government subsidizes loss-making enterprises continually through public resources that could otherwise be allocated for social expenditure.

85. This poor performance has sector as well as economy wide impacts in Fiji. In the relevant sectors, the dominance of SOEs means that the prospects for competitive market behaviour and new entrants are minimal. Overall, the management and performance of these entities impacts national economic performance considerably by dragging down the growth rate.

86. A review of state owned enterprises in Fiji²¹, concluded that with one or two exceptions, the state owned businesses were not earning a sufficient rate of return to cover their

²¹ ADB, 2002, TA 3242FIJ, Public Enterprise Reform Program, 2002

cost of capital. The review calculated that the combined return on assets of SOEs was close to zero, even when the large profits generated by ATH are included. This result implies that the other SOEs are not covering their cost of capital and many are not even covering their operating costs. In other words they are in breach of the Public Enterprise Act, which states that all SOEs are required to be solvent without government support.

87. The electricity generation company, FEA, is a case in point. The previous chapter pointed out that electricity costs in Fiji are high and impose a significant burden on the private sector. In spite of high charges, however, FEA's financial performance is weak. In 2001, FEA's return on shareholders funds was -0.4 percent. Costs were not being fully recovered. The situation worsened in the two subsequent years. In the first part of 2004 the government granted FEA a F\$16.8 million loan and in August 2004 conceded to an increase in electricity tariffs. This move was met with dismay by the private sector, who has called for the abolition of FEA's position as the monopoly supplier of power. Currently, the status of the increase is uncertain. The poor financial condition of FEA is not, however.
88. Total public sector employment amounted to some 32 percent of the labour force in 2000. In 2001, the government wage bill accounted for 11.5 percent of GDP, or 47 percent of government expenditure. Some 20 percent of those employed in the public sector are employed by SOEs²². This dominance in employment has critical implications for the economy. Members of the private sector complain that public sector wages are higher than those paid by businesses and unrelated to productivity. In addition, they complain that the government drives up wages and salaries to the point where it is difficult to find workers at competitive wages. There have been periodic attempts to downsize public sector employment but they have not as yet been met with a great deal of success and in some cases have been reversed²³. The government now aims to reduce the wage bill to the equivalent of 9 per cent of GDP. SOE reform is a critical part of achieving this goal.

²² International Monetary Fund. 2003. Fiji Selected Issues and Statistical Appendix.

²³ Some 500 employees of Airports Fiji Limited [which is 100 per cent owned by the government] were granted retirement packages, including layoff bonuses. Government policy changed, however, and many of the employees that had been laid off were rehired while being allowed to retain their severance payments. This has caused some morale problems among those who continued to be employed, in general the better workers.

2) SOE Governance Issues

89. Provisions governing the management and operation of SOEs fall under two acts – the Public Enterprises Act (PEA) of 1995 and the Public Finance Management Act of 1999. Both were intended to place SOEs on a more financially sound basis and ensure more efficient operation. There are, however, substantial areas of overlap between the two acts as well as different underlying philosophies. The earlier act had the very clear aim of making SOEs financially accountable and, in some cases, preparing them for privatization. On the other hand, the Public Finance Management Act, which has a broader scope and sometimes supersedes the PEA, places far less emphasis on the need for SOEs to be commercially oriented. In addition, each act specifies a different form of governance for SOEs and it is often unclear under which Act the particular SOE's management falls. This situation gives rise to the possibility of inter-ministerial disputes which, in practice, makes achieving effective oversight of SOEs difficult. The problem is further compounded by each act having different performance criteria for SOEs, making accountability difficult or impossible to achieve.
90. This lack of clear accountability leads to governance issues that impede the efficient running of SOEs. The Ministry of Finance owns the share holding in Government Commercial Corporations (GCCs) and is acutely aware of the need for strong economic performance in order to maximize rates of return on investment. The Ministry of Public Enterprises is responsible for performance, while regulation of several of the GCCs is under the ambit of line ministries such as the Ministry of Transport. In addition, governance issues are complicated by the social mandates of some of the SOEs, in terms of which they are required to offer social services, which results in cross subsidization and difficulties in accounting precisely for performance.
91. Currently, there are significant numbers of civil servants on the boards of SOEs, which also has obvious drawbacks. Civil servants rarely have the commercial expertise necessary to provide effective oversight. Therefore the recent statements from the government that the number of civil servants in Board positions will be greatly reduced are strongly welcomed.

C. The Costs of State Ownership

92. A further problem with state ownership is that the state crowds out potential private sector activity by offering below cost services that make private investment in the sector extremely risky. Nevertheless, at the very least there should be no restrictions on competition in the sectors in which the state operates. Frequently, the unstated (or sometimes stated) rationale for the government running businesses is that it generates employment – SOEs are a vehicle for employment generation. This is a poor reason for the government to be involved in commercial activity, however. Labour employed in this way is almost always much less productive than their private sector counterparts, putting the burden for growth on the private sector to a much greater extent than would otherwise be the case. In the long run the economy's growth rate is determined by the rate of return on capital. From this analysis, it is easy to see that state ownership contributes to Fiji's low rate of growth. Rates of return on assets in the SOE sector are below one percent. Therefore to achieve a high growth rate for the economy as a whole, the private sector has to earn a correspondingly higher rate of return on the assets that it invests in order to offset the low rates of return earned by SOEs.
93. Lastly, many of the SOEs in Fiji have been bailed out by government injection of further funding – the recent F\$16.8 million loan to FEA is only the latest example. Borrowing money to finance the losses of inefficient state enterprises has the effect of making funds for private sector investment more costly, which also reduces the growth rate of the economy.

D. What is the Appropriate Role of the State in Ownership?

94. Neither efficiency nor equity considerations provide grounds for the large role of the state in owning enterprises in Fiji. There appears to be an implicit assumption (and sometimes this point is made explicitly) that without state ownership, vital economic services would not be supplied because the private sector is incapable of doing so²⁴. It is

²⁴ At the time of writing of this report there were rumors in Fiji that one of the major international consulting companies had been asked to write a feasibility study for establishing a government owned corporation for the processing and marketing of fish and marine products. The study was rumored to be an impact evaluation on the formation of the National Fishing Corporation (NFC) and an assessment of the viability of the NFC as a state owned commercial company in the fisheries sector. The rumors were that the consultants had

hard to maintain this view, however, when talking to Fijian business people and entrepreneurs. The private sector has the ability and the desire to supply most or all of the services undertaken by government. The state is only needed when the private sector fails, or when there is no market for the services in question. The state should, therefore, focus on creating the conditions in which private businesses can prosper rather than running enterprise themselves.

95. A further illustration of the inefficiencies of state ownership emanates from widespread reports of lack of maintenance and deterioration of infrastructure, particularly for water provision, electricity and roads. It is likely that substantial sums will have to be spent to upgrade infrastructure, making the need for improving the financial viability of SOEs even more urgent in order to release funds for this purpose.

E. Options for Reform

96. Reform options range from outright privatization, to management contracts, to public private partnerships, to corporatisation and to some hybrid of these choices. To identify the particular option for each of the GCCs is beyond the scope of this private sector assessment. Nevertheless, this should not in any way be interpreted as indicating that the task is not important. The low rates of return on assets, the high prices of many of the services supplied by SOEs, the monopoly positions that entrench inefficiencies, and the drain on the government budget are all issues that are seriously hindering the growth of the Fijian economy. The government has initiated steps to clarify the direction of reform. For example, it is establishing a steering committee in the Ministry of Public Enterprises to guide the process and it has identified the Port Authority for reorganization.
97. Current reform efforts of the Ministry fall into the following three broad categories:
 - o **The Restructuring of Ailing Companies.** The government is restructuring struggling companies through private sector participation to make them viable. For

recommended that such an entity be established. However, it is extremely unlikely that there is any basis for such speculation. Firstly, no company of any repute would be sufficiently cynical and lacking in ethics to recommend such a step given the poor performance of SOEs in Fiji. Secondly, it is unlikely that any government agency, especially the Ministry of Fisheries would be interested in undertaking investment in this area, given that the government has committed to reducing the number of SOEs.

example, Rewa Rice Limited, Viti Corps Company Limited, Daily Post Limited, Fiji Ships and Heavy Industries Limited and Yaqara Pastoral Company Limited.

- **Further Reforms.** The government is further reforming those entities and sectors that went through an initial phase of reforms such as:
 - Aviation: The government is separating its commercial function to ensure that it is purely a regulator.
 - Ports: The government is reorganizing and rationalizing the corporate structure of the ports to reduced overheads and increase efficiency. The stevedoring arm of the Company will be positioned for privatization at a later date.
 - Electricity: The government is separating and removing the regulatory and licensing arm from FEA with the view to allow competition in power generation.
 - The Public Trustee Office: The government candidate has identified the Public Trustee Office as a candidate for corporatisation.
 - The Government Handicraft Centre: The government is reorganizing the Government Handicraft Centre for a potential management contract.
 - The Department of Immigration: The government is transferring the frontline border/primary processing role at the airports to the Fiji Islands Customs and Revenue Authority.
- **Declaration of New Entities for Reorganization or Restructuring.** The government has also identified new entities for reorganization or restructuring such as the Department of Quarantine. Other possibilities include the Registrar of Companies, the Department of Animal Health, the Public Works Department, Government Printing and Government Supplies.

98. These are all government activities that should be encouraged and supported by donors.

F. Conclusions and Recommendations

99. It is clear that the substantial presence of the state in running businesses is harming the private sector and reducing the prospects of the economy as whole for achieving high rates of growth. The analysis contained in the ADB TA 3242FIJ, which demonstrated

the very low or negative rates of return currently being achieved by businesses that are owned by the state, provides a foundation for reopening the issue. Recent actions in the area of ports and the airports show that the government is aware of the problem and is taking steps towards reform. ADB support for technical assistance has been requested, something that this report endorses strongly.

100. Decisive action is needed throughout the sector, in particular because the monopoly position of SOEs is greatly increasing costs to the economy, as for example, with FEA. With regard to FEA, this report supports two immediate steps. First, remove the prohibition on private providers supplying power to whomever they wish. This reform will introduce much needed competition and incentives for efficiency. Second, FEA should be advised that it will not be the recipient of any further government guarantees, provided with a timetable within which it must meet strict performance targets, and informed that full privatization is a viable policy option.
101. Since government guarantees or loans are not accounted for in the budget, there is no public policy discussion of the costs and benefits of these public companies. This is an important legal gap. A possible solution is new legislation to set up a parliamentary budget office. With appropriate powers and authorities, such an office could put the costs of all publicly own private companies as well as public credits and subsidies on the national budget. This change would in turn force a public discussion.
102. A further issue is the hidden costs of the social objectives many of the SOEs are required to fulfil. CEOs of the SOEs point out, with justification, that their mandate forces them to supply services to rural areas and poorer sections of the community at a price that does not cover costs. An important first step is to identify what these costs are, so that specific provision can be made in the budget of the entities concerned, which will allow a better evaluation of their efficiencies.
103. The report on SOEs referred to above, outlines steps that would begin to put FEA, and some of the other SOEs on a path to better management and greater fiscal accountability. However, the process of SOE reform was suspended as a result of political uncertainty following the coup. This report strongly recommends that the program for SOE reform be resumed, updated and extended to those entities that were not included in the initial round of analysis. Furthermore, this report recommends that a

more comprehensive review of government-owned businesses be included as part of the analysis – there is no reason why immediate divestment of a number of state-owned businesses should not occur²⁵. Divestment does not necessarily require immediate outright privatization, but could take one of the many forms of public-private partnership that are available – management contracts, “build, operate, transfer” (BOT) arrangements, concessions, introduction of competition in sectors where SOEs operate and so on. For Fiji, tackling the low rates of return earned by SOEs and reducing the State’s involvement in the economy is critical in promoting a dynamic private sector environment. It is highly encouraging that the government is beginning to tackle these issues, which is worthy of strong support from the donor community.

²⁵ In this regard, the authors take strong issue with the rationale for government ownership that appears in TA 3242FIJ. “*This review has stressed many times that the purpose of Government ownership of Public Enterprises is to return a profit to Government*”.(p61). While we agree that SOEs need to be subject to commercial disciplines, the above statement could be interpreted as meaning that governments have opportunities to make profits by running businesses, and even could be used as a rationale for restricting competition. This is our main disagreement with an otherwise excellent review. Government ownership is the preferred option only when there is total market failure that prevents the private sector from undertaking an activity.

V. Property Issues and Private Sector Development in Fiji

A. Introduction

104. Any discussion of the issue of property rights in land must take place within the context that property in the Pacific Region, Fiji included, has a significance that goes far beyond economic issues. It involves spirituality, family and societal cohesion and a connection to place that is profound. Any suggestions for change, therefore, have to take this reality into account. Furthermore, Fiji has made far more progress than other countries in the region in combining the economic necessity of property rights with connection to the land.

105. This chapter discusses property rights as they affect private sector development and then examines topics related to property rights in land and dwellings in Fiji. It also analyzes the implications of the current system for leasing agricultural land as well as the inability of Fijians to use their property as collateral. Property rights related to movable property are discussed in Chapter VII.

B. Property Rights and Private Sector Development

106. Secure property rights provide the foundation for the private sector to engage in long term investments that fuel economic growth and wealth creation. Financial systems cannot evolve without them. In many industrial countries, effective and secure property rights are the basis for a large proportion of the lending that occurs. Startups and business expansion are financed frequently by small business owners' equity in land and buildings. But in the vast majority of transition and developing countries, only the wealthy have the ability to finance the purchase or improvement of their property. This problem arises from the insecure property rights for land and buildings that typically exists in most low income countries around the world. Ultimately, secure individual property rights are the foundation of an efficient market economy.

107. The multiple effects of secure property have only recently been recognized as a critical factor in economic development. Namely, secure property rights create the motivation to invest effort and resources to obtain and improve property to put it to productive

uses and to sell it freely. The effects on the less prosperous have been especially overlooked. If the poor can obtain secure property rights, it allows the ownership of property held by occupational right to be converted into wealth through registered title. These rights gives those at the lowest end of income distribution a stake in the future and an incentive to invest, not only in their properties but also in the human capital of themselves and their children.

“The United States, Canada, Japan, and Europe – the 25 developed nations of the world – have prospered so much more than those without their kind of accessible, integrated formal property systems that today no one would seriously propose economic solutions that disregarded the need for formal property²⁶.”

108. This claim by Hernando De Soto’s, a major proponent of property rights, is strengthened by recent experience with formal property registration. In Peru, for example, secure registered titles for the dwellings of the poor are being provided using revolutionary low cost titling and registration techniques. While the current value of slum dwellings is low, these properties still represents the major asset owned by poor families. The moment a house has been titled and registered its value increases substantially, providing a huge increase in net worth²⁷ as well as an asset that the poor can now leverage.

109. A well functioning system of rights in property consists of the ability to:

- Purchase property,
- Obtain secure title,
- Register real estate, and
- Use property as collateral.

110. Unfortunately in most developing countries, rights for both fixed property (real estate) and movable property (machinery, inventory, accounts receivable etc.) are so poorly protected that either they are worthless as collateral or securing them is so expensive

²⁶ de Soto, H. 2000. *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*. p165

²⁷ See Holden, Paul and Sarah Holden, 2004, “*Peru Investment Climate Projects Evaluation*”, Unpublished manuscript, World Bank, Washington, DC The wealth effects of the titling program on one million properties amounted to US\$ 500 million, an astronomical rate of return on a project that cost USD\$25 million.

and risky as to make their usefulness to business owners minimal. As a result, lending secured by movable property is rare and fixed property mortgage markets are inefficient and expensive.

111. In industrial countries, financial assets based on fixed property constitute a significant portion of the total assets of their financial systems. Since the foundations of property systems are well established, when banks ask for property as security for loans, they do not request values of property that are several multiples of the value of the loan. As a result, the risk of loss from business failure is lower in industrial countries.
112. Secure ownership of fixed property is therefore one of the foundations of investment, contracting, and entrepreneurship. As such, it is an essential element for a healthy and flourishing private sector. The benefits of secure property rights also arise from the way in which they influence expectations and perceptions of the future. The longer the time horizons of entrepreneurs, the lower the rate of return required to induce investment. This is intuitively obvious but is often overlooked. If planning horizons are short, then target rates of return on investment must be higher, which makes many projects that would be attractive in the industrial countries unattractive in countries where property rights are uncertain.
113. The following sections discuss how property rights for land and buildings affect private sector development in Fiji. (Chapter VII discusses rights in movable property.)

C. Property Rights Issues in Real Estate in Fiji

114. Property rights issues in Fiji can be divided into two main themes. The first is related to the rights concerning the ownership, use, and disposition of property itself. The second concerns the rights associated with establishing secure property interests²⁸. Property rights that deal with the ownership, use, and disposition of property include real estate (e.g., land law), personal property (e.g., laws on possession, warehouse bailment, seizure), and intellectual property. Property rights that deal with security interests in property include those against real estate and personal property. Of these property rights, this section will focus on property rights in real estate as they set out the

²⁸ Security interests are property rights that permit taking an interest in property to secure an obligation, such as a loan, and that in case of default, permit selling such property to pay the obligation secured.

foundation for the use of land in the economy and they have enormous impact on the business environment, especially for tourism and agriculture.

1) Different Property Rights and Interests in Real Estate in Fiji

115. Most land in Fiji is in Native Title (87 percent). It must be registered, and can be leased through the Native Land Trust Board (NLTB). Land ownership and dealings are regulated in Fiji under the Land Transfer Act. This legislation establishes a system of fee simple title using the Torrens System, similar to the statutory systems in Australia and New Zealand. Commercially available land in Fiji is categorized as freehold²⁹ (privately owned), State Lease (owned by the Government and leased to the public) or Native Lease (owned by indigenous Fijian landholding units and leased to the public through the NLTB.)

116. Fiji law provides a broad legal framework for property rights and their protection³⁰. It provides for fee simple³¹ and easements,³² it also provides for rights of way, and leases. In addition, interests in land may be held indirectly, as when land is held by cooperatives and companies that, in turn, have long-term contracts for land-use rights with the members or shareholders. Finally, there are future rights in these land rights, such as when the elements for claiming land ownership are known and will take place in the future. But, even this list is not exhaustive.

117. Property rights in real estate involve many institutions in Fiji: two property registries, one under the Land Transfer Act, one under the Native Land Act; custom and usage, agricultural tribunals, a formal court system for eviction, and institutions that monitor

²⁹ A freehold state is a fee simple (see footnote 21), of virtually infinite duration and of absolute inheritance, free of any condition, limitations, or restriction to particular heirs. 78 P. 2d 905, 907, 908, Law Dictionary, Barrons, p. 149.

³⁰ Fiji Constitution, section. 6 provides: “The people of the Fiji Islands recognise that, within the framework of this Constitution and the other laws of the State, the conduct of government is based on the following principles: ... (b) the ownership of Fijian land according to Fijian custom, the ownership of freehold land, and the rights of landlords and tenants under leases of agricultural land are preserved.”

³¹ The term means that a person (or entity) that has fee simple interest has complete dominion over real property.

³² An easement is a right created by an express or an implied agreement, of one owner of land, to make lawful and beneficial use of the land of another. It is an inchoate privilege and therefore not a fee or a state. Easement appurtenant is one that requires a dominant state to which the benefits of the easement attaches or appertains. Passes with the dominant state to all subsequent grantees and it is inheritable. Other types of easement include easement by prescription, easement in gross, easement of necessity, equitable easement, implied easement, affirmative easement, negative easement, public easement, reciprocal easement. Barrons p. 149.

the use of land rights for natural resources or energy. The basic underlying property laws (such as the Land Transfer Act, Land Sales Act, Native Land Act, and Property Law Act) apply equally to residential and commercial real estate.

2) Elements of Property Rights in Real Estate

118. The definition of land rights are critical for actions and behaviour at many levels of society including: a community's collective identity, the ability of households to subsist, the way in which the private sector uses land, and the operation of financial markets³³.

119. Four elements underpin every property right (this applies to movable property as well as to real property). They are creation, priority, publicity, and enforcement.

- **Creation:** The law must define and create property rights and permit clear and low costs methods for resolving ownership disputes as well as procedures for transferring property between parties and at death.
- **Priority:** The law must set logical and clear priorities among the different property rights and set a time of publicity from which a right will prevail against other claimants to the same property.
- **Publicity:** The law must provide a practical, effective and sustainable system for publicizing these land rights
- **Enforcement:** The law must set out a workable system for enforcing these rights, including enforcement by using force to evict unlawful occupants.

120. Fiji's laws define these rights. But, the way they are defined determines whether a secure and economically efficient system of tenure is created. The following sections review whether this is the case.

a) **Creation: Defining Clear Interests in Real Estate**

121. Several legal issues limit creating clear and secure interests in Fiji's real estate. These issues distort incentives and impact fundamentally the ability of the private sector to operate.

³³ A World Bank Policy Research Report Land Policies For Growth And Poverty Reduction," By Klaus Deininger, The World Bank, 2003.

I) PROBLEMS WITH THE NATIVE LAND TITLING AND LEASING PROCESSES

122. Eighty seven percent of Fiji is comprised of Native Land. It is titled under the jurisdiction and titling process of the Land Trust Board³⁴. The Board establishes the procedure to give notice of an inquiry and claim, to give others the opportunity to object, and records the title. (These titles can also be transferred.)³⁵ In practice, however, many Native Land rights remain in the Land Trust Board, while many land tenures do not appear in any registry at all³⁶, particularly for first title ownership. The problem arises because no single place exists where businesses can determine the property rights to a desired piece of real estate. Consequently, businesses face costs and uncertainties in determining the rightful legal owners of native land. They also face delays in perfecting any missed titling and registration requirements before leasing land, which makes the system costly and less secure. The Land Trust Board also sets out lease processes, which can be tedious and time-consuming. The legal procedure for renewal can take years because there is no law-mandated process. These delays and procedures serve to make property-related transactions costly.

II) COSTS OF REGISTRATION REQUIREMENTS

123. Fiji law only enforces the validity of a real estate transaction when it is registered. Non-registered transactions are void.³⁷ This requirement creates unneeded expense. A less expensive legal framework could permit valid land transactions among parties in any form of writing and without registration. Such a strategy would only require recording in the Registry when the parties wish that the transaction would have effect with respect to the public at large to establish priority against other parties. (Registering such transactions is an essential component of a well functioning property system – without it private parties could potentially be defeated by unregistered and, thus, hidden claims to land, making the system effectively unworkable).

124. No such public policy benefit arises from requiring registration to give real estate transactions legal validity. In business dealings, this registration requirement unnecessarily increases transaction costs because a title needs to be transferred to one or

³⁴ Native Lands Act. Section 4.

³⁵ The Native Land (Amendment) Act 2002.

³⁶ For example, several lawsuits before the Courts deal with non-registered possessors of native land.

³⁷ The Land Transfer Act Section 37.

more parties at the same time. Under Fiji's legal framework, each transfer has to be registered in the property registry. If the law were changed to require registration only for effect against third parties, the non-registered transfers would be valid and only the final transfer would be registered. This change would lower transaction costs with no offsetting economic loss.

III) RESTRICTIONS ON NON-RESIDENT DEALINGS IN LAND

125. The Land Sales Act and the Native Land Act impose restrictions on non-residents contracting to deal in land without the Government's consent.³⁸ This limitation creates problems particularly for the tourism industry. First, the tourism industry in Fiji depends on foreign investment - a five-star hotel management system will not be easy for Fiji locals to develop, for example. Hotel management systems are "internationally traded services" substantially more advanced abroad than in Fiji. Therefore, erection of five-star hotels in Fiji will depend on the legal environment for foreign investment - an environment that is not improved by the requirement of government authorization of investment as it increases the costs associated with undertaking a venture. Second, although the brochures of several law firms suggest that government consent is relatively easy to obtain, conclusions based on interviews with tourism operators and those handling the process on their behalf are that the process is costly and uncertain. The government's consent is granted on the government's "discretionary" authority.³⁹ Such a non-legal approach, based on the discretionary power of public officials, increases risk for potential investors and also invites conditions for bribery and corruption.⁴⁰ The example cited in Chapter III provides a graphic illustration of the costs associated with getting approvals.

126. A better approach would be to create more certainty for businesses by establishing clear rules under which the government must grant or reject a specific permit or license and resting permission on the business revealing specified information.

³⁸ The Land Sales Act.

³⁹ The Land Sales Act. Cap. 134.

⁴⁰ National Integrity Systems Country Study Report: Fiji, prepared for Transparency International Fiji by consulting firm of Olaks Consulting Services-specializing in Finance, Investment, Trade, and Good Governance areas and led by Mr. H P Singh, the Principal Consultant who is the former Deputy Governor of the Reserve Bank of Fiji and Consultant to the International Monetary Fund assisted Mr. Mosese Dakunivosa as Associate Consultant.

127. Even so, under the current process, the legal effect of the government's consent is unclear, which creates further uncertainties. For example, does the lack of permission for investment void a land transaction? If the information provided has defects and the authorization is revoked, what effect does it have on the land improvements already done?⁴¹ Ambiguities surround many such questions.

128. In addition, as pointed out in Chapter III, further uncertainty arises because of anomalies in the zoning laws. These uncertainties have the effect of requiring integrated developments to apply for zoning changes twice – once when the initial proposal is submitted and once when subdivision occurs. This requirement raises the costs of development substantially according to tourism industry operators interviewed as part of the background work for this report.

IV) CADASTRE

129. Fiji law relies on a simple map and natural description of boundaries at the time of first registration of Native Land.⁴² This is a fine legal principle. Typically, the occupants of the property have a clear idea of the location of their boundaries. Under those circumstances, a government's map would add little value to private parties' mapping or physical description of their property rights boundary. However, in Fiji, the law requires the titling claimant to submit a map drawn by a licensed surveyor, which increases land titling costs with very little offsetting public policy benefit.⁴³

a) *Priority: Establishing a Clear Ranking of Priority of Interests in Land*

130. Without clear rules for ranking the priority of ownership no land market can function properly. Real estate may have great value as a productive asset, but that value cannot be realized if a purchaser cannot tell who has other rights to the property. Fiji law does

⁴¹ In one lawsuit case, for example, it was unclear if the government consent was essential, and if so, whether the deposit for the land purchase was recoverable. Land Sales Act Section 6

⁴² Native Land Act, Section 4 and 5.

⁴³ The land market of the United States, arguably one of the most advanced land markets in the world, rests on a legal framework that gives priority to natural descriptions of land boundaries as set out by the private parties in the conveyance document or government title deed. This natural description prevails by law over any other description, including those of cadastral maps or any other more modern description technology. Many land deeds in the United States today include only natural boundary descriptions or an attached hand-drawn map of the property. Yet, they support billions of dollars in asset-back securitization transactions.

have a process for establishing the priority of land rights⁴⁴. The legal requirements, however, are outdated as they only provide priority from the date of filing as opposed to an exact time of filing. This arrangement creates conflicts, for example, when two or more parties file on the same day. The file search system provides some protection to this problem, by blocking any filing while a transaction is pending. But, at best, it forces bearing the unnecessary risk of chance registrations on the same day; at worst, it opens a window for fraud. A better approach lies in laws that endorse the more secure system of granting priority by date, hour, minute and second. However, the Land Transfer Act does not accommodate a modern computer system for assigning priority in the filing process.

b) *Publicity: Problems In Publicizing Interests In Land*

131. Publicity is the essential registry function necessary to property rights in land - making public the existence of a property right against third parties. Typically, contract law will bind the grantor (generally the seller) and grantee (generally the buyer) in the transaction. The public policy issues arise in determining the relation of the grantor and grantee to all other possible claimants (third parties). Making property rights public, and establishing a priority ranking of claims, are the main roles of a registry that is essential for property rights and a real estate market.

132. Under Fijian law, any new right in real estate, such as a new owner under a sale, must register his or her real estate right in the registry to make the transaction valid⁴⁵. This action, of course, can occur frequently. Certainly, it occurs at least twice: when the owner receives the land and when the owner dies and bequeaths the land to another person. Several concerns, however, arise about the legal framework that underlies the operation of Fiji's Registry. Fiji's legal provisions set out many requirements whose costs outweigh their benefits. For example, it requires that:

- o The "entire sales agreement" be filed instead of only a "notice" of the transaction;

⁴⁴ The Land Transfer Act applies to all land (Crown grants of land in Fiji were grants in fee simple), and leases of crown or native land. It governs the registration of land transfers and encumbrances of more than one year and it includes the registration of easements, rights of use, and restrictive covenants. The same law clearly ranks priority of interest in the land from the time of registration. Land Transfer Act s. 54.

⁴⁵ The Land Transfer Act (CHAPTER. 131) Section 11.

- Filing be done in paper only with original signatures;
- The registry officials make annotations in many different books;
- Many transactions have expensive registry certifications;
- There is limited access to the registry, which precludes ample public access (e.g., over the Internet.);
- A copy of the document be transcribed by hand into the ledger; and
- The government provide a strong guarantee, as it does in New Zealand, Australia, and some Canadian provinces.⁴⁶

133. All of these problems are compounded by Fiji facing governance problems. Those using the registry complain of substantial delays, lost paperwork, and a dysfunctional process. Many in the private sector complain about the competence of those officials at lower levels of government that deal with registry issues. Despite these limitations, the laws of Fiji provide for a real estate registry administered by the Government. Moreover, the State operates the registry as a monopoly. This legal framework, dictating a state-run monopoly, produces a registry service that is expensive, inefficient and, difficult to access.

c) Enforcement Problems in Real Estate

134. Most real estate disputes, including trespassing damages and boundary disputes, typically face the same court enforcement problems, as do other civil disputes in Fiji. Fijian high courts have jurisdiction to hear these civil cases. However, landlord and tenant disputes over agricultural land, come under the jurisdiction of the agricultural tribunals.⁴⁷ Mortgage foreclosure follows a process carried out by the Registrar.

135. Procedural law issues underlie the problems in the judiciary and establish the prior conditions for a slow and expensive court system.⁴⁸ Fiji land tenure law creates legal

⁴⁶ This raises the cost of the registry office because it increases the need for qualified personnel to process registrations and it lengthens and complicates procedures for appealing their decisions. Moreover, a government guarantee is worth no more than the credit rating of the government, so a government guarantee from Fiji will be worth less than a guarantee from New Zealand or Australia.

⁴⁷ Agricultural Landlord and Tenant Act, s. 3-(1)

⁴⁸ The court structure of Fiji has four levels. The Magistrates Courts - established under the Magistrates Court Act 1944, the High Court in line with Section 102–105 of the 1990 constitution, the Fiji Court of Appeal - under Section 106 and the Supreme Court of Fiji under Section 118.

uncertainty regarding fundamental land rights. In one case, that took two years to settle,⁴⁹ a non-resident Plaintiff reached an agreement with the Defendant company to purchase land in Fiji. Later the Plaintiff rescinded the contract and sought return of the deposits paid. The High Court held that absent the minister's prior consent, the effect of Section 6 of the Land Sales Act was to void the contract and the Plaintiff was entitled to the return of the deposits under the law of restitution. Thus the landowner, who acting in good faith had suspended offering the land to other potential purchasers, had no contractual protection because the purchaser had failed to follow administrative procedures that had nothing to do with the sale itself. This case illustrates a number of problems in substantive law and procedural rules, which are set out in the following sections.

I) PROBLEMS IN SUBSTANTIVE LAW

136. First, the law limits land transactions that require government approval. Typically, the real estate market permits subsequent conditions. Otherwise, a sale transaction is unduly burdened in coming to closure. But, Fiji's substantive law penalizes any transaction with a "void" legal effect that does not strictly follow the mandated permit, license or government consent. This legal approach serves to limit the ability of parties to cure defects and move on business dealings and it gives the purchaser an excuse to renege on a deal that they suddenly do not want. In so doing, Fiji law creates great uncertainty for land transactions. For an effective market, promises to buy real estate must always be defended under the law. All promises to buy real estate must be strictly enforceable under the substantive legal framework.

II) PROBLEMS IN PROCEDURAL RULES

137. Fiji's land cases take a long time to resolve – some cases take years for disposition. For a functioning real estate market, routine claims should be disposed of in summary or small claims proceedings in less than 30 days. The procedural rules in Fiji, instead, set out many litigation steps.⁵⁰ A Small Claims Tribunal was set up in 1990 to handle small disputes. But, it is unclear how it is working. It is possible to assess, however, that the present legal framework does not support small courts having great beneficial impact

⁴⁹ KIKUO SAKASHITA v. CONCAVE INVESTMENT LIMITED [1999] 45 FLR 13

⁵⁰ See the Magistrates Act and the Magistrates Court Rules.

among businesses for two reasons. First, there is no small claims procedure that all lower courts and tribunals in the country could use. Second, the small claims court that was set up has not been accompanied by a revised and complete set of civil procedure laws applicable to small claims. (A functioning small claims system requires carefully drafted small claims procedures law.)

III) PROBLEMS IN THE PROCEDURAL LAW

138. Fiji law fails to provide quick relief for trespassing and any other non-legal or illegal possession of land by a summary procedure. On the contrary, Fiji law requires extensive legal procedures⁵¹. As a result, the economic costs can be sizable. A ten-year delay when interest rates are 5 percent is equivalent to a 40 percent loss of the claimed value. In addition, a separate procedure and court system applies to landlord and tenant disputes over agricultural lands. The legal process set out in the Agricultural Landlord and Tenant Act, however, is also costly, as it demands many steps and the commitment of substantial time from the parties⁵². Finally, native land disputes are dealt with by Fijians themselves according to their native customs and are subject to any regulation made by the Fijian Affairs Board⁵³. There is nothing inherently costly to businesses in such a system. However, their decisions are not publicly available, so the applicable customs cannot be studied or ascertained in advance. Moreover, nothing in the procedure forces the Fijian Affairs Board to follow precedents created by earlier decisions. Native custom could be used to settle land tenure issues. However, an economically efficient system would require the recording of these decisions, making them readily available to the community and the public at large, and some assurance of following precedents and building upon the dispute resolutions that have already taken place.

d) Problems for Owners of Native Land.

139. Ironically, though customary owners may lease their land to investors and entrepreneurs, who can in turn use the lease as collateral, there appears no easy way for the customary owners to use the land as collateral directly. It might be possible for customary owners to lease the land to themselves, but this is a tortuous way of being

⁵¹ For example, a case filed in 1988 was only resolved eleven years later, in 1999.

⁵² See Agricultural Landlord and Tenant Act, sections 20 to 35.

⁵³ Native Lands Act, s. 3

able to mobilize native land as a wealth resource. Clearly a mechanism needs to be developed.

I) ISSUES WITH LAND IMPROVEMENTS AND LEASING IN FIJI

140. A lease in Fiji also faces restrictions. The Agricultural Landlords and Tenants Act (ALTA) limits a lease to a maximum of 30 years and maximum lease payments equivalent to a return of six percent per year of the unimproved capital value of the property⁵⁴. This situation provides little incentive for landowners to renew leases for productive use. Recently, this issue has become prominent. Fiji law does not permit construction of non-removable improvements on native land without the permission of the Land Trust Board and the lessors, which is a time consuming procedure⁵⁵.

141. Currently a substantial numbers of leases either have recently expired or are set to expire. Controversy has resulted because many lessees had undertaken apparently non-approved improvements, for which they have not been compensated. In addition, because of the non-renewal of leases, many highly skilled farmers lost the use of the land they were cultivating. There is anecdotal evidence that the landowners, having failed to cultivate their reacquired properties successfully, would like the lessees to return, but this claim could not be verified. Whatever the situation, however, the recent uncertainty surrounding the renewal of leases will adversely affect investment in agriculture. (It should be noted that any change in ALTA requires a two thirds affirmative vote in Parliament.) The current structure of ALTA is holding back the development of the Fijian agricultural sector, which is a vital part of the economy.

142. A review of ALTA is about to start. However, it is socially very sensitive particularly since the landlords are mainly native Fijians and the lessees are Indo-Fijians. One suggestion for reform is that the government consider introducing a master lease system. The government would lease all agricultural land from the NLTB and sublease the land to tenants. In this way, the government would make payment to the NLTB and be responsible for the collection of rents from tenants. Such a system would minimize

⁵⁴ The Agricultural Landlord and Tenant Act.

⁵⁵ In a recent case, the tenant of an expired native lease sought compensation for a non-removable dwelling left on the land that had been erected without permission. The High Court held that the regulations governing the construction of the dwelling required it to be removable and therefore the tenant was not entitled to compensation for its loss ([Surji v. NLTB](#) 43 FLR p 138).

conflicts between the *matagalis* and tenants, reduce administrative costs and bureaucracy in the process and allow for higher land rents⁵⁶.

143. In many countries, agriculture is often overlooked as a source of growth in favour of “more glamorous” sectors such as manufacturing, tourism and information technology. Frequently incentives and trade policy have an anti-agriculture bias. In Fiji, biases that negatively impact agriculture include:

- Price controls on foodstuffs, which have the effect of reducing incentives for quality production;
- The ability of the tourism operators with long term incentives to import food produce duty free;
- Import duties on manufactured products, which reduce the terms of trade between the agricultural sector and other sectors of the economy;
- ALTA lease provisions, which affect the incentives to invest. Highly intensive agricultural production requires long term investment.

144. The Fijian agricultural sector has the potential to contribute strongly to the country’s growth. It also has the potential to attract production from other countries, such as Hawaii, where agricultural land is more costly by a factor of 10. Higher quality production would enable the sector to supply the tourism industry to a far greater extent than it does now, raising the total value added in tourism. Abundant fertile land that is currently unused could also be harnessed for agricultural production. As in other sectors of the economy, however, rates of return relative to risk are not sufficiently high to induce investment. The government would like to open up new land for cultivation. However, in order to induce investors to move into the agricultural sectors, the biases against agriculture referred to in this chapter need to be removed.

⁵⁶ See Narayan, Paresh, K and Biman C. Prasad, Fiji’s Sugar, Tourism and Garment Industries: A Survey of Performance, Problems and Potential, *Fijian Studies*, Vol. 1, No. 1 pp3-28

D. Reform Recommendations

1) Undertake an Economic Assessment of the Laws and Regulations

145. An economic assessment of the restrictions and costs for businesses of Fiji's land laws, both procedural and substantive laws, is necessary. The assessment should examine whether each legal cost has a clear public policy objective. The assessment should recommend derogation of legal provisions that fail to meet clear public policy objectives. Even where legal costs are incurred in pursuit of an important objective, the assessment should recommend revising legal rights and procedures where public policy objectives can be met more cheaply or with increased certainty.

146. The main laws involved in this process include:

- The Agricultural Landlords and Tenants Act,
- The Land Transactions Act, including its rules for registration,
- The Native Land Act,
- The Land Sales Act,
- The Property Law Act, and
- The Magistrates Act and Magistrates Court Rules.

2) Evaluate the Need for a Small Land Claims Procedures Law

147. Such a procedure need not be limited in its application to a small claims court, but rather could be designed for use by any tribunal. This arrangement could contribute to reducing the delays inherent in the current legal processes. Following the economic assessment, amendments to these laws, and new laws when necessary, will need to be drafted and sanctioned by the Parliament. Expert assistance to the Government may be necessary in these activities in order to help present and discuss a reform that introduces new and different legal approaches.

3) Streamline NLTB Procedures

148. To improve the institutional framework and limit corruption, a "one-stop shop"-type of procedure could be incorporated into NLTB to streamline procedures and improve the administration of land transactions. It could combine, in one automated system, the

granting of any needed government consent with the registration of the transaction. For example, the consent for a non-resident owner with the registration of that purchase. A “one-stop shop”-type system, however, will have the greatest economic impact when combined with the economic assessment and legal reform set out above and when it provides for private participation, under a competitive regulatory framework. (For example, a “one-stop shop”-type system may license private registrars to connect to a shared Internet server and enter registrations in the system.)

4) Introduce Court Reporting

149. At the level of agricultural tribunals and customary decisions regarding native land, obtaining information is difficult or impossible. This situation adds to legal uncertainty because precedent is hard to ascertain. The recording of customary decisions should be made readily available to the community and the public at large to set out precedents and build upon the disputes that have already taken place.

5) Support Private Operation of Land Registries

150. Analyses of land tenure in Fiji often seem to assume that registries must be a state-run monopoly. Perhaps this is because the existing law says so, because European and US registries are also set up this way, or because registries carry out a public purpose. This is a misconception. The public purpose of a registry does not prevent private operation⁵⁷. Rather, it requires a legal framework that produces the public policy objective: publicity for the priority of different rights over land. A legal framework could readily regulate the private and competitive provision of registry services that meet the public policy objectives. Instead of funding the existing systems, further work could support the development of laws that provide for these changes to the underlying registry legal framework, including development of the necessary amendments to the Land Transfer Act and the Native Land Act. It could look beyond industrial country models to private and semi-private solutions developed in Romania and Colombia.

151. This is not an easy legal reform and will need to be completed systematically, including an economic assessment and analysis, dissemination and training, public awareness, and support to parliamentary representatives. However, it is the only plausible strategy for

⁵⁷ As, for example, the Land Registry in the Province of Ontario in Canada, or the system of privately run registries in Romania and Spain illustrate.

escaping the recurring cycle of periodic donor replacement of decrepit registry equipment. Computer automation alone can provide the window dressing for reform, but none of the changes in incentives required for sustainable operation.⁵⁸ Undeniably, a real estate registry administered by the private sector in a competitive framework would look different from the registries specified in the laws of every other industrial country, contrary to most common law and civil code practices. All of these recommendations are potentially hindered by the constraints presented by poor governance. Without imaginative solutions, Fiji will have to wait an undetermined length of time to develop civil institutions of the quality of the industrial countries. Little value-added exists if projects only propose, robot-like, to emulate existing industrial country practices without considering how to achieve the same economic objectives under the local constraints. Effective reform of Fiji's real estate registry, for example, will only take place if the laws that provide for a state and monopolistic administration of the real estate registries are amended to provide for private and competitive administration. All of the proposed reforms will need to take the local constraints similarly into account.

6) Reform ALTA

152. The issues facing agricultural land lessors and lessees illustrate the need for revising the way in which agricultural land is leased. In particular, the low rental payment and the issue of improvements to land require urgent attention. They distort incentives, reduce investment and add to uncertainty in an important sector of the Fijian economy. In addition, the issues discussed in the section on Land Improvements and Leasing indicate that there are biases against agriculture emanating from other sectors of the economy and other laws and rules.

⁵⁸ See, Heywood W. Fleisig and Nuria de la Peña, *Law, Legal Institutions, and Development: Lessons of the 1990s for Property Rights, Secured Transactions, Business Registration, and Contract Enforcement*, (Washington, DC: Center for the Economic Analysis of Law, October 2003), prepared for the World Bank Lessons of the 1990s project.

VI. The Legal Framework for Business in Fiji

A. Introduction

153. Fiji's legal framework for business is weak. It does not provide a foundation for contracting that reflects modern legal practices, it mandates procedures that greatly add to the cost of doing business, and its dispute resolution mechanisms function poorly. Of all the countries in the Pacific Region included in the World Bank doing business indicators, Fiji is the country that experiences the greatest delays in resolving legal disputes. This chapter⁵⁹ begins with a discussion of the persistent use of non-legal institutions in Fiji. It goes on to review the main features of the legal framework for commercial transactions and contracting in the country.

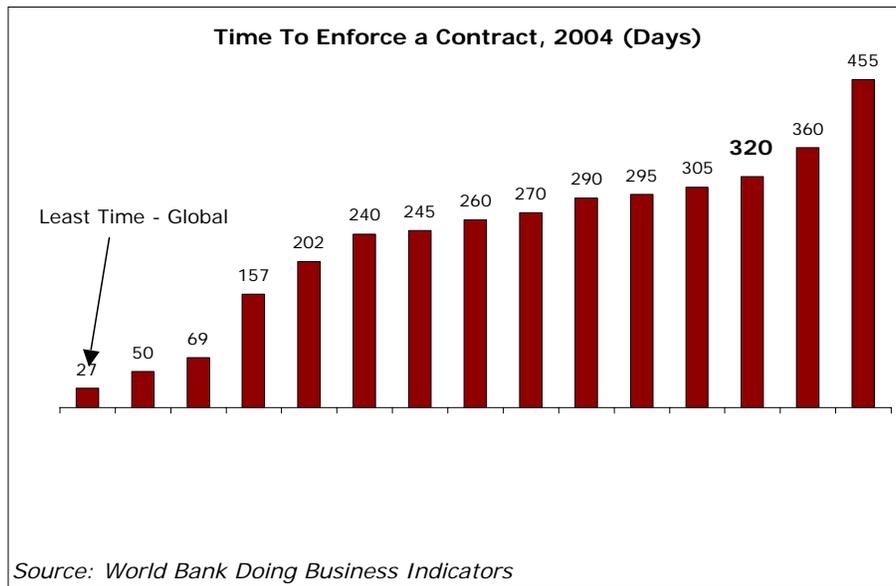
B. An Overview of Legal Issues in Fiji

154. Fiji inherited most of its commercial laws from England. It has modelled its more recent laws after those of Australia and New Zealand. Unfortunately, these laws incur high transaction costs for doing business in Fiji. The legal procedures work in the countries of origin because of the larger investments in public institutions so businesses get more value for the cost and the costs are lower relative to the value of the transaction than they are in Fiji. However, they are inappropriate within the framework of Fiji's economy and its government institutions.

155. These laws also contain many gaps that further increase transaction costs because they increase the risk of enforcing business deals. Fiji laws heavily tax business transactions with customs, excise, and stamp duties. The state also establishes price controls and unnecessarily regulates many industries, such as exports of fruits, vegetables, trees, plants, shrubs, and roots. These industries must obtain a license under the Fruit Export and Marketing Act. But, most of the license requirements have no obvious public policy justification; the few that do could achieve their ends better in other ways.

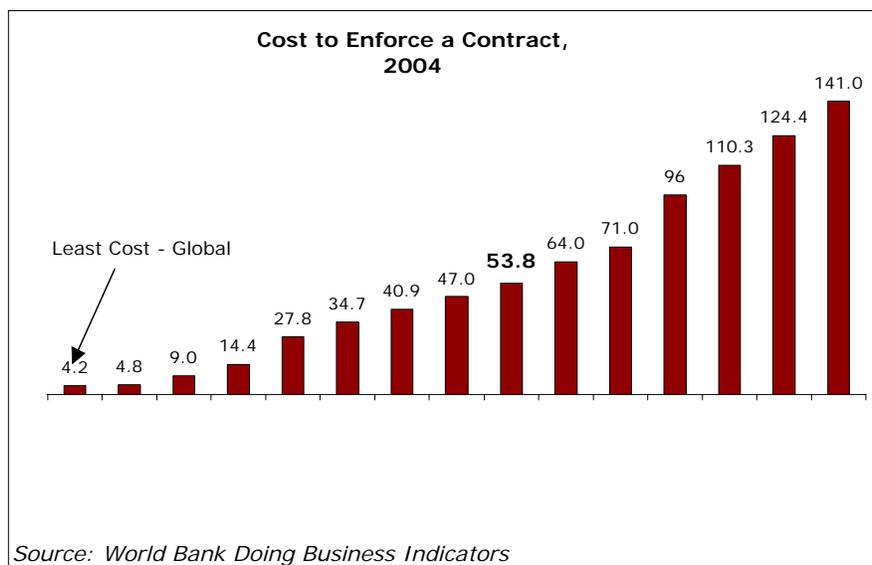
⁵⁹ This Chapter is based on a draft ADB report *Fiji: Reforming Commercial Laws to Advance Private Sector Development*, by the Enterprise Research Institute (ERI) and the Center for the Economic Analysis of Law (CEAL), Washington, DC (under ADB TA No. 6162-REG for *Improving the Legal Business Environment in the Pacific Region*).

Figure 6. Time to Enforce a Contract (Days)



156. In addition, there is a pervasive problem of petty corruption that is exacerbated by the absence of public prosecution of misconduct and Fiji’s business laws establishing the conditions in which petty corruption can flourish. This issue is discussed more below but at its root cause it is the legal system’s tendency to require many costly licenses and registrations and the discretionary nature of the approval of those licenses.

Figure 7. Cost to Enforce a Contract (% of p.c. income)



C. Pervasive Non-Legal Institutions in Fiji

157. Fiji's legal system is based on common law. Its markets rest partly on this legal foundation but also on a non-legal foundation of extra-legal and, sometimes, illegal, customs and usage. These legal and non-legal foundations directly affect the operation of businesses.

158. Non-legal institutions can work well. For example, property rights to real estate in Fiji can often be transferred and serve as collateral under a variety of legal provisions. Yet, the law also endorses native custom, and non-registered possession of Native Land seems to be common. This system often works well within the community. But, non-legal institutions work better when they have the backing of an effective legal system. The problems inherent in the usage of non-legal institutions are demonstrated by the following examples:

- In one published Fiji lawsuit, a possessor of non-registered native land did not transfer a valid lease.
- In another lawsuit, a landowner casually let his in-laws live on part of his land, native customs did not provide relief to this owner, and he spent years before the formal court system.
- Non-residents of Fiji are permitted to purchase land in Fiji. However, sales of land in excess of 1 acre require the consent of the Minister for Lands under the Lands Sales Act. At the same time, in a recent public Web page advertisement for a property for sale in Fiji, the seller states that they have already obtained a blanket authorization from the government for any foreign purchaser who would purchase the property. Such a procedure, however, is not envisioned under Fiji's land laws.

159. A recent study conducted by a reputable international NGO concerned with corruption found that Fiji's problem of kickbacks is pervasive⁶⁰. This situation is not surprising since the procedures and discretion surrounding the implementation of Fiji law provides the exact conditions that allow corruption and bribery to prosper. The legal procedures to obtain licenses or registrations require the "discretionary" authority of a public

⁶⁰ Transparency International. 2001. National Integrity Systems Country Study Report, Fiji.

official and there are no clear automatic legal standards under which the government must grant licenses and process registrations. Yet there is no compensating public policy objective inherent in these procedures – simpler proceedings in other countries function better than those in Fiji. The existing system encourages corruption and increases transactions costs. The forthcoming FIAS analysis of foreign investment rules and regulations will examine in detail how foreign investors are affected by these issues, something that this report strongly endorses. At the same time, an even more preferable option would be to look at procedures for all investors, not just foreign investors, as there is no reason to have different requirements for different groups of investors.

160. Non-legal solutions do have power in local situations where personal relationships replace formal law and enforcement. But, their weakness is that they collapse outside the local orbit. These geographic and associational limitations on non-legal solutions serve to undermine private sector development. The business laws that create competitive and efficient markets and the finance laws that bring those with savings together with those with the best investments are lacking. (In other words, those with the best investments may not always be the saver's neighbours, relatives, or members of the same religious sect, caste, or tribe.)

D. Problems in Business Entry and Operation

161. To be a formal business operating according to the law, a business entity must first have a business license or, if a company, register in the Companies Registry – a step that accomplishes two important public policy objectives. First, it establishes a "legal" location for a business, which makes it possible to find it legally and to settle a claim, if necessary. Second, it establishes who in the business has authority to commit the company to contractual arrangements. Both features reduce transactions costs, improving both the ability to do business and competition.

1) Business Registration

162. Fiji meets these two public policy objectives poorly and simultaneously burdens business with legal costs that do not achieve clear public policy benefits. First, both local and companies registries provide poor public access. It is not possible to learn inexpensively the name of a company, its address and to identify the officers and

directors that represent it⁶¹. Rather a physical trip to the registry is necessary, as the law does not provide clear public access to existing licenses. At the same time, when it prescribes public access to registries, it does not clearly mandate free access. It does not specify the means or costs for such access, nor does it specifically state that such public access should include reading and copying information in electronic formats. This limitation defeats one of the main purposes of business registration - enabling the public to locate a company and identify its officers and directors.

163. Second, the law does not make it clear that a company's legal representative has the power to bind the company after registration. This situation increases the costs of verifying the authority of legal representatives and the risks that a company could later void a transaction, increasing the transaction costs of trade with new parties and, thereby, confining transactions to parties already well-known to each other.⁶²

164. Over and above these general problems, additional issues arise for companies. The Companies Act of 1993, which prescribes company law in Fiji, is based on English law⁶³ and has a number of implications for companies. The Registrar of Companies and his officers administer the requirements of the Act. Fiji Company law is based on English antecedents and the business structures recognized in English law.⁶⁴ Available company structures vary from private companies; generally used for private or smaller business purposes that restrict dealings in their shares, to public companies used to structure larger enterprises.

165. **Restricting Company Formation and Operating Requirements.** The requirements for setting up a company in Fiji are overly restrictive and serve little purpose in improving the operation of businesses. Strict requirements have been established for the Board of Directors, the number of shareholders and the documents that must be filed. Every public company must have a minimum of three directors, two of whom must be local residents. Every private company must have a minimum of two directors, one of

⁶¹ e.g. through an Internet search or by telephone call.

⁶² See for example, Property Law, s. 5-(1)

⁶³ Legal entities under Fiji law include partnerships, limited liability companies, joint ventures and trusts (including unit trusts). The Companies Act, the Partnership Act, the Trustee Act and the Unit Trusts Act regulate these structures.

⁶⁴ Legal entities under Fiji law include partnerships, limited liability companies, joint ventures and trusts (including unit trusts). The Companies Act, the Partnership Act, the Trustee Act and the Unit Trusts Act regulate these structures.

whom is required to be a resident. Seven or more persons are required to form a public company, while two or more are required for a private company. Modern corporate registries require only the incorporation instrument when companies are incorporating in Fiji. But, several documents must be filed with the Registrar.⁶⁵ For companies that have been incorporated, most modern company laws require only an update of a company's address and its list of officers and directors on an annual basis. But Fiji requires much more information for all companies to file annually.⁶⁶ These additional requirements raise business transactions costs and the costs of the Registry system.

166. **Unnecessary Business Licenses.** Fiji law sets out requirements for a general business license that extends to all companies even though this information is already filed with the Companies Registry. Generally, regulatory systems only require these business licenses from unincorporated businesses - because the government has limited information on them.

167. **Companies Registry Law.** The legal framework of Fiji's Companies Act sets out a company registry that is costly to use and operate. The law prescribes many filings that have no public policy objective, which makes the system and personnel requirements of the Registry much more expensive than would be necessary with a well-designed legal framework.

2) Other Business Operation Licensing Requirements

168. Fiji has more than 68 laws on licensing, each administered by separate government agencies.⁶⁷ No coordination exists in the law among these agencies and the business

⁶⁵ These include: particulars of directors, return of allotment, notice of situation (company name, share capital, registered office, operations matters), annual return report of a statutory meeting by a public company, and a prospectus or a statement in lieu of a prospectus by a public company.

⁶⁶ The annual return must be made in the form prescribed by the Companies Act and contain the following information: a summary of share capital, details of total indebtedness with regard to mortgages and charges · a list of shareholders, together with details of shares transferred, particulars of directors and secretary. In the case of public companies, a certified copy of the most recent audited balance sheet and accounts also must accompany the annual return.

⁶⁷ The Business Licensing Act CAP 204, is primarily revenue raising legislation. Once the license fee is paid, the license will be issued. All businesses situated within a municipality, pay their license fee to that municipality. Licenses are required in order to operate certain types of business e.g. banking, insurance, telecommunications, radio and television, fishing, timber. These arrangements raise costs for private business and stretch government resources. The Administrator - Generals office is responsible for administering the legislation and its limited budget causes delays. The systems are still essentially manual and not computerized. Under the Land Sales Act, non-residents of Fiji (as defined) are required to obtain the consent of the Minister for Lands to purchase land in Fiji in excess of 1 acre in area (native land is excluded from this requirement). Non-residents

must consecutively undertake each step repeating the documentation that it must submit. These steps add costs, in terms of both time and money, which deter entering the formal business community. Numerous unnecessary licensing requirements of this sort exist. For example, foreign businesses must obtain the government's consent to purchase land already owned by non-natives and to undertake investment in Fiji. Even a foreign distributor of optical equipment would need to follow this process. These requirements are extensive and costly. The original one-stop shop for foreign investment at the Fiji Trade and Investment Bureau⁶⁸ was set up to streamline this process. One-stop shops alone do not remove the underlying legal barriers to business entry unless they reform the law. The recent revision to the process speeds up the initial approval by FTIB by making approval the purview of the head of the Board and requiring a decision in a short period of time. But, it does not address the underlying problem because the underlying laws that govern the procedures have not been reformed.

169. There are still extensive legal procedures before multiple ministries after the investment approval and there is little coordination among ministries in requesting the same information.⁶⁹ Fiji's licensing laws and regulations base the granting of a license or permit on the discretionary power of the executive but do not establish objective criteria for the automatic granting of those licenses once the criteria are met. These arrangements are typical of discretionary systems. In many ministries there is no catalogue of the procedures to be followed, nor the exact criteria that determine how an application will be evaluated. At the request of the government, the process is being reviewed as part of a World Bank/FIAS project.

of Fiji require the approval of the Fiji Islands Trade & Investment Bureau (FTIB) to establish a business in Fiji and to acquire shares in a Fiji incorporated company. An application form is required to be completed and submitted to FTIB. No fee is charged for filing this application. This procedure is governed by the provisions of the Foreign Investment Act 1999. Under the Act, written notice of the grant or refusal of an application must be given within 15 days of the making of the application. Fiji law also sets out requirements for a general business license that applies to all business, including those already incorporated. Regulatory systems often require a general business license from unincorporated businesses -- for these, the government has no information. However, in Fiji, the requirement extends to companies, whose information is already filed with the Companies Registry.

⁶⁸ At www.ftib.org.fj/show/contents/biz_infra/salient_feature/relationship.htm -: "Role of FTIB: The Fiji Islands Trade and Investment Bureau (FTIB) was first formed as a statutory organization by the Economic Development Board (EDB) Act No. 11 of 1980 to promote, stimulate and facilitate economic development." Section 5 of the Fiji Islands Trade and Investment Bureau Act specifies that FTIB is to promote exports, investment and advise Government on economic policies that will lead to the expansion of investment in Fiji."

⁶⁹ Investment Approval Process, at www.ftib.org.fj.

E. Enforcement of Business Transactions

“...a major impediment to the development of peer monitoring—as well as the development of other institutions—comes from inadequate legal systems to enforce contracts.”

Joseph Stiglitz⁷⁰

170. Well-developed legal systems have several ways of enforcing business transactions and business liability. In the financial market chapter below, the section on secured transactions discusses one system -- enforcement of a transaction secured by collateral. However, in many business dealings, no prior security agreement exists for using property to guarantee contracts. Diverse transactions, ranging from micro lending, to business ventures, to a service contract, are often only based on a simple agreement without any additional collateral security.

1) Arbitration

171. In Fiji, the Arbitration Act CAP 38 lays out the procedure for arbitration. Arbitration awards may be enforced in the same manner as a judgment of the High Court. It is not uncommon for building disputes to be referred to arbitration. Parties can agree in writing to submit present or future differences to arbitration, and such agreements are irrevocable, except by leave of the Supreme Court. If a party to an arbitration agreement brings legal proceedings, the Supreme Court may stop those proceedings.

172. While arbitrators can administer oaths or affirmations, state a case for the Supreme Court, and correct clerical mistakes in an award, they can not issue orders to lien or seize assets, or issue compulsory orders to obtain evidence. Awards are enforced by leave of the Supreme Court but appeals may be taken to the Supreme Court. This arrangement increases costs because arbitration often ends up going to court for meaningful judgments and the parties face the possibility of repeating the arbitration process or commencing a judicial process. The situation may explain why many avoid using arbitration.⁷¹ It seems that arbitration is not often used to deal with commercial

⁷⁰ “Peer Monitoring and Credit Markets” The World Bank Economic Review, Vol. 4, No. 1 (Washington, DC: The World Bank, 1990), pp. 363.

⁷¹ There are three reported judicial decisions relating to the Arbitration Act, one concerned with whether the arbitrator had made an error of law which could be corrected by the Supreme Court, and two with the question

disputes, except for insurance policies, which are probably prepared overseas. This lack of experience with arbitration probably reflects the lack of binding arbitration, experienced and skilled arbitrators who have the confidence of the commercial community, as well as possible satisfaction with the courts resolving disputes.

2) Enforcing Agreements Without Collateral

173. When enforcing disputes for contract agreements without collateral, alternative dispute resolution systems are a widely and successfully used option in many countries. Contracts are generally set up to specify that in the event of a dispute that it be settled outside the court through a system like arbitration. A dispute resolved by arbitration avoids the court system, which in Fiji is slow, and allows business to circumvent any problems in the court system. However, Fiji's enforcement laws require that it be done by the courts and in so doing severely limits the economic usefulness of arbitration.

of whether proceedings before the Supreme Court, later called the High Court, should be stayed to allow for the matter to be determined by arbitration:

(i) *Chauhan Bros v Yorkshire Insurance Co Ltd* (1962) 8 FLR 16

An insurance policy provided that in the event of loss occasioned by fire, the insurance company would “pay, reinstate or make good to the insured...such loss.” The insured premises, which were built of wood, were destroyed by fire, and would have cost 600 pounds to rebuild in wood. However, the local authority refused to allow them to be rebuilt in wood, but required a more permanent material, which cost substantially more than 600 pounds. The insurance company was prepared to pay only the cost of rebuilding in wood, i.e. 600 pounds. The dispute was submitted to arbitration, and the arbitrator upheld the insurance company on the ground that the loss of more than 600 pounds was not occasioned by the fire, but by the local authority.

The insurance company appealed on the ground that the arbitrator had made an error of law, but the award was upheld by the Supreme Court which held that the arbitrator was correct in law in holding that the additional loss had been occasioned by the local authority, not by the fire.

(ii) *Fiji Builders Ltd v Tip Top Ice Cream (Ltd)* (1966) 12 FLR 65

A construction company contracted to build a road and drainage works for an ice cream manufacturing company, whose engineer certified for extra work that the ice cream manufacturer refused to pay, so the construction company brought civil proceedings against the ice cream manufacturer. The defendant sought a stay of the proceedings on the ground that the contract incorporated certain terms, which required disputes to be determined by arbitration. The defendant argued that the terms of the contract provided for the construction company's engineer to be the arbitrator, and this would be improper.

The Supreme Court held that the contract did not provide for the construction company's engineer to be the arbitrator, and granted the stay of proceedings to enable an arbitrator to be appointed and the dispute to be determined by that arbitrator.

(iii) *Footwear Manufacturers Ltd v New India Assurance Co Ltd* (1998) 44 FLR 215

A footwear manufacturing company which was insured by an insurance company for damage occasioned by fire issued civil proceedings in the High Court claiming \$390,000 for money which it claimed the insurance was obliged to pay to it under the policy, and which had not been paid. The insurance company applied for a stay of the proceedings on the ground that the insurance policy required that the matter be submitted to arbitration. Before that application was heard, the footwear company applied for summary judgment without a hearing, which is permitted by the rules of the High Court.

The High Court held that both applications should be heard together, and since there was no real dispute that \$195,000 was owing, judgment was given for that amount, but a stay order was granted in respect of the balance.

Although further research is necessary to learn the extent of the problem fully, it seems that the issue lies in the lack of an expeditious enforcement mechanism of arbitral awards before the Courts. Under the Arbitration Act, arbitration awards must be enforceable before the courts under the existing judicial processes. This requirement may be all right in industrial countries with quick court enforcement systems, but in Fiji, it could take considerably more time and cost. This situation diminishes the benefits of arbitration in producing faster and cheaper contract enforcement.

3) Enforcement of Claims with No Business Agreement

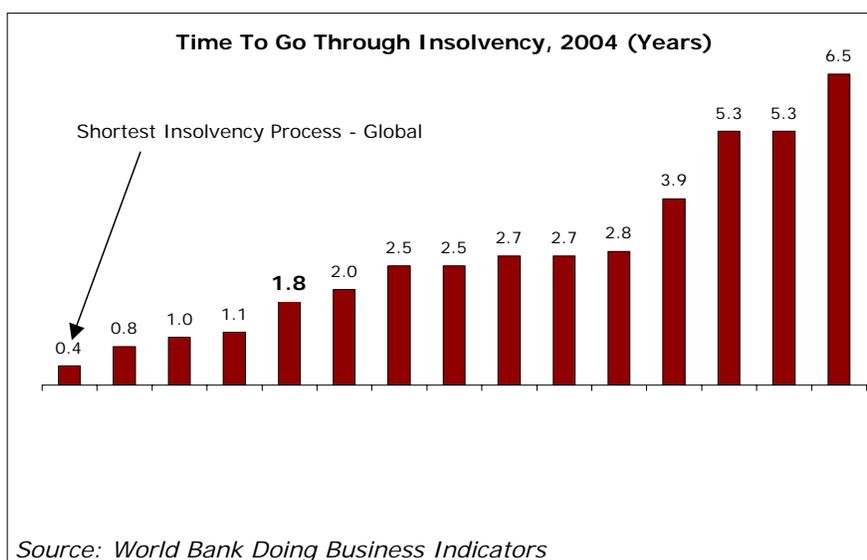
174. In Fiji the civil court procedures discussed above for land are used for enforcing claims where no prior agreement exists. These civil procedures, however, could also be improved. Particularly important are expanded summary and small claims legal processes that may be used by all courts as discussed earlier.

4) Bankruptcy

175. In Fiji, a company may be wound up either by court order or voluntarily by its shareholders. A bankruptcy prerequisite is the company not being able to meet its liabilities within a twelve-month period from commencement of the winding up. Under a court order for the winding up of a company, a receiver or liquidator will normally be appointed to finalize the company's affairs. When the winding up has been completed, a court order dissolving the company is issued. In the case of a deficiency of assets to meet the company's debts and liabilities on a winding up, shareholders can be required to meet the deficiency. Shareholders of a company limited by shares are liable to the extent of any unpaid capital on issued shares (this is the capital requirement). The World Bank Doing Business Indicators show that the winding up period for a bankrupt company in Fiji is 1.8 years, a relatively short time period by international comparison. However, recovery rates are relatively low – some 20 cents on the dollar⁷².

⁷² Although it is not clear from the description whether this is for unsecured creditors only or an average of secured and unsecured creditors recoveries.

Figure 8. Time to go through Insolvency (years)



176. The legal framework for bankruptcy in Fiji provides a good system for separating secured loans from bankruptcy.⁷³ Since the benefits that derive from secured transactions are enormous, a sound bankruptcy law should not delay or diminish the collection of secured loans in bankruptcy. In Fiji, this feature includes land as collateral as well as goods sold on credit under a bill of sale and the company charge.⁷⁴ However, the system presents some important drawbacks. The court appointed trustee⁷⁵ system in Fiji is a more expensive mechanism than a creditors-appointed trustee or receivership. Similarly, the aspects of the process that are now administered by the courts, could be more efficient if administered by the creditors. There is also uncertainty in the law as to how much power the court has over the duties of the receiver.⁷⁶ Many other essential aspects of bankruptcy should be studied in detail, such as labour and tort claims, and standards for voiding fraudulent transactions. The present Act, however, seems to set out a costly procedural system for Fiji both in terms of the legal costs and the time that the process takes. Therefore, the overall bankruptcy system rating given in the World Bank doing business indicators – a three on a scale of one to four, with four being the

⁷³ See the Land Transfer Act.

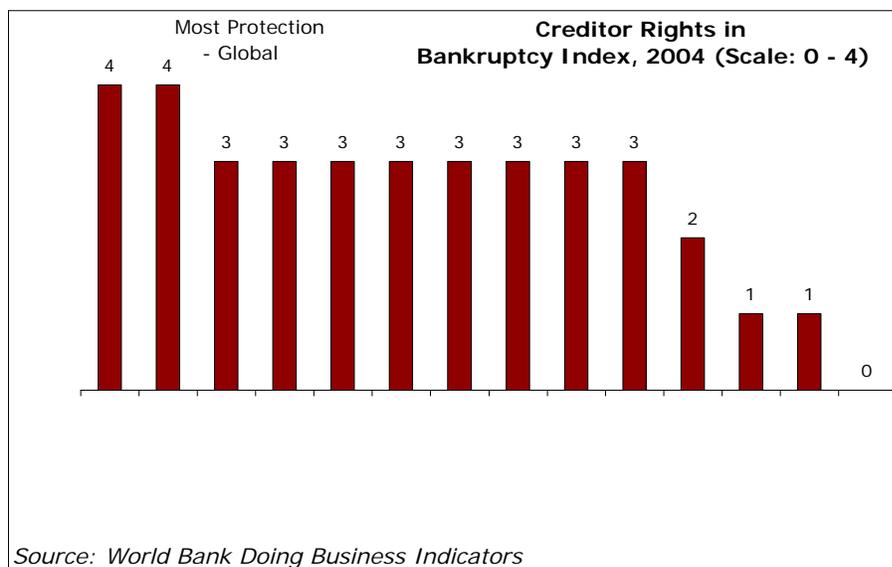
⁷⁴ See the Bills of Sale Act.

⁷⁵ See Bankruptcy Act, Section 94.

⁷⁶ See Companies Act (Cap 247) Sections 243 and 251 and MOHAMMED SHEIK KHAN & SHEIK'S RENT-A-CAR LTD v. THE OFFICIAL RECEIVER OF FIJI 45 FLR p. 220

best – is misleading. Significant deficiencies exist in the bankruptcy framework and creditors recoveries are low.

Figure 9. Creditor Rights in Bankruptcy (Index, Scale 0 – 4)



F. Consumer Protection

177. The Fiji Islands Fair Trading Decree of 1992 incorporates multiple techniques for promoting consumer protection. Sections 27 to 39 concentrate on anti-competitive conduct by sellers, both in relation to collective restraints on trade and in relation to monopolization. There are provisions which are broadly worded (“lessening competition,” “market power”), and others specify particular prohibitions on conduct (pyramid selling schemes, resale price maintenance Section 98, which seems to be the only provision concerned with information disclosure. Sections 53 to 89 concentrate on regulating abusive conduct by sellers. Again, there are many provisions that are broadly worded (“unconscionable,” “deceptive”), and therefore attempt to deter abusive conduct in general terms. The efficacy of these provisions will depend on how energetically they are enforced, which is a topic for further study. There are also many sections that deal with specific, known abuses, such as “bait and switch” advertising and referral sales. Finally, there are provisions which define with some precision what a seller must do, and must not do, in a particular type of potentially abusive consumer transaction, such as door-to-door sales. A Fair Trading (Amendment) Act enacted in 1998 introduced additional provisions on competition.

G. Reform Recommendations

1) Establish a Single Source Project for Business Registration and Licensing

178. As in any registry reform, the first and most important step lies in thoroughly reviewing the commercial and other business laws that set the requirements for entering the formal business sector. Such a review should present a detailed analysis of the law's costs and expected benefits, including the public policy objectives they espouse. Some of the laws that this revision should encompass include: the Business Licensing Act, the Commerce Act 1998, the Companies Act, the Consumer Credit Act 1999, as well as all the specific licensing laws and regulations.

179. The key to analyzing all licensing requirements lies, first, in undertaking a careful economic analysis that examines whether the public policy benefit of the license outweighs the costs of such license. Second, in converting licensing processes into automatic legal processes set up on Internet sites, and derogating as much as possible all legal licensing processes that use administrative decisions by public officials.

2) Establish an Electronic Transactions Act

1. Fiji does not have a law that effectively supports electronic transactions, which raises the costs of transacting and effectively rules out Internet based commerce in the country. Three elements are key for this legal effect:
 - First, Fiji would need to adopt an electronic transaction law. This could be drafted specifically for Fiji and cover only domestic transactions. However, the authors would rather recommend adopting model rules that are also consistent in many other countries, such as the model rules by UNCITRAL.
 - Second, Fiji will need to amend the Rules of Civil Procedure regarding evidence to accommodate electronic transactions⁷⁷ and computer-related financial crimes. See for example, Vanuatu's *Electronic Transactions Act 2000* and the *E-Business Act 2000*.

⁷⁷ UNCITRAL Model Law on Electronic Commerce (1996) at www.uncitral.org. Legislation implementing provisions of the Model Law has been adopted in Australia (1999), Colombia* (1999), Dominican Republic* (2002), Ecuador* (2002), France (2000), India* (2000), Ireland (2000), Jordan (2001), Mauritius (2000), Mexico (2000), New Zealand (2002), Pakistan (2002), Panama* (2001), Philippines (2000), Republic of Korea (1999), Singapore (1998), Slovenia (2000), South Africa* (2002), Thailand (2002) and Venezuela (2001).

180. Third, donor assistance may be needed to provide Fiji with technical and financial support to make the proposed laws more effective. In particular, a donor funded initiative to develop the relevant technological infrastructure using both public and private sector participants is worthy of strong consideration. One option for donors would be to help establish a South Pacific E-Commerce Law and Technology Institute or similar facility to advise small island countries on these processes. Such an organization would be better situated to handle local and regional issues and could work in conjunction with the South Pacific Islands Forum Secretariat

3) Support Arbitration

181. Merchants and business operators have settled disputes privately for more than a thousand years, with good results. Arbitration is one modern version of this system. This simple system for settling disputes outside of the problematic courts could help more in Fiji's contract enforcement problems than any other proposal regarding the rule of law and contract enforcement. Finding non-judicial ways to deal with contract enforcement in Fiji, such as providing for arbitration, can be a great tool for speedy contract enforcement, relieving the congested courts of many cases, and permitting judicial reform projects to address central issues of judicial concern that cannot be settled by arbitration. The key will lie in examining different features of arbitration laws

The Model Law has also been adopted in the Bailiwick of Guernsey (2000), the Bailiwick of Jersey (2000) and the Isle of Man (2000), all Crown Dependencies of the United Kingdom of Great Britain and Northern Ireland; in Bermuda (1999), Cayman Islands (2000), and the Turks and Caicos Islands (2000), overseas territories of the United Kingdom of Great Britain and Northern Ireland; and in the Hong Kong Special Administrative Region of China (2000).

Uniform legislation influenced by the Model Law and the principles on which it is based has been prepared in the United States (Uniform Electronic Transactions Act, adopted in 1999 by the National Conference of Commissioners on Uniform State Law) and enacted by the States of Alabama (2001), Arizona (2000), Arkansas (2001), California (1999), Colorado (2002), Connecticut (2002), Delaware (2000), Florida (2000), Hawaii (2000), Idaho (2000), Indiana (2000), Iowa (2000), Kansas (2000), Kentucky (2000), Louisiana (2001), Maine (2000), Maryland (2000), Massachusetts (2003), Michigan (2000), Minnesota (2000), Mississippi (2001), Missouri (2003), Montana (2001), Nebraska (2000), Nevada (2001), New Hampshire (2001), New Jersey (2000), New Mexico (2001), North Carolina (2000), North Dakota (2001), Ohio (2000), Oklahoma (2000), Oregon (2001), Pennsylvania (1999), Rhode Island (2000), South Dakota (2000), Tennessee (2001), Texas (2001), Utah (2000), Vermont (2003), Virginia (2000), West Virginia (2001), Wyoming (2001) and the District of Columbia (2001). The State of Illinois had already enacted the Model Law in 1998.

Uniform legislation influenced by the Model Law and the principles on which it is based has also been prepared in Canada (Uniform Electronic Commerce Act, adopted in 1999 by the Uniform Law Conference of Canada) and enacted in a number of Provinces and Territories, including British Columbia (2001), Manitoba (2000), New Brunswick (2001), Newfoundland and Labrador (2001), Nova Scotia (2000), Ontario (2001), Prince Edward Island (2001), Saskatchewan (2000) and Yukon (2000). Legislation influenced by the Model Law and the principles on which it is based has also been adopted in the Province of Quebec (2001).

* Except for the provisions on certification and electronic signatures.

and the economic impact of different options for Fiji.

4) Enforce Awards Automatically or Privately

182. Society's saving from private parties agreeing to arbitrate is lost or minimized if the evidence must be presented again to the judge to obtain enforcement. Awards must either be enforced automatically by the courts or, even better, enforced by licensed private agents. These may include, for example, rights to set-off from the loser's bank account, automatic deduction from checking accounts, harmless repossession, private sale, and *ex parte* court orders for seizure and eviction when the use of force is necessary, together with simplified and cheap police procedures to execute such orders.

5) Amend the Bankruptcy Law

183. Economic analysis of the bankruptcy process should identify the costs and benefits of the present processes legal costs. Then, amendments to the present Bankruptcy Act should be drafted.

6) Establish a Parliamentary Budget Authority

184. Set up a parliamentary budget authority: this includes such activities as drafting a parliamentary budget authority legal framework, and training the parliament staff.

185. These recommendations will be further refined as the analysis associated with the legal technical assistance program sponsored by the ADB proceeds. As this occurs, more detailed recommendations will be made. There can be no doubt, however, of the critical nature of these reforms and the importance that the legal framework plays in fostering an environment conducive to private sector growth.

186. The following table summarizes the legal issues in Fiji – for more detail see the legal analysis paper.

H. Summary of Legal Issues

	Issues Facing Developing Economies				
	Registering Businesses	Operating Businesses	Closing Businesses	Protecting Property	Protecting Consumers
Relevance (Why is this issue important?)	Business registration moves the emphasis of an economy to the formal sector, creating more opportunities for growth and permitting access to finance.	Firms grow quickly when they can reduce the costs of doing business – e.g., engaging in transactions with other businesses, or transporting goods.	The faster a business can close and resolve bankruptcy, the faster people and resources can return to the market.	Without property protection, businesses face greater risks and financing and investment falls. In remote Fiji, businesses depend on reducing transportation costs and need a legal framework for ship and aircraft ownership.	Consumer protection levels the playing field between large, well advised business entities and individual consumers and small businesses.
Fiji's current situation	People looking to start a business run into serious legal hurdles. They are incited to keep their businesses informal.	Complex and antiquated regulations prevent businesses from realizing efficiencies and reducing costs. Contracts are difficult to enforce reducing the sphere with which firms can safely deal.	Closing a business requires a lot of time and money. As business owners resolve the closing of one business, they cannot take the time to open another one.	Businesses face high risks and limited investment because they cannot police their own property. Without an effective legal framework for owning ships and planes, businesses face greater transportation costs.	Consumers seeking services face monopolistic pricing structures, effectively excluding them from purchasing.
Key metrics (How is the issue measured?)	<ul style="list-style-type: none"> • Time to start a business (64 days, nearly the longest in the Pacific) • Cost to start a business ((2.5 % of per capita Income) • Number of Formal vs. Informal Businesses (Fiji has a large informal sector) 	<ul style="list-style-type: none"> • Time to Enforce a Contract (320 days) • Cost to Enforce a Contract (53.8 % of per capita Income) 	<ul style="list-style-type: none"> • Time to close down a Business (1.8 years) • Recovery Rate in Insolvency (20 cents on the dollar) 	<ul style="list-style-type: none"> • Reduced air and shipping costs • Time to enforce contracts • Pledging of warehouse goods 	<ul style="list-style-type: none"> • High telephone call costs • High Internet Costs • Low cell phone penetration
Reform strategy	Simplify business registration process by reforming legislation and regulation.	Consider economic impacts of corporate law and undertake necessary reforms.	Identify areas for improving efficiency in bankruptcy by reforming the law.	Create an effective legal framework for owning ships and planes, and for private policing.	Reduce telecommunications costs and protect consumers better.
Reform Impact	<ul style="list-style-type: none"> • Reduced time to register a business (2 days in Australia) • Low Cost of business registration (0.2 % of per capita income in New Zealand) 	<ul style="list-style-type: none"> • Quick resolution of contracts (27 days in Tunisia, 50 days in New Zealand) • Cheap contract enforcement (Norway: 4.2 % of per capita Income; 4.8% in New Zealand.) 	<ul style="list-style-type: none"> • Reduced time to close down a business (0.4 years for Ireland) • Increased recovery rate in Insolvency (92% on the dollar in Japan) 	<ul style="list-style-type: none"> • Warehouse goods pledged as collateral including crops • Increased number of ships and aircraft registered, incl through the internet • Reduction in shipping and air costs 	<ul style="list-style-type: none"> • More cell phone use, less costs • More Internet service providers, reduced costs • Use of cell phones for electronic transactions
Relevant Acts that need Reform (New legislation marked with *)	<ul style="list-style-type: none"> • Business Licensing Act • Corporations Act • Internet-based Business License and Corporate Registrations Archive* 	<ul style="list-style-type: none"> • Secured Transactions Act • Arbitration Act • Sales Law • Rules for Civil Procedure • Usury Laws • Credit Reporting Act 	<ul style="list-style-type: none"> • Bankruptcy Act 	<ul style="list-style-type: none"> • Warehouse Keepers and Receipt Act* • Private Police Act* • Ships and Aircraft Registry and Law* 	<ul style="list-style-type: none"> • Internet Law • Electronic Transactions Law • Consumer Protection Act • Price Control Acts

Please Note: All Laws and Regulations should be made available via, at minimum, the printing office, and ideally, the Internet.

VII. Financial Markets

A. Introduction

187. Fiji has the most developed and extensive financial market in the Pacific Region. It features five commercial banks, three credit institutions, 10 insurance companies, the Fiji Development Bank and the Fiji National Provident Fund along with a number of smaller non-bank financial institutions, 6 unit trusts (similar to mutual funds) with close to F\$ 130 million under management. There is a small stock market and also a fledgling venture capital company, the Kontiki Fund, which invests in start up companies. Foreign companies own a majority share of all of the commercial banks – the Australia and New Zealand Banking Group (ANZ), Westpac, Colonial National Bank, Bank of Baroda, and Habib Bank.

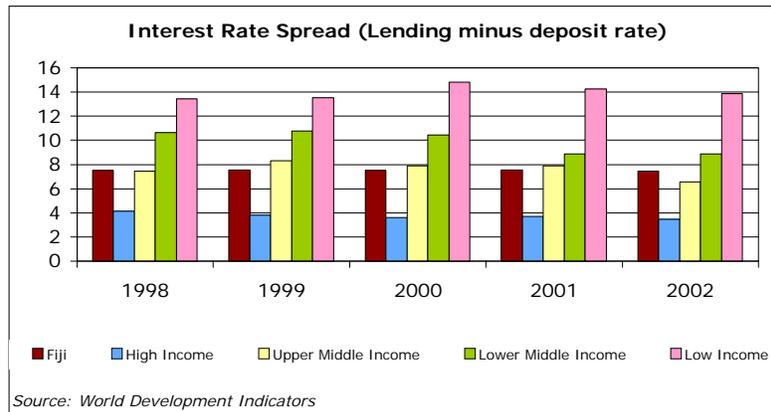
188. Nevertheless, there are grounds to believe that the financial system is falling far short of its potential – financing for a broad range of economic activities is still not available and a substantial portion of the population, particularly native Fijians are effectively excluded from access to finance. There are, however, great opportunities for developing a dynamic financial sector that could finance a broad range of businesses, from lending to small and micro-enterprises, to the stock exchange becoming a regional centre for the raising of finance in the Pacific. The reform steps necessary to move in this direction are outlined in this chapter.

B. Financial Sector Issues

189. Fiji's financial system has a number of problems that include:

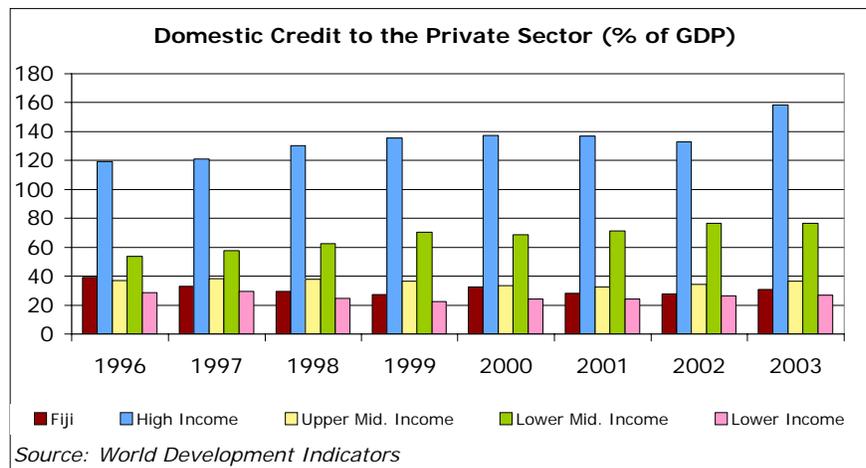
- *High Interest Rate Spreads.* While lending rates are relatively favourable, interest rate spreads are high, in the order of 7–8 percent. (Although they do not compare badly with other lower middle income countries.) In addition, loan costs are high in real terms given bank charges and fees. The spread indicates high unit costs and perceived credit risk due to the difficulty of taking assets as security against loans.

Figure 10. Comparative Interest Rate Spreads



- *Low Levels of Credit to the Private Sector.* Additionally, credit to the private sector is chronically low and provides evidence of the constrained nature of credit in Fiji and its underdeveloped financial market. The ratio of private sector credit to GDP is only slightly higher than low income countries and way below that which would effectively finance the levels of investment required to raise the growth rate.

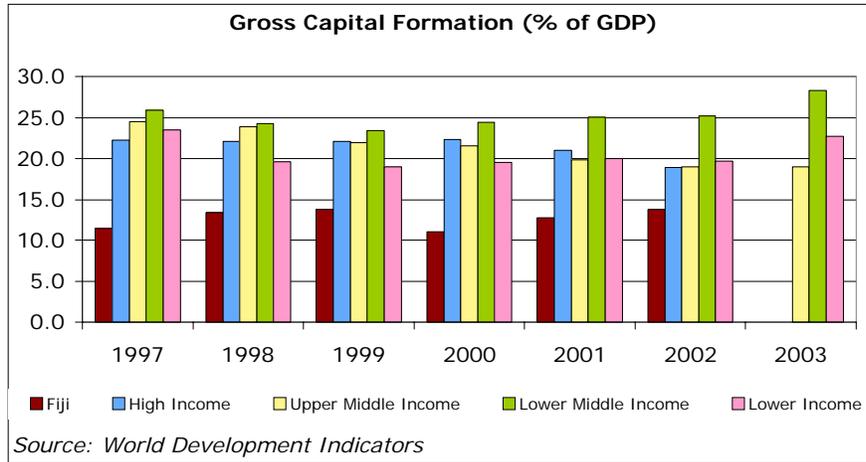
Figure 11. Comparative Domestic Credit to the Private Sector



- *Low Levels of Investment.* Fiji's investment levels have languished below the equivalent of 15 percent of GDP for the last few years. Investment fell sharply in the aftermath of the attempted coup and remains well below levels required to achieve a rate of growth that will bring long term prosperity to Fiji's population. Fiji's gross capital formation is also poor by international comparison, and is well below that of low income countries in the World Bank classification. At current levels of investment, there is no possibility of achieving GDP growth commensurate with

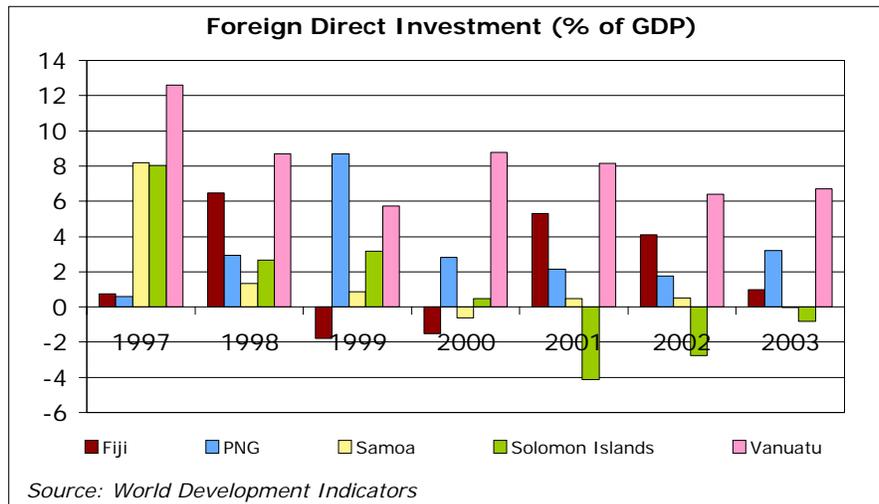
even 5 percent. Maintaining existing growth rates is going to be difficult let alone increasing those rates.

Figure 12. Comparative Gross Capital Formation



- *Low Levels of Foreign Direct Investment.* Fiji’s FDI levels have improved since the period surrounding the political unrest but they are still at chronically low levels and do not compare well regionally. While the levels may have rebounded given the improved political situation, they reflect the more general administrative barriers to investment that exist in Fiji.

Figure 13. Regional Comparison of Foreign Direct Investment



- *The economy is not highly monetized,* with an M2/GDP ratio of 37.1 percent in 2002⁷⁸. It is, however, reasonably liquid given the recent easing of foreign exchange

⁷⁸ World Development Indicators Database

restrictions. Of course, this liquidity is also due to the cautious lending by banks who are understandably risk averse in an economy where debt recovery is difficult.

- *Remittances have risen sharply* over the past few years and now total close to F\$300 million annually. This increase is both an injection of financial resources into the economy as well as a potential source of additional funding for capital projects. However, the latter will only occur when rates of return on investment rise – under present circumstances they will not provide funds for investment.

C. Financial Market Institutions

190. There are a number of financial institutions in which the government has significant involvement. This involvement serves, in some cases, to introduce distortions into an already problematic financial market. In addition, government involvement in capital markets results inherently in conflict of interest. The institutions in which the government either partially or entirely controls include:

1) The Fiji National Provident Fund (FNPF)

191. The FNPF has close to F\$3 billion in assets and thus dominates the capital market and Fiji's financial sector. Offshore investments are limited and its ability to invest in listed companies in Fiji is strictly regulated. There are a number of implications for FNPF's structure and the way it is run.

- Since FNPF is the largest purchaser of government securities it strongly influences interest rates in the Fiji economy. In addition, it is a captive purchaser since it has a very limited range of investment options. Capital market restraints on government spending are therefore weakened. The 2004/2005 budget illustrates this problem. The budget deficit for 2004 is projected at F\$368 million, the majority of the financing of which will come from FNPF.
- Since some 70 percent of FNPF's assets are in government securities, future pension payments are closely related to the macroeconomic policies of the government.
- FNPF makes only limited investments outside the country [as of June 2005, they amounted to F\$306 million]. This concentrates risks in Fiji. Recently, legislation

governing investment was passed which will enable to invest in the United States and other industrial economies more easily. Nevertheless, constraints on balancing the FNPF portfolio reduces the financial soundness of FNPF. Exchange control considerations impacts investment by FNPF, with implications on future pension payments

- FNPF has no requirement that it should place funds with other investment managers. The recent legislation has placed the regulation of FNPF under the auspices of the Reserve Bank who have had a good record in ensuring financial soundness of other institutions that it regulates. Hopefully, this will lead to further portfolio management diversification. Having the entire portfolio managed in-house results in the inefficiencies that accompany any monopoly. Since the capital market is well regulated by the Capital Market Development Authority (CMDA), some portion of funds should be placed with each of the unit trusts that meet CMDA standards of financial prudence. This arrangement will not only provide FNPF with competition in the management of pension funds but will also contribute to the development of the stock market.
- FNPF is prohibited from investing in any public company that does not have a five-year track record on the stock market. This requirement is overly restrictive. Large pension funds in the United States and Europe can invest even in start up companies on a venture capital basis. FNPF should be allowed to invest in newly listed companies⁷⁹.

⁷⁹ FNPF does contribute to the capital of the Kula Fund, but the amounts are very small – less than F\$5 million.

Box 2. Exchange Controls and Exchange Rate Policy

Fiji currently pegs the dollar to a trade weighted basket of trading partner currencies. It uses exchange rate policy as a *nominal anchor* to control increases in prices. Fiji is a small open economy with no influence over its terms of trade. This means that it cannot affect the prices of either its imports or its exports.

An implication of a fixed exchange rate policy such as Fiji's is that it requires international reserves in order to maintain the peg. In particular, large outflows of capital would threaten reserve holdings and perhaps force a discreet, large, and unwanted change in the exchange rate. The Central Bank therefore administers a comprehensive set of exchange controls that place restrictions on the free movement of capital. Permission is required for many foreign exchange dealings. In practice, permission is granted freely for many types of transactions. However, exchange control considerations effectively impact on FNPf foreign investment considerations. A detailed analysis of the issues is beyond this report's scope but it is not inconceivable that the accumulation of risks resulting from FNPf concentrating the bulk of its assets in Fiji is greater than the risks involved in more exchange rate flexibility. While giving the Provident Fund the opportunity to invest more abroad, substantial relaxation or removal of exchange controls also forces responsible behaviour on the Body Politic if collapse of the exchange rate is to be avoided.

2) The Fiji Development Bank (FDB)

192. The FDB is a State-owned development bank, although its role is not well defined beyond the intention to finance investment in Fiji. It has the stated goal to become "more commercial". A recently completed ADB-financed review of the FDB recommended:

"...a strategic framework embedded in a clearly defined and consistent government bank policy framework for effective competition and prudential supervision to improve the commercial approach and effectiveness in development financing for small and medium businesses."⁸⁰

193. However, there is a danger that its operation provides substantial disincentives for private sector banks, and gives them additional justification for not lending to smaller businesses and riskier projects. A key governance issue is the significant involvement by the Government in the appointment of the FDB board. The operation of development banks in other countries provides substantial grounds for concern. The vast majority have a significant proportion of non-performing loans that hinder rather than promote financial market development. Furthermore, with effective financial market reform, the need for a development bank should be substantially reduced. This issue is discussed at greater length in a later section of this chapter. A recent IMF report⁸¹ illustrates the conflict between financial institutions that supposedly follow "development criteria" in

⁸⁰ Asian Development Bank

⁸¹ International Monetary Fund, 2003, Fiji: Selected Issues and Statistical Appendix, IMF Country Report 03/9

their lending policies, and prudential standards that protect the integrity of depositors' funds.

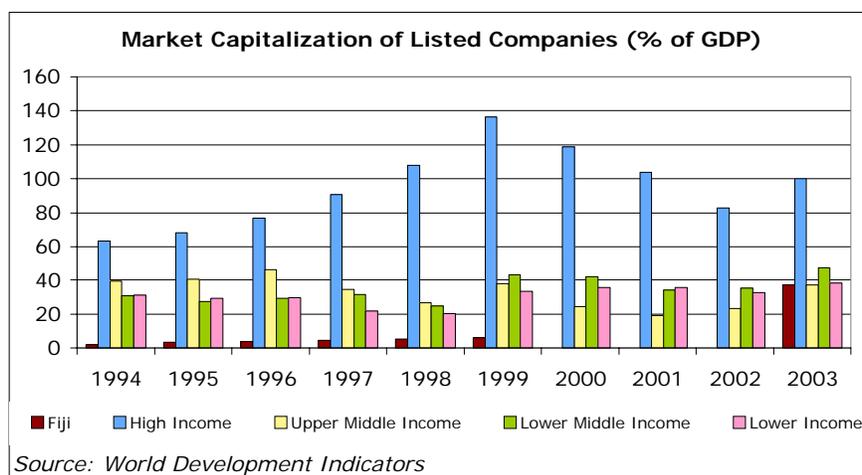
3) Fiji Investment Corporation (FIC)

194. The FIC was established in 2002 with an initial funding of F\$11 million. The aims of the corporation are multivariate but include allowing for the pooling of resources, providing equity to foreign investors for projects that require government participation, generally facilitating investment and increasing investor confidence. It does not appear to have had a substantial impact on investment financing.

4) Capital Market Development Authority (CMDA)

195. The Capital Market Development Authority (CMDA) commenced operations in 1998. It has a role to expand the number and type of financial intermediaries operating in Fiji and to develop and regulate the capital market. There has been growth in the stock market - the number of listed companies has grown from 6 to 15, trading volumes have grown over F\$6 million annually and there are 6 unit trusts with over F\$90 million under management. However, by any measure the stock market remains embryonic and is not yet achieving its potential in Fiji, let alone becoming an effective stock market for the Pacific Region as a whole. CMDA is providing effective prudential regulation of the capital market, although to date it has been frustrated in its efforts to promote substantial market development. A major reason arises from the dominance of the FNPF as discussed in the previous section. CMDA is sufficiently developed to spearhead the next stage of financial market development and is capable of prudentially regulating a diversification of the management of FNPF funds.

Figure 14. Market Capitalization of Listed Companies



D. The Financial Market and Collateral Issues

196. Legal problems in the collateral framework – the property rights laws that govern the use of property as collateral for loans – are the most crucial legal problems in Fiji limiting the growth of commercial lending. This section describes this link for moveable property and sets out the main problems and options for reform. (Chapter V discusses these issues within the context of land.)

1) The Need for Private Finance

197. In 2001, the GDP of developing countries amounted to approximately \$6 trillion. Based on past performance, developing countries must invest about \$1.2 trillion annually just to keep pace with industrial country per capita incomes. Of the amount needed for investment, multilateral development banks and the IMF supplied net new lending of only about \$18 billion in 2001; aid agencies supplied even less. In other words, donors and multilateral development banks represent less than the rounding error of developing countries' investment needs. Therefore, as in other developing countries, Fiji's investment needs will require private funds.

198. Fiji's private finance needs could be met with equities or debt. By all other experience, debt will be the dominant form of finance from outside the firm. At present, Fiji's limited capital market guarantees that outcome. However, even looking to the future, the bulk of finance will probably be debt. (In the United States, with one of the most advanced systems in the world for organizing equity markets, new equity issues amounted to less than five percent of new lending in 2000.) But, for private lending to serve borrowers' needs, the legal and institutional framework needs to assure private lenders about one thing - that the borrower will pay. A country's legal framework for debt collection provides that assurance.

2) The Benefits of an Appropriate Legal Framework for Debt Collection

199. Within the legal framework for debt collection, one essential property right lies in the right to use property as collateral for loans. An efficient system of secured transactions improves access to credit: it lowers interest rates, permits larger loans relative to cash

flow, and provides longer periods to repay. The theory behind this is complex,⁸² but examples abound. Lenders in the United States and other industrial countries all offer better loan terms when a borrower offers collateral compared to a loan backed only by a signature. A borrower offering real estate as collateral could expect to get a loan nine times larger, repayable over a period of time eleven times longer, at an interest rate about 50 percent lower than if the borrower did not have collateral. For a loan secured by movable property, the borrower would get loan terms somewhere between those for unsecured loans and those secured by real estate.

200. When the law permits effective use of collateral, the risk from lending falls. Lenders react by offering more credit at the same or better terms. More credit at lower interest rates permits higher rates of investment and more capital per worker, leading to much higher incomes. Seventy percent of bank loans in the United States are secured. At the same time, credit in the United States is about ten times higher relative to GNP than it is in most developing countries. Farmers and business operators borrow routinely at interest rates about 600 basis points higher than the government-borrowing rate, a fraction of the spread facing their counterparts in most developing countries. A legal framework for secured transactions also reduces poverty and reduces wealth disparities, because secured transactions for movable property improves access to credit by the poor and by micro and small enterprises, compared to those with large assets in real estate. But, Fiji laws do not reflect these legal issues.

201. With few exceptions, Fijian farmers and business operators get little advantage from offering property as collateral for loans. But the question is why this experience differs so much from that of industrial countries?

3) The Economic Elements of a Sound Collateral Framework

202. The fundamental economic feature of collateral and a secured lending system (one that uses collateral) lies in granting priority to a lender in collecting against a debtor's property. A security interest is "a right of satisfaction" from collateral/property to which

⁸² For a discussion of credit rationing in a developing country context, see Karla Hoff and Joseph Stiglitz "Introduction: Imperfect Information and Rural Credit Markets -- Puzzles and Perspectives" in *The World Bank Economic Review* Vol. 4, No. 1 (Washington, DC: The World Bank, 1990), pp. 235 -250. As the authors note, using collateral is one way that lenders surmount informational asymmetries and enforcement problems that produce credit rationing. See pp. 242-243.

the security interest is attached. If the debtor defaults, the collateral can be sold or exchanged, and the security interest of the secured creditor will be satisfied (or paid) ahead of the general claims of unsecured creditors. Moreover, the security interest of a secured creditor will be satisfied in the order of its priority among the other secured creditors that have a security interest against that same collateral. Without a security interest, a creditor is "unsecured". An unsecured creditor has only a general claim against a debtor's property - a claim that gives the creditor no better right to payment than any other unsecured creditor.

203. The legal framework in Fiji ostensibly lets creditors enter into a secured loan by creating a security interest against a debtor's property⁸³. However, this logical possibility under the law cannot alone bring the economic benefits of a secured lending system. Taken together, Fiji's laws might superficially indicate that property can serve as security for loans. But, Fiji's secured transactions framework does not pass these essential economic tests as the next section shows.

4) Problems with Fiji's Collateral Framework

a) Creation Problems

204. **Coverage Gaps.** Gaps in coverage of transactions and those entering into loan contracts limit the use of secured transactions:

- The company charge can only secure assets of a registered company, eliminating most small businesses and individual entrepreneurs from using collateral.
- The Bills of Sale Act applies to unincorporated businesses, but can only secure the purchase of new goods.
- The Crops Liens Act has limited application to financing crops and it sets out very strict prerequisites for using future crops as collateral. Bankers interviewed indicated that they rarely if ever made loans using crops as collateral.

205. **Costs.** In addition, most security interests in Fiji are costly. For example, a business must incorporate to use the company charge to finance its inventory. Unincorporated

⁸³ The company charge under the Companies Act, the bill of sale under the Bills of Sale Act, and crop lien under the Crops Liens Act provide such a legal basis for movable property. The Land Transfer Act provides for the mortgage in real estate.

businesses in Fiji, therefore, do not have a security interest under which they can use their inventory or accounts receivable as collateral⁸⁴.

206. **Limitations of the company charge.** In Fiji, limitations in the company charge hold back business development:

- The legal framework for the company charge leads to an over-collateralisation of present and future assets to one lender. In general, lenders require all the assets of a company to be pledged as collateral and usually require assets, the value of which are the equivalent of several times the value of the loan.
- It limits competition from other lenders who, under other systems, could secure loans with other assets of the same company.

207. Limited competition, however, is a central problem in Fiji's economy and in its provision of financial services. The enforcement mechanisms of the company charge, moreover, do not permit an efficient balance between creditors and debtors - under the Company Charge creditors can confiscate a large amount of property even after a small default – an example of the weak protection of consumer rights in Fiji.

b) Priority Problems

208. Priority plays an essential role in a secured transactions system: it establishes the order in which the enforcement procedure will satisfy claims against the property serving as collateral. For lenders, establishing their priority against the collateral is crucial: even valuable property cannot serve as collateral if a lender cannot determine the value of other claims secured by that property that has a higher priority than the claim that the lender contemplates. For example, a future wheat crop with a minimum value of \$10,000 may be excellent collateral for a \$6000 loan if no prior claims exist. However, the same crop will be less adequate collateral for a smaller \$5000 loan if a prior claim for \$7,000 exists. Where conflicts of priority exist, secured financing will not take place.⁸⁵

⁸⁴ For unincorporated businesses, the legal framework permits purchasing goods on credit under the Bills of Sale act. However, a bill of sale must always incur the costs of attestation and registration. Failure to follow this requirement voids the sale transaction. The Bill of Sales Act.

⁸⁵ In default, loans without priority will become portfolios of uncollectible loans. Indeed, a secured loan by definition cannot have a conflict of priority. Without resolution of priority, even a loan that the law defines as a secured loan is, in economic terms, unsecured.

209. Fiji law does not set out comprehensive rules for priority ranking of creditors against movable property. Each law states that registration in some registry gives priority. With the exception of the security interest in future crops under some provisions in the Crops Liens Act and the Bills of Sale Act, the law says little about the conflict between creditors under different laws.

210. For account receivables financing, Fiji law grants priority by notice and does not provide a ranking of priority by registration. This situation severely limits accounts receivable financing. Priority issues in real estate are less of a problem in Fiji -- the law does include specific provisions that rank the priority of claims in real estate from the time of registration. Finally, for both movable and real estate property, Fiji's laws provide for a ranking of priority of security interests only from the day of registration.

c) Publicity (Registries) Problems

211. The laws that set out the operation of Fiji's registries do not provide a legal framework that can support an efficient registration system. Some common legal issues emerge from the various Acts that govern registration of mortgages, company charges, and bills of sale:

- **Agreement Registry versus a Notice Filing Archive.** Fiji law follows a registration system that calls for filing the agreement that governs the security interest to make it public.⁸⁶ Registering the entire agreement costs more: the costs of filing the entire agreement are greater and not standard; checking is complex and time consuming. Moreover, because so much information is filed, both filers and administrators have incentives to restrict public access. This arrangement defeats the purpose of the filing system: making public such data.
- **Manual Operation.** Manual operation is the only registration method supported by the existing legal framework for mortgages and bills of sale.

d) Enforcement Problems

212. Can the creditor, in the event of default by the debtor, repossess or evict and then sell the property that the debtor gave as collateral? Any rational lender or credit seller will

⁸⁶ Section 10 of the Bills of Sale Act. See also, registration provisions under the Land Transfer Act for mortgages, and the Companies Law for the company charge.

focus on the value of collateral after the costs of sale and seizure, not on its nominal market value. Lenders who face slow and expensive enforcement will simply adjust the size of the loan downward relative to the value of collateral realized after the costs of sale and seizure, not its market value before these actions are taken. Enforcement has two steps: repossession (for movable property) or eviction (for real estate), and sale. Enforcement issues were discussed in detail in Chapter VI.E.

5) Unsecured Loans

a) Creation Problems

213. Because there is great freedom of contracting under Fiji law, unsecured loans and sales on credit will face fewer constraints than secured loans. Still, bill of sale will always incur registration costs.

b) Publicity Problems

214. Information about unsecured lending rests on the private market, which can share information in credit bureaus. The best legal frameworks that foster the development of credit bureaus are those that most liberally permit the use, compilation, and sharing of information. Essential in this situation is legal support for public access to courts and public registries.

215. Recently, a credit bureau was established in Fiji, although it is too early to determine the degree to which it is effective. Early indications are encouraging. There are 90,000 consumer names, 15,000 companies and 20,000 non-limited companies in the database and 34 companies, including financial institutions subscribe to it. It produces 3 types of reports:

- Financial behaviour
- Default statistics on amounts over F\$20
- Public notices

216. It is too early to say how the availability of credit information will affect the granting of credit in Fiji, but well functioning credit bureaus have promoted lending in other countries.

E. Conclusions

217. By comparison with other Pacific Region countries, financial markets in Fiji are well-developed. Yet there are serious gaps in their ability to finance investment and to encourage savings. This chapter has reviewed the most important issues hindering further financial market development. It concludes that the institutional framework for secured lending appears inadequate and is in need of reform. Fortuitously, Fiji is included among the countries in an upcoming ADB Regional Technical Assistance that will analyze the deficiencies in the system of collateral and make suggestions for reform. Progress in this area should make a substantial contribution to increasing bank lending.
218. A further conclusion is that FNPF because of its very size is hindering financial market development. It dominates every aspect of the financial sector. It monopolizes management of its fund, which has the effect of limiting the size of Unit Trusts, which have the capability to manage part of the portfolio. Given the expertise of CMDA in supervising these institutions to ensure financial soundness, there is no reason why a significant portion of FNPF funds should not be placed under outside management. In addition, exchange control regulations prevent prudent diversification of FNPF's portfolio outside Fiji, regulations that potentially could damage future pension payments by focusing all portfolio risk within Fiji. A healthy diversification is recommended strongly. The Government of Fiji has requested technical assistance from the ADB to analyze the issues facing FNPF and make recommendations regarding its future structure and operation. This report strongly supports such a request.

VIII. Conclusions and Policy Recommendations

219. During the course of country visits, analyzing the issues, and writing the report, many topics were identified as being relevant for promoting private sector development in Fiji. However, this section focuses on a relatively limited number of priorities for reform. Concentrating on key issues will yield greater dividends than providing a long list of measures that need to be addressed. In addition, the report does not dwell on the damage that political uncertainty has done to investment and confidence in the country. However, there is no question about the impact of the attempted coups of the past 20 years – they have substantially contributed to making Fiji a less attractive place to invest for both Fijian nationals and foreign investors, which in turn has damaged growth and contributed to poverty. The stability of the political system and the credibility of policy is an essential foundation of a good environment for private sector development that fosters investment, entrepreneurship, and growth.
220. Many different indicators show that there are serious deficiencies in the business environment in Fiji. The red tape involved in starting a business is extensive. Financial markets do not fund investment effectively. The state has a large role in the economy, utilizes assets inefficiently, and partially crowds out the private sector. It is likely that a limited number of relatively simple changes, such as reducing some of the pervasive red tape in the economy could result in an increase in Fiji's growth rate in the short run. Sustaining growth in the longer term, however, will necessitate some fundamental changes in the institutions supporting the business environment in Fiji.
221. It is encouraging that the government recognizes the need for a greater role for the private sector. In several areas identified as important by this report, reform is commencing. The role of SOEs is being reviewed and new policy is being developed to change fundamentally the way that SOEs operate. Foreign investment procedures are being examined with a view to speeding up the processes surrounding approvals. A new process of consultation with the private sector has been established, with the formation of a “brains trust” of business people to report to the prime minister on raising

investment and the formation of a number of public/private committees to provide input into the Strategic Development Plan. These are made up of senior public sector officials and members of the business community. The government has acknowledged the need for legal reform in the area of commercial law.

222. A question that remains open, is how far the realization of the importance of the private sector extends among government employees. Any meaningful change, small or large, requires the support not only of the business community and senior government officials but also of the bureaucracy at large. To achieve this end, all parties must commit to a more meaningful dialogue on private sector issues and problems in Fiji. In this regard, donors have an important role to play. They can act as interlocutors by helping to promote dialogue through encouraging forums where interchange takes place. They can also commit to assisting with reform itself.

A. Incentive and Tax Issues

223. The Government of Fiji is currently providing incentives to foreign investors in the form of tax holidays, and to local businesses in the form of strongly accelerated depreciation allowances. At the same time, the company tax rate of 31 percent is comparatively high. The combination of the two factors results in business decisions that do not lead to the best allocation of resources for the development of the Fijian economy. Furthermore, gross capital formation as a percentage of GDP is low and insufficient to generate the growth necessary to employ the burgeoning number of school leavers. For the most recent years for which data are available, foreign direct investment has been negative. It can hardly be said that the incentive regime is successful and the potential for offering further concessions is limited.

224. Clearly, the current system of incentives is not working. Incentives are offered in an attempt to offset the high cost business environment – a better and more sustainable solution would be to reduce the costs of doing business, lower the general rate of company tax and eliminate incentives altogether. Fiji has the opportunity to be an example to small economies everywhere. The “race to the bottom“ that results from countries attempting to attract companies with ever greater concessions is damaging to all those involved. It provides foreign investors with the opportunity to play countries

off against each other. Studies in the USA of states that provide substantial incentives to investors have shown that the costs of the incentives exceed the benefits. We recommend reducing the company tax rate sharply and eliminating all special incentives and concessions. The exact amount by which the tax rate should be reduced must be the subject of further analysis. Nevertheless, this step can be combined with a drastic reduction in the red tape involved in setting up businesses as outlined below.

B. State Owned Enterprises and the Government's Role in the Economy

225. The State is ubiquitous in Fiji. It owns or has a significant shareholding in 29 enterprises. It has a majority stake in Fintel, the cellular phone company, and through the FNPF controls the rest of the Telecom sector. It prevents private investment in such areas as building a slipway for repairing ships. The very low or negative rates of return they earn on their assets shows the inefficiencies of their operation. Because they have government mandated monopolies, they crowd out private investment. With the exception of the monopoly profits from ATH, state owned companies earn returns on equity that fall far short of the cost of funds. The ADB has supported SOE reform through technical assistance and the government had indicated that it intends to reform the SOE sector through corporatisation, privatization, and the introduction of competition. But so far there has not been a substantial amount of progress. There are many options for change that do not require wholesale privatization, but would improve efficiency substantially.

226. The ADB has previously assisted the government in an earlier analysis of SOE issues. Recently, the government announced its intention to engage in further SOE reform. This report endorses strongly the SOE reform initiative and would endorse any request to the ADB to provide further assistance to the Government to formulate a coherent SOE strategy, including timetables and action plans that will result in the introduction of competition in the areas where SOEs operate. Tackling the low rates of return earned by SOEs is one of the most important issues in promoting a dynamic private sector environment in the country. With regard to FEA, this report supports two immediate steps. First, remove prohibition on private providers supplying power to whomever they wish. This change will introduce much needed competition and incentives for

efficiency. Second, FEA should be advised that it will not be the recipient of any further government guarantees, provided with a timetable within which it must meet strict performance targets, and that full privatization is a viable policy option.

227. Reforms in this area, with the help of donors, such as the ADB can be accomplished relatively quickly and hold the possibility of substantial increases in efficiency, which can feed into the economy quickly and which can substantially reduce transactions costs. In particular, initiatives to improve the operating efficiencies of the airport through exploring public private partnerships can quickly benefit tourist and business travel to Fiji. Currently, a substantial reduction in international and business telephone charges through better regulation of telephone provision is being discussed. This measure, along with the introduction of further competition through the sale of additional cellular licenses has the potential to quickly improve productivity in dynamic sectors of the economy.

C. Land Issues

228. Land issues in the Pacific Region are difficult to resolve. Perhaps for this reason, governments and donors have shied away from tackling them. Any reform will take an extended period to analyze, discuss and finally implement. This, however, is a reason to start work immediately, rather than to postpone it for an undefined future date. The land leasing framework in Fiji is far more advanced than it is in other countries in the Pacific Region. Indeed other countries in the Pacific have much to learn from the progress made in Fiji. This is not to say, however, that there are not many problems with Fiji's system of land holding that seriously impact private sector development in the country.

229. The report suggested options such as certainty of renewal, or long term notice of non-renewal, resolution of the issue of compensation for improvements, and the exploration of a system of block grants for agricultural land. In the area of leasing for other purposes, compensation issues need to be examined and an analysis of ways in which Fijians can mobilize their land assets more effectively is required urgently. The time to start looking at these issues is now.

D. Legal and Regulatory Issues

230. The conclusions of the recent analysis of the legal framework for business is that the legal system in Fiji is based, in many cases, on outdated UK, Australian or New Zealand laws, which do not provide an effective foundation for modern commerce. The analysis outlines a number of areas for legal reform. The Ministry of Commerce has expressed interest in proceeding with these reforms and has identified electronic transactions, contract enforcement and collateral reform as being areas that have particular priority.
231. The problems of delays arising from investment approvals have been documented in several other ADB reports. This does not mean that they are any less pressing for having been identified. There is the anomalous situation where incentives are being used to attract investment on the one hand and the lengthy approval process is driving investors away on the other.
232. The long term aim should be a regime of light regulation. The World Bank Doing Business Indicators illustrate clearly that Fiji ranks poorly in the time it takes to start a business and in the time it takes to enforce contracts. Over the past year, there has been an intensive review of foreign investment regulatory processes under the auspices of the Ministry of Commerce and FIAS. A substantial number of barriers to foreign investment have been identified and the process of rationalizing and eliminating some of the most significant barriers has commenced. Progress is already being achieved. This report endorses this initiative strongly and supports its continuation. This report recommends, additionally, that the distinction in law and procedures between local and foreign investors be abolished.

E. Financial Market Issues

233. Capital markets are underdeveloped, even though they are deeper than any of the other Pacific Region economies. This underdevelopment arises from two factors.
234. The institutional framework that supports the pledging of collateral is inadequate and requires reform. Currently, banks are reluctant to lend to any but the larger companies and will not lend to sole proprietorships at all. Leasing is difficult and equipment suppliers cannot pledge their accounts receivable effectively, so the suppliers in turn do not offer credit. We recommend that reform of the secured transactions framework of

Fiji be considered an urgent priority. Fiji is part of an upcoming ADB Regional Technical Assistance on secured transactions reform in the Pacific Region. This analysis should provide a direction for a secured transactions reform program in Fiji.

235. The dominance of the Fiji National Provident Fund is seriously hindering financial deepening. Although FNPF is heavily regulated in order to ensure financial stability but the protection provided by this regulation is illusory. Because the vast majority of its assets have to be invested in Fiji, it is totally reliant on developments within the country for providing for the future well being of its contributors, which make up the bulk of the working population in Fiji. This report recommends that the current policy of fixed exchange rates be reviewed with a view to further relaxing and ultimately abolishing exchange control. Furthermore, FNPF is the main purchaser of government bonds, so it is effectively setting interest rates in Fiji. It is by far the main source of financing for the budget deficit. Whether having a “captive” provider of such funds is a question that deserves a substantial amount of further investigation. It also is the sole manager of its investment capital; having a portion of its portfolio managed by the Unit Trusts could foster more competition. Some of the rules of FNPF hinder stock market development – no investments can be made in companies that have not been public for 5 years, which hampers the growth of Fiji’s nascent stock market. Recently, the law governing the operation of FNPF have been changed to allow greater flexibility in foreign investment and to put FNPF under the supervision of the Reserve Bank of Fiji. This move heightens the closeness of the link between foreign investment by FNPF and exchange rate policy since the Reserve Bank is in charge of both issues.

F. Reform Implementation

236. The topics discussed in this report cover a wide spectrum of economic and legal issues. They fall under the jurisdiction and purview of several government ministries or departments and agencies. It is not realistic to expect that any single ministry or department could encompass the range of issues that has been discussed. How then to bring about meaningful reform? Without “champions” pushing for change, little will happen.

237. The suggestion of this report is to identify counterparts outside government who will take on particular issues and push for change. For instance, the Law Society could become the counterpart with the Ministry of Justice to promote legal change, the CMDA could be the counterpart to promote financial market reform, the Chamber of Commerce could promote reform of the incentive environment, and so on. In addition, the new advisory committees have substantial potential to promote reform over a wide range of issues. However, the intention of the government, as articulated by senior officials and the prime minister, must manifest itself in pressure on the middle level of government employees to ensure that any momentum generated does not founder on the rocks of bureaucratic inertia. Only in this way will meaningful change occur to enable Fiji to attain the potential that it so clearly has.

238. A further issue is the **timing and sequencing of the reforms** suggested in this report. The following section contains a summary table with suggestions for how this might be achieved for some of the priority reform areas, how they could be sequenced, the government agencies that could be responsible, and the possible role of donors in the reform process. Clearly, the summary table overleaf represents only a first step towards preparing reform implementation. It is up to the various government agencies involved to commit to reforms, establish mechanisms and ownership for the process, and communicate this to key stakeholders, including the private sector and relevant donors, soliciting their implementation support. It is noted in this context that ADB has expressed general commitment to supporting SOE reforms and public private partnerships, and carrying out diagnostic studies (including reform implementation plans) in the identified priority areas of legal and regulatory reform and collateral reform.

239. Putting the private sector at the heart of Fiji's economy will require making some difficult choices. It will take courage, leadership, and political will to do so. However, these choices must be made if poverty is to be reduced and opportunities. If opportunities are seized boldly, the rewards for Fiji could be enormous.

IX. Summary Strategy for Implementing a PSD Agenda

Reform Area	Strategy	Sequencing/Timing	Government Responsibility	Possible Donor Support
IMMEDIATE PRIORITY AND READINESS				
SOE Reform / Public-private Partnerships	Support SOE reforms and private public partnerships	Commence in late 2005/early 2006 for a duration of initially 2-3 years	Ministry of Public Enterprises and Public Sector Reform possibly in cooperation with CMDA, South Pacific Stock Exchange, Institute of Directors	ADB (approval in 2005 or 2006) for US\$800,000
Collateral Reform	Establishment of a well-functioning (collateral) framework, including new secured transactions law, internet-based notice filing archive, and capacity building.	Commence in 2006 over 2-3 years.	Ministry of Finance and National Planning, in close cooperation with Ministries of Justice and Commerce, Reserve Bank, CMDA, Banks and legal practitioners will need to be actively involved.	ADB: diagnostic study being undertaken under Regional TA resources in 2005. Country specific TA for reform implementation to be programmed in 2006
Legal and Regulatory Framework	Strengthening the legal and regulatory environment for private sector investment	Priority reforms, such as electronic transactions, business registry and contract enforcement, can be implemented over 3-5 years, but the larger reform agenda may require a 10 year horizon.	Ministry of Commerce, Regulatory Reform Task Force, Ministry of Finance and National Planning, in close cooperation with Ministries of Commerce and Justice, Chief Justice's Chambers, and relevant line Ministries	ADB: diagnostic study provided under ADB Regional TA. FIAS: undertaking diagnostic of registry of companies. Large reform agenda requires cooperation with other donors, particularly FIAS/World Bank, AusAID, and NZAID.
(Foreign) Investment Regulation	Investment regulation and processes, and promotion.	Ongoing	Ministry of Commerce	FIAS
FNPF Investment Regulation	Regulation and supervision of operations and asset management	Diagnostic and implementation over 2 years	Reserve Bank, Ministry of Finance and National Planning, FNPF	World Bank assistance requested by Government.
MEDIUM-TERM PRIORITY AND REFORM READINESS				
Tax and Incentive System	Review of the tax and incentive system	Review, strategy formulation, consultations and approval over 1-2 years, implementation over 2 years.	Revenue Policy Committee & Ministry of Commerce	Possibly PFTAC/IMF
Customary Land Issues	Analyze ways for Fijians to mobilize land assets by negotiating fully negotiable leases; streamline NLTB procedures.	Possibly 5 years, but ideally within the framework of larger land related reforms.	Prime Minister's Office, NLTB, Ministry of Fijian Affairs	To be determined
ONGOING/COMPLEMENTARY				
Physical Infrastructure and Services	Improve the provision, operation, and maintenance of infrastructure	Ongoing	Relevant line Ministries	ADB (in water sanitation, roads, electricity, airports) and other donors
Rural PSD Issues	Examine the constraints to a thriving private sector in rural areas	Commence within 2 years	Relevant Line Ministries	ADB support for Technical Assistance

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Appendix A: Fiji Licensing Laws

240. List of licensing requirements from the Consolidated Index (to January 2003) of the Solicitor General “Laws of the Fiji Islands General Index Acts & Subsidiary Legislation Date Revised: 6 January 2003):

Coconut Industry (Licenses And Fees) Regulations
Banking (Licence Fees) Regulations
BUSINESS LICENSING ACT (CAP. 204)
(Amdt: 26/97)
Ba (Business Licence Fees) By-Laws - L/N 126/86
Businesses Requiring Licence
Business Licence (Fees) Regulations
Business Licence (Fees) (Amendment) Regulations - L/N 6/87
Labasa (Business Licence Fees) By-Laws - L/N 127/86
Lami (Business Licence Fees) By-Laws - L/N 128/86
Lautoka (Business Licence Fees) By-Laws - L/N 125/86
Levuka (Business Licence Fees) By-Laws - L/N 133/86
Nadi (Business Licence Fees) By-Laws - L/N 129/86
Nausori (Business Licence Fees) By-Laws - L/N 130/86
Savusavu (Business Licence Fees) By-Laws - L/N 132/86
Sigatoka (Business Licence Fees) By-Laws - L/N 131/86
Suva (Business Licence Fees) By-Laws - L/N 124/86 Tavua Business Licence Fees By-Laws, 1992 (L/N 9/93)
Ba Business Licence Fees (Amendment) By-Laws 1993 (L/N 37/93)
Savusavu (Business Licence Fees (Amendment) By-Laws, 1993 - L/N 38/93 (Revokes 1979 By- Laws)
Labasa (Business Licence Fees) (Amendment) By-Laws, 1993(L/N 39/93)(Revokes 1979 By-Laws)
Suva Business Licence Fees By-Laws, 1993 (L/N 40/93) (Revokes 19879 By-Laws)
Lautoka Business Licence Fees) By-Laws, 1993 (L/N 41/93)(Revokes 1979 By-Laws)
Lami Business Licence Fees By-Laws, 1993. (L/N 42/93) (Revokes 1979 By-Laws)
Levuka (Business Licence Fees) By-Laws 1993. (L/N 43/93)(Revokes 1979 By-Laws)
Nausori Business Fees By-Laws, 1993(L/N 44/93) (Revokes 1979 By-Laws)
Sigatoka Business Licence Fees By-Laws - (L/N 45/93) (Revokes 1979 By-Laws)
Nadi Business Licence Fees By-Laws, (L/N 46/93)(Revokes 1979 By-Laws)
Nausori Business Licence Fees By-Laws 1994 - (L/N 72/94)
Levuka Business Licence Fees) By-Laws 1994 - (L/N 73/94)
Business Licensing (Labour) (Fees) By-Laws, 1995(L/N 33/95) - Revokes 1986 and 1993 By-Laws)
Business Licensing (Nadi Business Licence Fees) By-Laws, 1995(L/N 39/95) Revokes - 1986 & 1993 By-Laws.
Business Licensing (Suva Business License Fees) By-Laws 1995(L/N 46/95) Revokes 1986 & 1993 By-Laws, Nadi

Business Licensing (Lami Business Licence Fees) By-Laws, 1995(L/N 132/95)(Revokes 1986 & 1993 By-Laws)

Business Licensing (Lautoka Business Licence Fees) By-Laws, 1995(L/N 133/95)

Business Licensing (Nausori Business Licence Fees) By-Laws, 1995 (L/N 134/95)

Business Licensing (Levuka Fees), 1995 (L/N 135/95)

Business Licensing (Ba Business Licence Fees) By-Laws, 1995 - L/N 136/95

Business Licensing (Sigatoka Business Licence Fees) By-Laws (L/N 137/95)

Business Licensing (Savusavu Business Licence Fees)By-Laws,1995 (L/N 138/95) - (Revoked 1986 & 1993 By-Laws)

Business Licensing (Local Govt Business Licence) (Regulations, 1995 (L/N 113/95

Suva (Business Licence Fees) (Amendment) By-Laws, 1997- L/N 107/97

Lami Business Licence Fees (Amendment) By-Laws, 1997- L/N 108/97

Lami (Business Licence Fees) (Amendment) By-Laws, 1997- L/N 111/97

Labasa (Business Licence Fees) (Amendment) By-Laws, 1997- L/N 116/97

Sigatoka (Business Licence Fees) (Amendment) By-Laws, 1997 - L/N 153/97

Nadi (Business Licence Fees) (Amendment) By-Laws, 1997 - L/N 163/97

Lautoka (Business Licence Fees) (Amendment) By-Laws, 1997- L/N 165/97

Levuka (Business Licence Fees) (Amendment) By-Laws, 1998- L/N 33/98

Ba (Business Licence Fee) (Amendment) By-Laws, 1998- L/N 23/98

Tavua (Business Licence Fees) (Amendment) By-Laws, 1998- L/N 37/98

Lautoka (Business Licensing Fees) (Amendment) By-Laws 1998 - L/N 90/98

Labasa (Business Licence Fees) (Amendment) By-Laws - L/N 105/98

Nadi (Business Licence Fees) (Amendment) By-Laws - L/N 132/98

Sigatoka (Business Licence Fees) (Amendment) By-Laws, 1999 - L/N 14/99

Lami (Business Licence Fees) (Amendment) By-Laws, 1999- L/N 52/99

Business Licence (Fees) (Amendment) Regulations 1999 - L/N - 156/99

Nasinu Town Council (Business Licence Fees) By Laws 2000 - L/N 149/2000

Levuka (Business Licence Fees) By-Laws 2001 – L/N 20/2001 – (1995 By-Laws revoked)

Suva (Business Licence Fees) By-Laws 2002 – L/N 106/2002

Capital Markets (Securities Exchanges & Licensing) Regulations 1997 - L/N 52/97

Civil Aviation (Fees for Licenses and Certificates) Regulations

Customs (Prohibited Imports and Exports) (Licensing of Imported Rice) (Amendment) Regulations, 2000- L/N 23/2000

Customs (Prohibited Imports and Exports) (Revocation of Licensing of Imported Rice) (Amendment) Regulations, 2001- L/N 19/2001

FISHERIES ACT (CAP. 158)

Amdt: 46/91

Appointment of Licensing Officers: Motor Vehicle Licence Fees (Exemption) Order

Restaurant Licenses: Quota to Tavern Licence – G/N 1674/2002

Appendix B: Fiji's State-owned Enterprises

Category/Enterprise	Shareholding (%)
Government Commercial Companies	
1. Airports Fiji Limited	100
2. Fiji Broadcasting Limited	100
3. Fiji Hardwood Corporation Limited	100
4. Ports Terminal Limited	100
5. Rewa Rice Limited	100
6. Unit Trust of Fiji	100
7. Viti Corp Limited	100
8. Yaqara Pastoral Company Limited	100
9. Post Fiji Limited	100
10. National Trading Corporation Limited	100
11. Fiji Shipbuilding Corporation Limited	100
Commercial Statutory Authorities	
1. Civil Aviation Authority of Fiji	100
2. Fiji Electricity Authority	100
3. Housing Authority	100
4. Maritime and Ports Authority of the Fiji Islands	100
5. Public Rental Board	100
6. Fiji National Training Council	100
Majority Owned Government Companies	
1. Air Pacific Limited	51
2. Fiji Pine Limited	99.9
3. Fiji Sugar Corporation Limited	68
4. Fiji International Telecommunication Limited	51
5. Pacific Fishing Company Limited	98
Minority Owned Companies	
1. Air Fiji Limited	11.5
2. Colonial National Bank	49
3. Amalgamated Telecom Holdings Limited	49
4. Fiji Reinsurance Company Limited	20
5. Pacific Forum Line Limited	23
6. Shipbuilding Fiji Limited (being wound up)	49
7. Daily Post Newspaper	44