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## SMALL STATES IN TRANSITION – FROM VULNERABILITY TO COMPETITIVENESS

# TONGA

## NATIONAL EXPORT STRATEGY: SCOPE, FOCUS AND PROCESS

## **Brief economic overview**

The economy of Tonga has traditionally been dominated by the agricultural sector, with manufacturing contributing to a relatively small percentage of GDP. Over recent years, the fishing industry and the service sector, including tourism, have become more important. The economy recorded robust growth of 5.3% in 2000. This was led by a large increase in the trade and services sector (tourism) related to millennium celebrations, together with the income effect from increased workers remittances. Growth was also supported by a recovery in agricultural production.

However in 2001 and 2002, the growth rate was at quite modest rates of around 2%. Inflation remains at around 11 – 12%, mainly as a result of increasing world prices and some further devaluation of the pa'anga. Remittances continue to make an important contribution to the economy.

## **Economic Statistics**

- **Population:** 100,300 (2000)
- **Land Area:** 800 square kilometers
- **Exclusive economic Zone:** 700,000 square kilometers
- **Political Status:** an independence monarchy
- **GNP:** US\$ 172million (2002)
- **Major Industries:** fisheries, agriculture, manufacturing and tourism
- **Merchandise Exports (FOB):** US\$ 9 MILLION (2002)
- **Major exports:** squash, fish, root crops and vanilla
- **Merchandise Imports (CIF):** US\$ 70 million (2002)
- **Major Imports:** food and live animals, machines, transport equipment, manufactured goods, mineral fuels etc
- **Currency:** Tongan Dollar – Pa'anga
- **Average Foreign Exchange:** US \$1 = T\$ 1.7585(2002)

## **Trade Policies**

There is no domestic law that dealt specifically with trading requirements. There are certain trading requirements are covered by certain other laws such as the Customs Regulation and the Industrial Development Incentive Act. The Minister exercises the discretionary power for Labour, Commerce and Industries in the application of such requirements.

Tonga requires strong partnership between the government and the private sectors in trade policy development.

Tonga still depends on import duties as an important source of government revenue. About 46 % of government revenue derived from customs duties and the Port and Services Tax. Other major sources of government revenue are Income tax, Taxes on goods and Services, Entrepreneurial and Property Income, administrative fees and charges.

### ***Some of the issue relating to trade policy development in Tonga includes:***

- Limited coordination amongst government agencies in the implementation of trade policies
- Limited involvement of the private sector and civil society in trade policy development
- Government still depend on customs tariffs as major source of revenue

The Ministry of Labour, Commerce and Industries is actively pursuing private sector development and in particular, foreign investment. The government has increasingly worked closely with the Private sector in trying to meet their demands and needs for a productive development. However

there is room for improvement of the cooperation between Government and the private sector that needs to be addressed.

Government Consultative Committee with representatives from private sector and non-government organization was established to consult with government in matters related to the development of private sector especially when dealing with law reforms on trade or any other issues that might concern the private sector. The Tonga Chamber of Commerce represents the interest and any concerns from the private sector to the government. Hence, the government is able to consider their views in developing of reform policies and regulations.

### **Tonga Accession to WTO**

Tonga is in the process of accession to the WTO. The WTO is about the facilitation of trade- its role is to provide a forum for the negotiation of trade liberalization and the provision of rules underlying that liberalization. The objective is fair trade, not free trade.

Accession to the WTO and the introduction of the rules and regulations that it involves gives Tonga, a platform on which to work towards improving our trade position. The introduction of transparency and improved customs facilities, the reduction of duties and the MFN treatment that will be afforded to us as a member are just some of the improvements that we will see as a result of WTO membership.

One of the principles of the WTO system is for countries to lower their trade barriers and to allow trade to flow more freely. Just how low those barriers should go is something member countries bargain with each other. Tonga's negotiation position will depend on how ready we feel we are to lower the barriers and on what we want to obtain from other members in return.

Tonga intends to offset revenue losses that may result from lower customs duty rates under WTO requirement, through establishing User Pays system and broadening of the Sales Tax base.

The true effect on government revenue will, however, not be known until the Ministry of Finance releases its tax reform package. Obviously a replacement to these sources of revenue will have to be found, probably through the introduction of consumption taxes.

On the positive side, the combination of a reduction in import duties and improvements in customs procedures should reduce the incidence of illegal importations into Tonga, which will assist both government and legitimate businesses in Tonga.

Reduced tariffs on intermediate goods should also lead to significant reductions in cost of production. If the reduction in input prices is significant, it may boost levels of manufacturing in Tonga. Currently there are a limited number of products manufactured in the Kingdom and almost all of those that are, are for the domestic market. Reductions in costs may make products manufactured in Tonga competitive in the export market.

As a future WTO member, Tonga will make sure that every information needed by traders and businesses are available and updated. This can be done by making available information through the Ministry of Labour, Commerce and Industries to meet any enquiry they might need.

The obligations to abide with WTO requirements present challenges for the planning and implementation of domestic laws and regulations in Tonga. For food products to meet international food safety and quality standards, Tonga needs to invest substantially in both physical and institutional infrastructure.

## Trade Strategy

One of the core mandates of government under the Ministry of Labour, Commerce and Industry is Trade Development and promote export-oriented industry. The trade development's function is to expand Tonga's share of the global export market by working with firms and individuals, especially small medium businesses to increase the number of exporters, expand strategic and emerging markets, develop and nurture a dynamic export culture and promote awareness of Tonga's exports.

Tonga has realized the important of investment in order to provide employment and foreign exchange. The Strategic Development Plan 7, 2001-2004 identifies agriculture, fisheries and tourism as priority sectors for policy development.

The Industrial Development Incentives Act encourages the growth of export-oriented industries through the provisions of certain duty exemptions for products imported by these types of industries. Other Investment incentive systems are also provided such as following:

- **Tax holiday:** for up to five years, which may be extended by a further 10 years. (for companies only). For expansion of the initial plant, an additional tax holiday will be granted.
- **Tax exemption:** Dividends relating to the tax holiday period that the shareholders receive will not be taxed if it is during the tax holiday.
- **Withholding Tax:** For non-resident shareholders or company entrepreneurs, there is provision for exemption from the 15% withholding tax for the period of the tax holiday.
- **Moratorium on Income Tax:** Possible moratorium on income tax for companies, after tax holiday.
- **Customs Duties:** Capital goods exempted from all customs duties
- **Port and Services Tax:** Concession rate for imports of capital goods and semi-finished goods
- **Repatriation of Funds:** repatriation of funds is permitted
- **Protection:** Protection from competition available for specified periods

## Foreign Investment Act 2002

The Ministry is actively pursuing private sector development and in particular, foreign investment. The Legislative Assembly had approved the new Foreign Investment Act. This Act will also provide guarantees for national treatment of foreign investments, the repatriation of investment capital and also provision of dispute resolution mechanisms. It is expected that this Act will contribute positively towards an attractive investment and trade development.

## Tonga Trade

The Tonga Trade under the Ministry of Labour, Commerce and Industries established as a 'search engine' for local producers exploring new potential markets overseas.

The overall objective of Tonga Trade is to identify, attract, secure and maintain new and existing markets for Tongan products and services to optimise foreign exchange earnings. The following strategies have been adopted to achieve the above-mentioned objectives:

- Conduct regular, systematic market research to identify export opportunities for local products.
- Identify niche markets in which Tonga can compete, and focus trade promotions planning and activities on the need of the market.
- Disseminate information on market opportunities to existing and potential exporter in a timely manner.

- Coordinate, organize and encourage trade missions and participation in trade fairs both locally and overseas.
- Ensure the awareness of staff regarding trade agreements and the availability of such information in order to enhance our access to overseas markets.
- Establish and develop strong links with industry associations and councils.
- Assist industry associations and councils develop marketing and total quality management plans.

The services of Tonga Trade are only confined to trade information and advice in all areas of trade, including export, marketing and import management. The actual exportation of commodities and service are left to the private sector entirely. Tonga Trade provides services to the private sector to boost its confidence and to develop and strengthen investment in the export market.

### **Major Export sectors**

#### **a. Agriculture:**

The Ministry of Agriculture plays an active facilitation role in agricultural development in the provision of advice and technical support through extension services to the rural farmers. This Ministry also responsible for:

- Quality of fresh crops for export;
- Implementing the Plant Quarantine Regulations, the Fruit Export Act (Vanilla) Regulations of 1993 and Fruit Export Act (Buttercup Squash) Regulations of 1993, and the law on Pesticides that controls their importation and use.

However, during previous years, the share of agriculture to the Gross Domestic Product declined. There are the following issues and constraints that provide justification for the declining of agricultural exports:

- Limited Agricultural land available;
- Access to finance for agricultural activities is limited;
- Vulnerability to natural calamities and new diseases and pests;
- Falling world prices for basic commodities such as copra;
- High domestic and international transportation costs;
- Limited access of remote islands and rural areas;
- Limited knowledge on market information;
- Increasing barriers and standards imposed by developed markets;
- Limited information and knowledge on diversification strategies.

There are number of other crops that have the potential to grow and produce further export earnings but growth is constrained by numerous factors including:

- Climatic effects on the volumes produced;
- Supply and demand factors;
- Lack of integrated quality management in production and processing systems that optimize the comparative advantages of Tonga;
- Insufficient expertise within government and industry in the areas of agronomy and entomology;
- Insufficient government agricultural extension programs advising farmers on the strategic control of disease and pests of agricultural crops.

### **b. Fishing:**

The fishing industry has continued to expand with increased investment in the sector and expansion of the export sector. The sector provides direct employment to nearly 500 persons.

At present six companies are engaged in export processing of fish. Seafood exports from Tonga mainly target Japan and US. Even though there is interest in exports to EU, Tonga is unable to do so due to the lack of EU approved competent authority. Currently there are 34 tuna long line vessels licensed in Tonga.

Within the fisheries sector, a major barrier is seen in the lack of a competent certification authority or body for the certification and audit of HACCP and quality assurance systems. The EU has raised this as an issue that needs to be addressed in order to gain access to their markets. There is currently a lack of resources and expertise within government agencies to undertake this function. Relatively high freight costs are an impediment for export of fish.

Other issues and constraints facing the fisheries sector include:

- High transportation costs to major markets due to remoteness of Tonga;
- Limited downstream processing due to smallness of domestic markets;
- Limited access to markets due to heavy price competition in international markets;
- Threats of the long term sustainability of fishery resources;
- External pressure for more sustainable fishing practices.

### **Marketing of export commodities**

Private sector is responsible for marketing of export products. The Tongan Friendly Islander Marketing Cooperative with 3000 members is a cooperative society in which 80% are farmers, 15% engaged in fisheries and 5 % handicrafts. The marketing cooperative has been exporting squash, vanilla, root crops and handicrafts for the past twenty years. The cooperative provides supply facilities for farm equipment, fertilizers, pesticides and seeds to its members as well as providing technical advice and training on productivity. The cooperative has managed to supply its markets efficiently except in cases of natural disasters and droughts.

The long-term success of the cooperative relies on the development of infrastructure support and modern facilities for the storage and transportation of products. A cooling facility is needed on the wharf for storage of squash prior to exports.

The set up of the marketing cooperative provides a successful case of small farmers coming together to improve production for exports and at the same time sustaining income for the farmers.

### **Possible solutions for Tonga's trade issues**

- Increased participation of the private sector, NGO and civil society in trade policy development;
- Improved access to market information both at the national and international levels;
- Coordination amongst government Departments;
- Regional cooperation;
- Capacity Building;
- Improve transportation links by linking with other sectors;
- Access to technical assistance;
- Trade promotions;
- Availability of capital fund to assist investors;
- Promote export-oriented industries.

Tonga requires substantial assistance and investments particularly in the trade and development of the agriculture, fisheries, manufacturing and tourism. These sectors provide the backbone of Tonga economy. The majority of the populations still rely on these sectors for earning their living. Tonga should develop policies that will encourage and facilitate our businesses to take advantage of any benefits and opportunities that may be forthcoming to assist in these developments of the key economic sectors. Further, we need to continue work hand in hand with private sectors through consultation on issues that facing the government and how the private sector could assist with resolving such problems. Awareness of private sector on trade related issues is also important and government should involve them in policy developments .WTO membership gives Tonga a potential starting points to working together to create an environment conducive to the growth of trade from Tonga.