The Tongan knitwear industry: a study of export manufacturing development in Pacific Islands

Andrew McGregor

In most countries in the Pacific region governments offer many incentives to both local and foreign manufacturing investors. In addition, external aid sources offer various types of financial and technical assistance and via the South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA) all countries have preferential access to Australian and New Zealand markets. Despite the assistance available, results have been below expectations with the exception of Tonga, where the response and performance of involved companies have been impressive and manufacturing now represents the economy's fastest growing sector. The export-oriented industries that have been established range from the fabrication of yachts to the manufacture of saddles.

The history of one successful Tongan enterprise, the South Pacific Manufacturing Company (SPMC) is recounted below, the factors behind its performance considered and its economic contribution to the Tongan economy studied. The potential for replication of this type of enterprise elsewhere is also examined.

History of the venture

The SPMC was established in 1979 by Louis Pogoni, a citizen of New Zealand who had previously been successfully involved in the knitwear and garment industries in New Zealand. Pogoni saw Tonga as an attractive place to live and looked for a business venture that would enable him to do so. His interest coincided with the commencement of the government's active promotion of light manufacturing following the publication of the Third Development Plan in 1976.

In late 1979 the SPMC began operation in two rented rooms at the back of a house employing seven local trainees and a supervisor/trainer from New Zealand. Using domestic type knitting machines and yarn imported from New Zealand, production of pure wool cardigans and pullovers commenced.

The aim was to produce a high quality product with enduring market appeal, hence a small range of garments in traditional/classical styles was produced. A successful place in the high-risk, high-profit, fluid 'boutique' market would not be feasible for a producer in Tonga, distant from the market in terms of both shipping and fashion information.

In March 1980 the enterprise moved to the newly established Small Industries Centre (SIC) located 1.5 km from Nuku'alofa. Established by the government this area provides firms with infrastructure and access to industrial sites on long lease.

By the end of the second year of operation the work-force had grown to about 30 employees with a weekly output of approximately 100 units. Sales to New Zealand began during the second year and garments were distributed as seconds, without their current label, through a marketing chain previously

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established by Pogoni. This enabled quality standards to be established without jeopardizing the reputation of a fledgling knitwear industry in the unlikely location of Tonga.

The SPMC expanded in 1983 and again in 1986 when in addition to an expansion at the SIC a second factory was opened some 20 kilometres from Nuku'alofa. These premises are rented from the Catholic Church - thus the problem of access to land is resolved and the new location enables utilization of another pool of labour. A further expansion involving capital deepening is currently underway and it is foreseen that this will allow a 50 per cent increase in production with a 10 per cent increase in employment. Current output of 1100 units a week should expand to 1600-1700.

Current employment of around 320 makes the venture Tonga's largest private sector employer. On completion of a 3-4 month training period during which they earn 20 pa'anga a week, workers are paid on a per unit basis and earn on average 35 pa'anga a week which is above the national average. A dozen or so workers are paid a fixed wage and are responsible for such tasks as quality control, mending and washing. Quality control is extremely stringent, with each garment being inspected on three separate occasions; approximately 20 per cent of garments are rejected as seconds.

In 1988 about half the annual production of 47,000 units was exported to New Zealand and the rest to the US, Canada and Australia. In the US these garments retailed for between US$90 and US$120 per unit, although with further investment in promotion and marketing, prices could probably be raised. Because Tonga straddles markets in both the northern and southern hemispheres, it can produce this essentially seasonal product year-round without building up expensive stocks.

Factors behind the SPMC's performance

Many factors have been important in the success of this enterprise. Pogoni's previous experience and established contacts were crucial especially in the initial start-up period of the enterprise. Close direct involvement in the enterprise seems to be a prerequisite for the success of this type of venture. By living in Tonga, Pogoni ensured this requirement was met.

The government has played a crucial role in facilitating the establishment of the Tongan knitwear industry. The government package has included providing attractive investment incentives, supplying physical infrastructure and land, and providing a decision-making environment conducive to the needs of entrepreneurial investors.

Government investment incentives include a tax holiday of up to five years (company tax is now 17 per cent), withholding tax exemption for non-resident shareholders or company
entrepreneurs for the period of the tax holiday, a lower income tax for employees, customs duty exemptions and low interest loans via the Tongan Development Bank. In addition there is no formal requirement to involve local equity in the enterprise whereas in other Pacific island countries, well intentioned minimum local equity requirements have been a disincentive and have probably done little to encourage indigenous entrepreneurial development. Under its own initiative the SPMC now has plans to make equity available to employees (up to 15 per cent) and to the Tongan private sector (an additional 15 per cent).

The establishment of the SIC has proved to be an important incentive to manufacturing investors and demand for the facilities has far exceeded the expectations of the planners - there is now a waiting list for sites.

The SIC's main value is its provision of long-term access to land in a situation where foreigners cannot purchase land. Leases are for 50 years. Standard factory sheds are provided, together with infrastructure such as roads, sewerage disposal, power, water and telecommunications at a reasonable cost although the facilities do encounter some problems common to Nuku'alofa such as inadequate water supply and telecommunications. Rents are subsidized; the SIC has not been recovering the full depreciation on its factory sheds.

An important contribution of the SIC, at least during the SPMC's initial start-up period, was tangible evidence of the government's sustained commitment to manufacturing investment. This support was crucial to Louis Pogoni's decision to establish a knitwear factory in Tonga.

Apart from incentives like tax relief and its role in the SIC the government's administrative procedures yield relatively quick decisions and yet at the same time appear to provide adequate safeguards against unscrupulous operators. In some countries in the region there often appears to be an ambivalence toward foreign investors whereby they are encouraged by official policy but discouraged by bureaucratic obstacles and political actions. Tonga appears to have been more adroit in handling foreign entrepreneurial investment than other countries in the region.

In Papua New Guinea, for example, it is reported that the accounting and legal firms advising potential foreign investors, inform their clients to expect a delay of about one and one-half years before they can begin their project even after it is approved.\(^2\) The costs of this indecision to potential investors are substantial in terms of working capital expended and alternative opportunities foregone.

In Tonga the issuing of a business licence is an uncomplicated one-stop process that takes from two weeks to three months depending on the adequacy of documentation. In the case of the SPMC, the company was officially informed of the government's decision within two months of applying for a business licence.

Such swift response is especially important for small enterprises considering establishing operations in a country like Tonga. An entrepreneurial investor, such as Pogoni, is distinctly different from the large multinational investor who can mobilize substantial funds and is usually interested in investing in natural resources and large tourist plant. The magnitude of the profits from these investments is sufficiently large, and the time-scale sufficiently long, to sustain prolonged project negotiations. In contrast, the entrepreneur by nature requires quick decision on their investment proposal and in the context of an economy the size of Tonga, such investors are likely to be the major source of foreign investment and technology transfer and thus have considerable significance.

In addition the SPMC has made considerable use of available financial and technical aid. This has included Pacific Islands Development Scheme contributions of approximately NZ$70,000 to the initial feasibility study and training costs, and interest free loans for capital equipment, financial assistance from US Agency of International Development of about US$20,000 to assist penetration in the US market and SPARTECA financed promotional visits. The Asian Development Bank has made an important contribution indirectly through loan financing to the government for the SIC.

The contribution of the enterprise to the Tongan economy

The economic contribution of the SPMC venture to the Tongan economy is considerable despite the high raw material import content.

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The annual wage bill of the enterprise is currently around US$0.5 million in an economy with an official gross domestic product (GDP) of less than US$100 million, and annual gross foreign exchange earnings of the enterprise are estimated to be approximately US$1.3 million. This has to be seen in the context of a small open economy in which imports exceed exports in the ratio of 4:1.

The SPMC has only one retail outlet in Australia and a minute market share in North America. Tonga thus faces a virtually unlimited market for expansion. However, labour supply is a serious constraint to growth. Outmigration and an exceptionally high rate of remittances mean that Tonga does not have a large pool of low-cost labour available. Thus a Mauritius, or even a Fiji type manufacture boom based on low-cost type garments is highly unlikely in the Tongan context.

Expansion prospects

Most of the islands in the South Pacific, in principle, could offer equally suitable locations for this type of enterprise. They are all a party to SPARTECA, offer a generous package of incentives, have low-wage structures, and have a female labour force with the required skills in varying degrees. Countries like Tuvalu and Kiribati are obvious examples. These micro states have an abundant supply of available labour, with limited outmigration options, and a well entrenched weaving and craft tradition. On the negative side the transportation constraints are even greater than they are in Tonga.

Applicability of this type of venture elsewhere in the Pacific

The two fundamental limiting factors, however, are the identification of suitable entrepreneurs who are willing to invest their capital and skills in the Pacific islands and the administrative systems that can expeditiously accommodate such investors.