The Tax Free Factory/Tax Free Zone scheme in Fiji

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Since its inception in 1987, the Tax Free Factory/Tax Free Zone scheme has contributed to Fiji's economy by stimulating investment and encouraging export-oriented enterprises. This scheme has also contributed substantially to the growth of the manufacturing sector. This paper provides an overview of the scheme in Fiji, compares it with similar schemes in other developing countries and outlines the future prospects of the scheme.

The Tax Free Factory/Tax Free Zone scheme was introduced by the government of Fiji in 1987 with the aim of increasing capital inflow, exports and employment, and stimulating investment. The scheme is administered by the Fiji Trade and Investment Board and reflects the government's aim to shift production from import-substituting to export-oriented industries. It combines a package of incentives with financial concessions and subsidies to attract companies to establish operations in Fiji.

A tax free zone is a collection of factories within a specific location which enjoy preferential conditions. Individual factories, enjoying the same preferential conditions, are known as tax free factories. While there is no tax free zone at present, Kalabu, located just outside Suva, has been officially designated as a tax free zone site. The development of this site is to be funded by the European Community and work will include the development of infrastructure, water supply and electricity, and the construction of six buildings.

The tax free factories established since the introduction of the scheme include both existing and new companies. An enterprise qualifies for tax free factory status if it exports 95 per cent of its annual production or is engaged in the re-export of at least 95 per cent of its output. At the end of 1992, there were 119 tax free factories engaged in the production of a variety of exports, including garments (84), leather and footwear (11), wood and furniture (7), food (3) and others (14) (Table 1). Garment manufacture currently dominates, accounting for 71 per cent of factories and 85 per cent of total employment in tax free factories in 1992.

Concessions and incentives

As in all such schemes, tax free factories in Fiji enjoy a number of advantages designed to enable their products to compete successfully and gain a foothold in overseas markets. Materials to be processed by, and items required for the establishment of tax free factories are exempt from import duties and licences. Products manufactured under the scheme are exempt from excise duty. In addition, the factories are exempt from corporate profits tax for a period of 13 years with no tax on interest, dividends and royalties. Foreign owned firms are allowed to repatriate capital and profits. All firms including non-tax free factory enterprises may recruit specialist personnel from overseas. Other advantages include accelerated depreciation allowances on capital and equipment, carrying forward losses (losses incurred in any year may be offset against profits earned during the next succeeding 6 years), and in certain circumstances the Minister of Finance may waive or reduce dividend, interest or royalty withholding taxes.

Fiji currently enjoys preferential treatment when exporting to the Australian and New Zealand markets under the South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA). Exports from Fiji complying with SPARTECA rules of origin enter duty free, giving exporters some advantage over competitors from outside the region. Fiji also exports preferentially to European countries under the Lomé agreement and to a number of other countries under the General System of Trade Preferences.

Contribution to the economy

Under the scheme, firms are either locally owned, joint ventures with foreign companies or wholly foreign owned operations. Of the 119 tax free factories in operation in 1992, 54 per cent were locally owned, 16 per cent were joint ventures and 30 per cent were wholly foreign owned. Of the 36 wholly foreign owned companies, 12 were from Australia and 9 from New Zealand; of the 19 joint ventures, 8 were with Australian companies and 6 with New Zealand companies. While Australian and New Zealand companies tend to dominate, recently there has been some investment by a number of Southeast Asian companies.

The manufacturing sector, other than sugar refining (which has not participated in the scheme) accounted for one-fifth of the increase in total output between 1988 and 1992 (Table 2). Approximately one-half of this increase was made by factories that had been operating in 1987. This growth was largely concentrated in the garment industry.

Employment

Total employment in the formal sector increased from 78,000 to 92,000, or by 19 per cent, between 1988 and 1993 (Table 4). Approximately one-half of this growth was in manufacturing. Growth in employment in

Table 1 **Tax free factories by sector, 1988-92**

Sector	1988	1989	1990	1991	1992(p)
Garment	27	53	78	79	84
Wood and furniture	6	9	11	8	7
Leather and footwear	2	7	8	9	11
Other	8	14	17	14	17
Total	43	83	114	110	119

(p) provisional.

Source: Fiji Trade and Investment Board.

Table 2 **Contribution of the manufacturing sector to the Fiji economy, 1988-92**

Value added	1988	1989	1990	1991	1992(p)
GDP at 1977 constant prices (US$ million)	728.4	815.6	854.9	860.6	884.9
Change from previous year (%)	2.4	12.0	4.8	0.7	2.8
Manufacturing sector output (US$ million)	83.2	92.8	99.1	103.7	102.9
Change from previous year (%)	-0.8	11.5	6.8	4.6	-0.8
Manufacturing sector as percentage of GDP	11.4	11.4	11.6	12.0	11.6
Output of manufacturing excluding sugar (US$ million)	59.1	62.3	72.0	77.9	74.7

(p) provisional.

Sources: Bureau of Statistics; Fiji Trade and Investment Board.

tax free factories was slightly larger than that in all manufacturing. Again, the largest growth was in garment production, which accounted for over 90 per cent of the increase. A decline in the employment in tax free food production offset increases in other groups (Table 3).

Investment

Investment in tax free factories has grown rapidly since the scheme's inception. Total accumulated investment in the tax free factory sector increased from F$14 million in 1988 to F$70 million in 1992 (Table 5). As one-half of tax free factories were existing enterprises in 1988, subsequent increases in 1989-92 were a result of new investment (Table 5). Seventy per cent of this capital inflow was investment in garment production.

Exports

Total exports of tax free factories in 1992 are estimated to have been F$170 million, of which garments accounted for F$105 million, food F$43.2 million and other sectors F$21 million. Garment exports amounted to F$30 million in 1988 and increased dramatically to F$131 million in 1991 (Table 6). However, in 1992 the value of garment exports fell by 2 per cent, largely because of depressed markets in New Zealand and Australia, and changing preferences.

Recently there has been an increase in exports to the United States and to the European Community. The combined effect of Fiji's garment exports and exports from other countries, especially in the nightwear category, caused disturbances among the US producers. This led to the imposition of quota restraints during 1990 and 1992 under a bilateral agreement between Fiji and the United States. Since this agreement has expired, the United States wants to impose quota restrictions on another category of garment exports, the knitwear shirt and blouse category. No agreement has been reached yet but this matter has to be resolved quickly because the US government can impose a unilateral restraint on this category of exports.

Fiji still has not secured a large market share in the European Community. This could be due to the long distance and also to

Table 3 **Employment by manufacturing groups, 1988-92**

Sector	1988	1989	1990	1991	1992(p)
Garment	3,022	6,434	7,829	8,745	10,066
Wood and furniture	97	165	233	162	221
Leather and footwear	99	164	300	389	633
Food	906	1,013	926	783	783
Other	83	159	215	107	174
Total	4,207	7,935	9,503	10,186	11,877

(p) provisional.

Source: Fiji Trade and Investment Board.

Table 4 **Tax free factory employment as a percentage of total and of manufacturing sector employment, 1988-92**

	1988	1989	1990	1991	1992(p)
Total emp.	77,731	88,177	88,952	91,558	92,480
Change in total emp. (%)	0.2	13.4	0.9	2.9	1.0
Emp. in manuf. sector	14,040	19,666	21,051	23,400	21,181
Change in manuf. sector emp. (%)	1.6	40.1	7.0	11.2	-9.5
Manuf. sector emp. as % of total emp.	18.1	22.3	23.7	25.6	22.9
Emp. in tax free factory sector	4,207	7,935	9,503	10,186	11,877
Change in tax free factory emp. %	-	88.6	19.8	7.2	16.6
Tax free factory emp. as % of total emp.	5.4	9.0	10.7	11.1	12.8

(p) provisional.

Sources: Fiji Trade and Investment Board; Fiji Bureau of Statistics.

the inability of local producers to keep track of changing trends. Fiji is currently working on programs to improve trade with the large EC market and the emphasis now is to produce for higher quality niche markets.

Fiji's garment production contains a considerable import component. The manufacture of garments from imported textiles and other materials is referred to as 'cut-make-trim'. The net earnings accruing from the export of 'cut-make-trim' garments is the amount of value added by the Fijian producers. The Reserve Bank of Fiji, estimates that value added is approximately 50 per cent of gross garment exports from Fiji. The garment sector is in the process of shifting from a 'cut-make-trim' basis to full manufacturing of garments.

Regional distribution

Tax free factories are located mainly in major urban centres. Suva (followed by Lautoka and then Nadi) accounted for the largest number of firms, employed the greatest number of people and recorded the highest accumulated investment. The largest single tax free factory in Fiji, however, is the Pacific Fishing Company Limited situated in Levuka.

Fiji's scheme and those in other developing countries

The creation of free trade and export processing zones in developing countries usually is part of a wider strategy of trade liberalisation. Such schemes provide a foundation upon which to transform economies previously dominated and shaped by import substitution strategies pursued in the 1960s. Although recognising the need to diversify and develop a manufacture-based economy, the import substitution strategy did so by sheltering domestic producers behind high tariffs and import licences, effectively creating a high tax structure for exporters, and excluding them from competing in world markets.

Table 5 **Accumulated investment by sector, 1988-92** (US$ million)

Sector	1988	1989	1990	1991	1992[p]
Garment	6.0	24.0	37.0	36.0	45.0
Wood and furniture	0.7	1.5	2.0	2.2	5.4
Leather and footwear	0.2	1.0	1.2	2.4	3.0
Food	5.9	6.3	8.2	11.1	11.8
Other	1.1	1.9	4.6	4.6	5.1
Total	13.9	34.7	53.0	56.3	70.3

[p] provisional.

Source: Fiji Trade and Investment Board.

Several developing countries have designed a set of taxation incentives to redress external imbalances. A package of financial concessions and subsidies were designed to attract new foreign capital to equip local industries for export, stimulate investment and increase foreign exchange liberalisation.

Nine countries in addition to Fiji are reviewed in this paper: Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Jamaica, Mauritius, Mexico and Taiwan. Fiji's scheme is the most recently established; Mexico, which implemented its scheme in 1965, is the largest with 1,333 firms employing some 350,000 workers in 1990.

The main features of the schemes in the other countries are summarized in Annex 1. The incentives offered are listed in Annex 2 and discussed in detail below.

Tax concessions

Corporate. Fiji offers a 100 per cent tax exemption on corporate income for 13 years. Of the Latin American countries that have introduced similar schemes, exemptions vary considerably. Guatemala, for example, offers a 100 per cent tax exemption for 12 years, El Salvador for 10 years, and the Dominican Republic from between 8 to 20 years. Costa Rica, on the other hand, offers a 100 per cent tax exemption for 6 years and then a 50 per cent exemption for the following 4 years. Both Honduras and Jamaica, provide 100 per cent exemptions in perpetuity. A flat 15 per cent tax is applied on the corporate income of tax free factories in Mauritius, 37 per cent is applied on those in Mexico. Taiwan offers the option of a 100 per cent exemption for 5 years or a 20 per cent tax on corporate income during the lifetime of the project. Fiji's tax exemption scheme generally compares favourably with those of other developing countries, except for the schemes in Honduras and Jamaica.

Import duties. Total exemption from duty on imports of most capital goods and other production goods is given in Fiji and in all other countries examined.

Taxes on dividends. Dividends to shareholders are exempt from taxes in the Dominican Republic, Honduras, El Salvador, Guatemala, Costa Rica and Jamaica. In Fiji, however, exemption is granted to non-resident shareholders only. Mauritius, on the other hand, provides exemption to all shareholders for a period of 10 years. A tax of 20 per cent is applied in Taiwan, while in Mexico, all dividends are subject to normal taxation.

Restriction on foreign ownership and repatriation of capital/profits

No restriction on foreign ownership is imposed in Fiji as is the case in all other countries examined. Furthermore, there were no restrictions on the repatriation of capital/profits in any of the ten countries.

Management of foreign currency

Management of foreign currency is controlled in El Salvador, Costa Rica and Mexico. It is limited to the official monitoring of the receipt of export funds in Fiji for all companies and the requirement to repatriate and sell foreign currency earnings to an authorized dealer within 6 months. In Fiji recent exchange control relaxation allows exporters to retain 10 per cent of the value of export earnings abroad. However, this facility needs the prior approval of the Reserve Bank. There are no restrictions on the management of foreign currency in the other six countries.

Domestic sales

As the schemes are designed to encourage exports, sales to the domestic market are often restricted. The level of restriction varies greatly. In Honduras sales to the local market are unlimited. Domestic sales in Costa Rica can account for 49 per cent of production, whereas in Mexico domestic sales can vary between 20 and 40 per cent. In the Dominican Republic domestic sales can account for up to 20 per cent of total sales. In contrast, Fiji manufacturers can sell only 5 per cent of production locally, Taiwan manufacturers 2 per cent and in El Salvador domestic sales are granted only on a case by case basis. In Jamaica and Mauritius domestic sales are prohibited, while in Guatemala some limited access is available.

Future developments

The Fiji government intends to invest F$14 million to develop a tax free zone at Kalabu near Suva. The project is funded by a grant of $10 million and a special loan of $4 million from the European Community. It includes the purchase of 32 hectares of land and the construction of 10,000 m^2 of factory space. The project will include the development of modern amenities and relevant infrastructure to attract new manufacturers to the area.

The tender for the design of the subdivision has been sent out to two companies, a joint venture company (Australia and Fiji) and an Irish company. The Fiji Public Works Department is carrying out a technical evaluation of the tenders and will accept the one that fits within the EC budget. It is anticipated that physical development of the site will commence in late 1994 and it is estimated that it will take 3 years to complete.

Sites at Laqere and Naulu outside Suva and Navutu in Lautoka are also being considered for development as tax free zones. The project in Navutu is being developed by a local company and supervised by the Lands

Table 6 **Tax free factory exports by sector, 1988-92** (US$ million)

Sector	1988	1989	1990	1991	1992(p)
Garment	30.1	99.3	115.8	131.1	105.5
Wood and furniture	0.9	1.5	2.5	2.1	2.0
Leather and footwear	1.4	3.3	5.4	5.7	9.7
Food	53.7	52.8	57.7	48.6	43.2
Other	1.3	0.5	4.0	12.3	9.2
Total	87.4	57.4	185.4	199.8	169.6

(p) provisional.

Sources: Fiji Trade and Investment Board; Bureau of Statistics.

Department of Fiji. The development of a tax free zone there should attract local and foreign investors, as the site provided by the government has all the necessary services at hand for effective implementation of the tax free zone scheme.

It is estimated that the establishment of the zone will initially provide new employment for 2,000 people and, over time, it is expected to generate up to 8,000 jobs. In addition, the importance of training local labour for management roles is well recognised, as is the need for other ancillary services such as export and trade promotion. The latter will be provided through the Fiji Trade and Investment Board.

Already contributing

Traditionally, Fiji has been an economy dependent on sugar and tourism for foreign currency earnings. As in many developing countries, the dominance of a single agricultural crop is fraught with problems, crop failure being only one. Despite the fact that Fiji is a first class destination for all types of tourists, world recession can severely limit number of tourists and the level of tourist expenditure.

To meet a growing import bill and to reduce dependence on a limited range of exports, a positive policy to discriminate in favour of exports was devised. There are many advantages in exploring an export-oriented policy, not the least of which is the opportunity to provide work for Fiji's young and talented population. By competing in world markets, the skills of Fiji's labour force should stay in line with those of major competitors.

The development of an incentive package for export producers is designed to attract not only domestic investment, but also foreign investment that has the added benefit of transfer of technology and 'know-how' which is essential for future growth and development.

Fiji's infrastructure and support services also benefit from the effort to attract modern means of production. It is necessary to maintain and build major roadways, to update and extend the telecommunications network and to increase business acumen, marketing and other business services.

The tax free zones are the first step in the long process of reversing the inward-looking policies of the past, in particular those relating to import substitution. Fiji's scheme is relatively new. Legislation outlining the framework of the scheme was only decreed by Cabinet in late 1991, and work on the first export zone will begin in 1994.

On the whole, however, the Tax Free Factory/Tax Free Zone scheme has already contributed to the Fijian economy both qualitatively and quantitatively. It has brought investment and introduced foreign skills, training and technology. The scheme is not seen as a long-term contributor to economic development but a short to medium-term measure to stimulate economic development. As the new export industries become established and the present concessions begin to lapse, it is expected that the companies will be operating at a sufficiently high level of efficiency to remain internationally competitive in the world export markets. The final aim is to move away from the Tax Free Factory/Tax Free Zone package towards a broader package of incentives offering opportunities to a wider segment of the economy and aimed at diversification of Fiji's export base.

Annex 1

Comparison of tax free zones in selected developing countries

	Fiji	El Salvador	Guatemala	Taiwan	Jamaica	Costa Rica	Mauritius	Dominican Republic	Honduras	Mexico
Date regime initiated	1988	1974	1973	1966	1976	1981	1970	1969	1976	1965
Number of operational zones	1	1	1	3	2	3	..	12	1	29
Total under-roof free zones (m^2)	-	43,600	13,000	..	82,700	53,530	680,000	377,500	26,000	..
Total number of firms in zones	120	9	39	240	24	35	500	187	14	1,333
Total direct employment in free zones	11,381	3,800	..	80,000	14,000	3,250	100,000	90,000	2,700	350,000
Ownership/ managment of tax zone	Public Private	Public	Public	Public	Public	Public Private	Public Profit	Public Profit Non-profit Mixed	Public	Public Private Mixed
Number of zones under construction	-	0	0	0	3	4	6	14	1	..
Rental rate (US$/$m^2$/month)	2.40	2.00	0.58	2.80	.15- 4.40	.90- 2.70	0.90 2.15	0.90- 4.00	2.70	Wide variation
Zone exports (US$million)	-	..	..	..	62	20	600	518	..	872 (value added)

Source: The Services Group, An Assessment of the Fijian Tax Free Zone Development Program, Report submitted to the Ministry of Trade and Commerce, 1990.

Annex 2

Comparison of tax free zone incentives in selected developing countries

	Fiji	El Salvador	Guatemala	Taiwan	Jamaica	Costa Rica	Mauritius	Dominican Republic	Honduras	Mexico
Corporate income tax abatement	100% exemption for 13 years	100% exemption for 10 years	100% exemption for 12 years	Optional 100% exemption for 5 years or 20% tax on corporate income	100% exemption in perpetuity	100% exemption for 6 years; 50% exemption for 4 years following	15% tax during life of company	100% exemption for 8-20 years	100% exemption in perpetuity	37% tax on corporate income
Capital profits repatriation	No restrictions	Not explicit	No restrictions	No restrictions	No restrictions	No restrictions	No restrictions	No restrictions	No restrictions	No restrictions
Number of days to receive approval	Less than 28	45-90	..	10-30	30-60	90	30-40	60	35-40	..
Tax on dividends	100% exemption to non-residents only	100% exemption	100% exemption	20% tax	100% exemption	100% exemption	100% exemption for 10 years	100% exemption	100% exemption	No exemption
Restrictions on foreign ownership	None	None	None	None	None	None	None	None	None	None
Sales to local market	5% of total capital	Case by case basis	Limited access	2% of total output	None allowed	49% of total output	None allowed	20% of total output	Unlimited access	20-40% of total output
Management of foreign currency	Controlled	Controlled	Unrestricted	Unrestricted	Unrestricted	Controlled	Unrestricted	Unrestricted	Unrestricted	Controlled

Source: The Services Group, An Assessment of the Fijian Tax Free Zone Development Program, Report submitted to the Ministry of Trade and Commerce, 1990.