

Governance and Disincentives to Investments

Introduction

I will attempt to discuss the topic "*Governance and Disincentives to Investments*" in Vanuatu, based on what we refer to as the "Quadrant Approach" consisting of the following important components.

(i) Environment – enabling & attractive, (ii) Project – profiles/package for promotion to investors, (iii) Promotion – Strategic promotion plan must be set up, (iv) Implementation – of crucial importance. Of these components I want to place more emphasis on how the Governing system and the manner in which we administer Foreign Direct Investments (FDI) is a barrier to investments in the republic of Vanuatu.

Environment- Enabling and Attractive?

The operating environment is a very important aspect because it includes everything commencing from inquiry stage right down to the operational aspects of investments and even to aftercare services. It is about the different components and functions of the whole governing system and how they affect (FDI) inflows into Vanuatu.

Towards the end of 1998 in September, the country witnessed the establishment of the Vanuatu Foreign Investment Board (VFIB), established by an Act of Parliament, the Foreign Investment Act No.15 of 1998. The Act was reviewed in 1999 and was again amended in 2001, and VFIB was changed to Vanuatu Investment Promotion Authority (VIPA), under the Investment Promotion Act No.5 of 2001. Its immediate challenge then and still to the present is to create and promote Vanuatu as a conducive investment environment in the Pacific region. And so most of the functions in the early years (1999–2000) were concentrated in trying to establish the administrative infrastructures and raise awareness among the Government departments and the relevant stakeholders in Vanuatu on the need of FDI and the importance that it could have on the economy. These functions were carried out against the tide of political instability, and other major hurdles, which are largely still inherent in the system today.

There seem to have been some very positive changes and improvements since 1998 in the way Foreign Direct Investment is perceived, the way it is encouraged and the way it is administered by the system. We now have formal procedures to administer FDI in Vanuatu. However, I would like to highlight below some of the key areas which are still seen as major disincentive factors of the system to FDI in Vanuatu.

Land Tenure Problems

A significant number of projects approved by VIPA cannot be successfully implemented because of the issues involving land such as disputes, demands from land owners, and also the slow administrative processes concerned with land lease approvals. Many others have been knocked out at the inquiry stage, when they could not locate suitable land close to town for their investments. This has been a significantly major disincentive to investments in Vanuatu. Many viable investments that could have taken place, could not proceed because of the difficulties of sorting out land issues. That is why the implementation rate since 1999 up to 2000 and even the present is quite low. Hopefully the Government will help to better address these issues with the Land Tribunal.

Political Instability

In 2001, the approved number of projects declined by 32.9% compared with the 2000 figure. The overall decline in the number of projects received was mainly due to the political instability and the consequent change of Government in that period (2001). This year 2002 two months before the national elections, VIPA was only receiving a maximum of 5 projects per month, compared to the normal rate of 10-15 projects every month. Things are back to normal now with the new Government in place and with their policy of promoting more investments. This is a trend showing that Political stability is a crucial component influencing the decision of investors, both new ones and the existing ones.

Bad Publicity by the Media

Recent crisis happening in the Melanesian region has huge positive and negative consequences on the FDI into Vanuatu. On one hand, the situation in Fiji and the Solomon Islands forced some investors to relocate their businesses to Vanuatu, while on the other hand, it created a very bad picture on the Melanesian region as a "trouble Zone", which affected the confidence of many international lending organizations, who could not easily lend money to investors seeking big financial capital for their projects in this region. We have a huge proposed fishing project for Palekula in Santo, which could not get funding because big lending institutions require the Government to give a total of 5 billion Vatu as a sovereignty risk. This is a huge project, but it could not proceed. And although Vanuatu is relatively peaceful and a little bit more stable than other Melanesian countries, we are placed on the same category. People assume that because Vanuatu is sandwiched between Solomons Islands and Fiji or PNG, we have the same problems, which is a misperception that needs to be corrected.

Cost of Doing Business in Vanuatu

The costs of doing businesses in Vanuatu starts on the first day the investor enters Vanuatu, and continues on to the operational stage of the business. I want to

highlight a very recent investment as a classical example. An investor in the fisheries sector paid the following fees: -

- VIPA Application fees (50,000Vt)
- Registration Fee (>100,000Vt)
- Export Establishment License (22,500Vt)
- Business License (60,000Vt)
- Non-Citizen Fee (100,000Vt/investor and there are 5 investors in this project)
- Access Fee (15,000Vt)
- Work Permit Fees (100,000Vt/Foreign employee and there are 4 foreign employees)
- Residence Permit (100,000/person and there are 5 of them)
- Fishing License (1.2 million per fishing boat and they will bring in two boats)
- Cost of leasing land (Still under negotiation)

There are a lot more other cost components, but the above calculations shows that on approval processes alone, before the investor implements the project, their expenses would have already exceeded 547,000Vt, excluding the Fishing License fee (1.2 million/boat) and cost of land, utilities, telecommunications, office rental, accommodation, transport, the NEW Municipal fees and other costs. It is even harder when there are improper tax policies, so any organization or province could impose any fee without due consideration on the impact on investment the long run.

We are faced with the challenge to create the best investment destination and market ourselves as one of the best and peaceful investment destination in the Pacific region, particularly in the Melanesian region. Some people felt that we should have taken advantage of the crisis happening in PNG, Solomon Islands and Fiji. Even if we had successfully made some promotions during the event of their crisis, we would still have the real challenge behind us and that is to reduce the cost factor to a competitive level!

“Where such costs cannot be reduced; then the investment environment [of Vanuatu] should become so efficient and productive that the cost factor becomes a secondary issue in the calculations of foreign investors.” (Jegathesan, UNCTAD Consultant, 2000).

Administrative Barriers within the System

We cannot be overcritical of the operating administrative system in Vanuatu. But I want to dwell on this section to discuss a number of very important issues pertaining to the investments and the difficulties imposed by the system itself on investments.

In a nutshell, the different approval systems of the whole Government system is still a cumbersome process. There are many application forms to be filled out, many

unnecessary layers of approvals, and the fees in each level. There are still delays because of the centralized authority giving authorization to some issues. (*"We have many unhappy foreign investors in Vanuatu that become extremely frustrated at the lack of action in the system and the constant problem of delays and inaction by the Government departments...As a result they either don't invest in the first place, or they pull out, or don't expand their existing investments. -Bill Hawks, KPMG, 2002*)

The Vanuatu Investment Promotion Authority has made a number of presentations to relevant stakeholders, particularly from most economic sectors, and has expressed concerns on the administrative barriers to investment in Vanuatu, but no Government has closely looked into the whole situation to assess the impact of these traditional types of procedures on investment since independence in 1980 up until now. Today we still use some of those long unnecessary procedures to approve investments, and often we find that they are slow and bulky and have been acting as a killer to many proposed investments.

Undesirable Attitude and Actions

There has been very little change over the recent years in the mindset of the people, to foster a positive approach towards foreign investments in Vanuatu. There is still a lot of unnecessary delays and procrastination in the system. This is one of the main difficulty that investors are facing today, and it is still an area that needs more attention at all levels, if Vanuatu wants to improve its investment environment.

Currently Vanuatu cannot really attract efficiency-seeking investments, which are highly innovative businesses. We still cannot do so at the moment given the high bureaucratic procedures/administrative barriers and laissez-faire attitude of the public servants still inherent within the public service system. The attitude of the public and the resentment of foreigners must also change. What happened in Santo a couple of months ago is a threat to many foreigners. Another good example is the Vanuatu National Right Wing Movement, who were demanding all AFP and Advisors to leave Vanuatu soil within 48 hours on Tuesday this week. When that happened, we quickly got signals from some foreigners questioning the situation and their security.

"VIPA gets many inquiries and applications for investments every year, but very few of them actually end up investing as they pick up the vibes from the market place that there is still resentment towards foreigners in Vanuatu, and this has a negative impact upon the investment climate and then the economy. "-Bill Hawkes, KPMG.

Our prediction based on the experiences we have had is that the barrier to entry against FDI in Vanuatu is 50% procedural paper work, while the other 50% is by and large based on reckless and indifferent attitude of the civil service and lack of political will and direction in the system to deal with issues pertaining to investments.

But it is not all bad news, because we are beginning to see a shift in mentality from severe regulation and policing to facilitation and compliance. That is a positive sign towards the gradual building of an investment destination for efficiency-seeking FDIs. Part of the reason is largely because of the well-educated young people coming into the system with an open mind and who are active. Foreign investors have admitted that things are moving a little bit faster now than it was in the eighties and nineties, because of the competent people coming into the system.

Types of Investments in Vanuatu

The types of FDI that Vanuatu currently attracts is not so much with the market seeking FDI category. Comparatively we have a very insignificant domestic market, and very limited access to major global markets, which leaves our country very insignificant and unattractive for market seeking FDIs, which are mostly big investments.

Efficiency-seeking FDI is very important for a small island economy like Vanuatu with small resource endowments. These efficiency-seeking investments can help to provide linkages for market and resource-seeking FDI. The domestic enterprises must be very efficient to create backward and forward linkages in Vanuatu and abroad.

At this stage, it is still too early for us to be marketing Vanuatu to efficiency-based companies overseas, particularly when there is no strong political will to amend some traditional administrative procedures. It will take us some more years before we can enter the efficiency market segment. But this depends largely on the Government's willingness to change and support the initiatives developed by relevant economic development agencies.

Currently, Vanuatu is receiving mostly the Resource/Asset seeking investments. These investments most of which are small in scope, (Small Medium Enterprises SMEs) are more interested in the resources of the country, the low-skilled labour and physical infrastructure that is already established. Vanuatu is slowly shifting towards creating an environment for efficiency seeking FDI, with the help from Foreign Investment Advisory Services (FIAS) and other international advisory institutions. It only needs willingness to change and cooperation of all line government departments to create an efficient system.

Summary

"If Vanuatu desires to stimulate its economy to attract FDI to stimulate domestic business initiative, create employment and wealth, etc., it cannot "fiddle on the periphery" of change. The Government must make bold moves to pull the economy out of the vicious cycle of economic stagnation, unemployment and poverty! This needs both the Political will and Vision of Ministerial leaders, and the Administrative will and efficiency of the civil service! If both manifest with positive strategic plans of actions, the private sectors will respond!"(Jegathesan, UNCTAD consultant, 2000).