Business Environment Reform Facility

Business Environment Reform in Small Island Developing States: Implications for St Helena

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BE RF Business Environment Reform Facility

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Contents

Acronyms and Abbreviations

ACP	Africa, Caribbean and Pacific group of countries
AUD	Australian dollar
AusAID	Australian Agency for International Development
BERF	Business Environment Reform Facility
CARICOM	Caribbean Community
CEO	Chief Executive Officer
CFA	Compact of Free Association
CIA	Central Intelligence Agency (of the United States)
CO	(DFID) Country Office
COHA	Council on Hemispheric Affairs
DFID	(UK) Department for International Development
DOI	Digital object identifier
EIF	Enhanced Integrated Framework
ESH	Enterprise St Helena
FAS	Freely associated state
FDI	Foreign direct investment
FSM	Federated States of Micronesia
FY	Financial year
GDP	Gross domestic product
GIPB	Global Investment Promotion Best Practices
GST	Goods and services tax
ICR	Investment climate reform
ICT	(DFID) Investment Climate Team
IFC	International Finance Corporation (a member of the World Bank Group)
IMF	International Monetary Fund
INEC	(Ecuadorian) National Statistics and Census Institute (*Instituto Nacional de Estadística y Censos*)
IPA	Investment promotion agency
ISBN	International standard book number
LVT	Land value tax
MDG	Millennium Development Goal
NZ	New Zealand
ONS	(UK) Office for National Statistics
OT	Overseas territory
OTD	(DFID) Overseas Territories Department
PEA	Political economy analysis
PFTAC	Pacific Financial Technical Assistance Centre
PPD	Public–private dialogue
PPP	Purchasing power parity
SARS	Severe acute respiratory syndrome
SHG	St Helena Government
SIDS	Small island developing state(s)
SLG	Special Law for the Galápagos (*Ley Orgánica de Régimen Especial de la Provincia de Galápagos*)
SME	Small and/or medium sized enterprise(s)
TCC	Transit control card
TIN	Taxpayer identification number
TPR	(WTO) Trade Policy Review
UAE	United Arab Emirates
UK	United Kingdom
UN	United Nations
UNCTAD	UN Conference on Trade and Development
UNESCAP	UN Economic and Social Commission for Asia and the Pacific
UNESCO	UN Educational, Scientific and Cultural Organisation
UNGA	UN General Assembly
US	United States (of America)
VAT	Value-added tax
WBDI	World Bank Development Indicators
WTO	World Trade Organisation

1. Executive Summary

Small island developing states (SIDS) face a variety of particular challenges, relating to their small size, distance from major markets, and their vulnerability to climate change, extreme weather and external economic shocks. Standard economic advice is not always appropriate to their circumstances and conventional policies do not always lead to the same outcomes that would be expected for larger, mainland economies. In investment climate reform, as in any other area of economic policy making, SIDS want to understand the experiences of other similar economies to the greatest extent possible before making their own policy choices.

This report presents the experiences of a number of SIDS through a series of case studies, focusing on different aspects of investment climate reform that are of particular interest to St Helena. The case studies are supported by an introduction to relevant economic policy considerations for SIDS and additional evidence of SIDS' experience.

1.1 Tax reform

- Revenue reform efforts in **Solomon Islands**, **Tonga** and **FSM** suggest that political economy considerations are a relatively minor obstacle, less important than sensitivity to the pace and scope that are manageable for small islands.
- Evidence from **Kiribati** and other Pacific islands (including the Cook Islands, Fiji, Kiribati, Niue, Papua New Guinea, Samoa, Tonga and Vanuatu) suggests that VAT is a manageable tax for both revenue authorities and firms in small islands. It has now become a central source of revenue for many SIDS. It should exempt smaller enterprises, as the costs of compliance for these companies are high compared to the tax they would pay. It is also slow to implement, and small islands should allow at least two to three years to complete the process.

1.2 Immigration

- After **Seychelles** limited benefits available to migrant workers, a double labour market emerged in which wages for many tourism sector jobs became too low to attract locals. Most graduates of the country's tourism college now do not seek work in the industry. While immigration is undoubtedly a critical enabler for tourism growth, it is important to extend the same workers' benefits to immigrants in order to ensure that local labour remains competitive.
- As a province of Ecuador, the **Galápagos Islands** have had negligible restrictions on immigration during a strong period of growth in visitor numbers. Immigration was necessary to support the startling level of economic growth that the islands have maintained, although some basic restrictions could have minimised negative side effects. This case study also considers a general equilibrium model for **Hawaii** which indicates that tourism growth would be limited to just 1.6 percent without inward

migration — and even under this sluggish growth the labour market would be so tight that tourists would face an unsustainable inflation rate of over 5 percent.

1.3 Encouraging investment

- In the face of a lack of evidence that investment incentives have a net positive impact on host countries, islands such as **Grenada** have developed a competitive advantage simply by providing high quality investment promotion services. Their investment promotion agency has an international reputation for quickly providing potential investors with tailored information on the local market, and providing administrative assistance in the process of establishing a new investment.
- Noting the success of developed countries in adopting immigration processes tailored to entrepreneurs, **Fiji** has followed suit and introduced an investor permit, providing the right to work for three years to an entrepreneur that has an investment project of at least FJD50,000 (US$24,000) approved by the government.

1.4 Engagement

- **Vanuatu's** WTO accession involved one of the most intensive consultation processes on business environment reform that has ever been attempted in a SIDS. Issues of direct relevance to St Helena, such as the provision of freehold titles to foreign firms, were amongst the most contentious issues covered. Many important lessons about how to approach business environment reform engagement in SIDS can be drawn both from the country's first, unsuccessful attempt, and the latter successful process. Consultation was challenging for the government both externally, with the private sector and civil society, and between different government agencies. Successful consultation in small islands is slow, resource-intensive, requires strong leadership and can benefit from being managed by an agency that is not incentivised to rush reform through.

1.5 Land, conservation and climate change

- The **Galápagos Islands** recognises that its success in attracting tourists is based on its unique ecosystem, not price competition. Substantial park fees for visitors and limits on visitor numbers have helped to preserve the islands' natural assets, and have been received with understanding by tourists. In turn the fees are spent maintaining park areas to ensure that visitors' experiences meet their expectations. Measures to limit climate change have helped to build the destination's overall brand.

2. Introduction

In 2016, DFID's Overseas Territories Department requested support from BERF to review the experience of small island developing states (SIDS) in implementing business environment reform programmes. The objective was to identify lessons that would be relevant to policy questions currently facing St Helena, a UK Overseas Territory in the South Atlantic.[1] These lessons will inform a subsequent BERF project to review the investment climate of St Helena, in order to recommend appropriate reforms that will maximise the benefits of forthcoming commercial air access to the island.

Due to its very small size — with a de facto population of around 4,800 — even the majority of SIDS are so much larger that the challenges they face are not always comparable. SIDS are also highly diverse in features such as culture, the importance of traditional legal systems, island geography, vulnerability to sea level rise and extreme weather events, and distance from major markets. Countries that are comparable in certain ways may be starkly different in others. Data and high-quality research is also patchy, for SIDS as a whole but particularly for the smallest islands. In addition, St Helena's status as an Overseas Territory of the UK itself sets it apart from many SIDS.

In light of these challenges, this report takes an eclectic approach. Rather than focus on a small group of countries that are most directly comparable to St Helena, comparators are selected on an issue-by-issue basis, based on the quality of source data as well as the relevance of the experience. Where appropriate, it draws on the experience of islands that are not independent, such as the Galápagos Islands, and even one small mainland country. The report is structured around a series of seven case studies that attempt to link intentions, actions and consequences, and above all try to highlight lessons relevant for other SIDS. Some basic statistics about each country that features significantly in the report can be found in section 8.

[1] St Helena is part of the overseas territory of St Helena, Ascension Island and Tristan da Cunha, but this assignment places almost exclusive emphasis on the main island of St Helena (see terms of reference in Appendix 1).

3. Taxation

The advent of commercial air access to St Helena is likely to be accompanied by a rebalancing of its entire economy, with tourism and foreign investment playing a larger part than ever before. It is therefore an opportune time to consider whether additional tax reform is needed to provide an attractive and equitable environment for the type of business activity that the government seeks to promote, and to ensure that the tourism sector takes on an appropriate share of the burden. In this section, the first case study takes a broad look at the political economy of tax reform, and provides insight into the main reasons that some reforms fail in small islands. The second study looks more closely at the implementation of VAT, an attractive way of capturing revenue from a tourist industry in which foreign firms have a significant presence.

In addition to the general principles of good tax policy, a few specific considerations are often important for SIDS. First, given the fixed costs of complexity, the balance between the efficiency of a tax and its simplicity to administer lies in a different place for very small countries, where administrative capacity is constrained by organisational size. This has often led advisors to recommend avoiding more complex taxes such as VAT. Whilst this is a valid concern, experience in many Pacific islands has demonstrated that even very small administrations can implement VAT successfully (see section 3.2). Secondly, the extreme openness of SIDS makes taxing corporate income a challenge, since foreign companies are often able to use transfer pricing to avoid reporting profits in territories in which it will be taxed significantly. Third, the importance of tourism to the economy of many SIDS creates a dilemma: to what extent can the industry be taxed (through hotel bed taxes, sales tax, VAT etc) without hampering the growth and success of the industry? Here, there is much variation between SIDS, between the intense price competition and similar offerings of the Caribbean islands versus the unique attractions of islands such as the Galápagos, where US$100 park fees are considered to be “good value” by three quarters of visitors (see section 7.2).

3.1 Political economy of revenue reform in Tonga, Solomon Islands and FSM[2]

Fiscal reform has been a priority for many Pacific islands for a long time, driven by a move toward free trade agreements and the need to manage economic volatility, particularly from tourism and remittance inflows. Since the IMF created the Pacific Financial Technical Assistance Centre (PFTAC) with the support or a broad coalition of donors in 1993, it has been the principle driving force of reform through its advice to island governments. However, implementation has been a challenge. Although only five percent of reforms proposed by PFTAC are rejected by the three countries in this case study, only 38 percent are successfully

[2] This case study is based on Chapter 8 of Duncan et al, 2011, written by Margaret Cotton. Unqualified page and table numbers are from this book. Additional material is drawn from Cotton, 2008. Although the main focus of the research is on Tonga, Solomon Islands and FSM, at times analysis of PFTAC’s work with other Pacific island countries and Tokelau is included.

completed.[3] This case study examines what happened to the reforms that were not rejected, yet not completed. What factors in a reform improve its chances of being successfully implemented, and what happened during implementation of reforms that prevented them from being successful?

The analytical framework draws on the core insights of three different strands in the literature. The Aid Effectiveness literature warns us that while technical assistance has a tendency to package reform into a "big push", this is ineffective. Successful change requires a stronger understanding of the recipient country's perspective and sees proposed reform through the eyes of the implementers. What is too often dismissed as a lack of commitment to reform, is really a difference of understanding between aid agency and recipient, or institutional capacity constraints that make reform impractical.

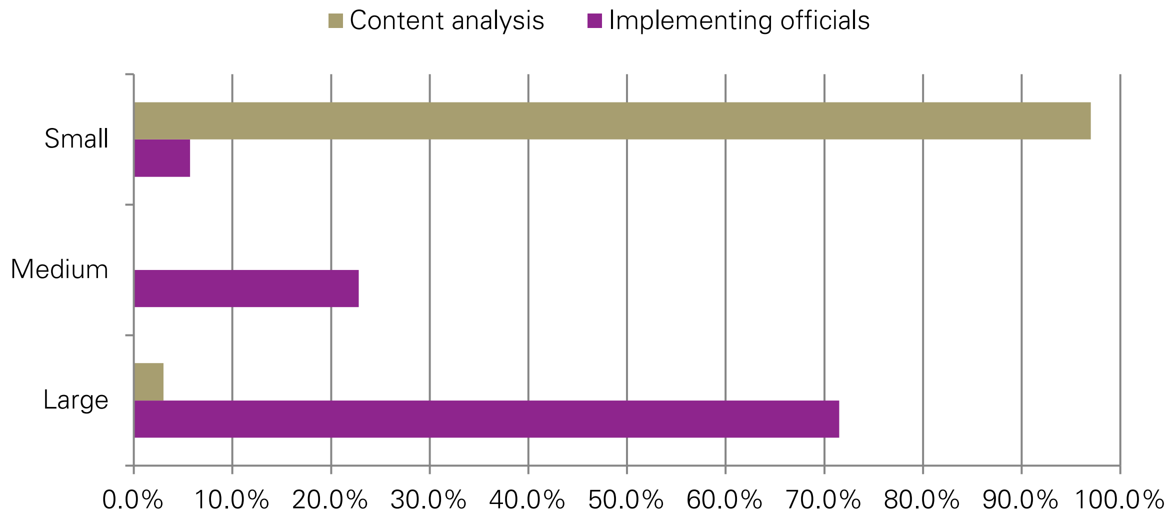
The Change Management literature also takes issue with the tendency of advice to recommend large-scale change, which it categorises as "transformational". Implementers balk in the face of these proposals, feel overwhelmed, and do nothing. Piecemeal improvements that build momentum from early successes are more likely to succeed (termed "transactional" changes). And the Cross-Cultural Management literature cautions that theories and models developed in one cultural context may have no applicability to a different context. The reforms in question certainly tend to involve advisors drawn from a different cultural context than that inhabited by implementing officials.

The research on which this study is based started with a dataset of five years of PFTAC proposals to three selected countries. The proposals were categorised as relating to policy or administration, and assigned a thematic area. Advisors and implementing officials were asked to categorise each proposal as large (transformational), small (transactional) or falling between the two. This was followed up by workshop discussions in the three countries in which individual reforms and the reasons that they were or were not implemented were discussed with stakeholders involved in the process.

The first key insight is that implementing officials perceived reform proposals as much larger than advisors. Whilst content analysis suggested that 97 percent of proposals were for minor reforms, implementing officials perceived only five percent to be so. And the results of reform attempts correspond much more closely to officials' perceptions: only 30 percent of reforms rated as large by recipients had been implemented. This suggests that more care could be taken to understand what scale of reform is considered feasible from the perspective of implementing agencies, so that technical advice is perceived to be reasonable and achievable by recipients — and that this might lead to more successful reforms.

[3] Table 8.2, pp169–70. The case study focuses on the 544 reforms proposed to Tonga, Solomon Islands and FSM between 2002 and 2007.

Figure 1: Recipients perceived proposals to be larger in scale than content analysis[4] suggested



Source: Cotton, 2008, figure 6, p51 (reproduced in Duncan et al, 2011, figure 8.1, p169).

Tax reform, by its very nature, has significant distributional effects, and it is to be expected that proposals will be opposed by those that expect to be made worse off. Perhaps the biggest surprise from the discussion, then, was the relatively minor role attributed to political economy opposition amongst the reasons given for implementation difficulties. Other constraints included the following.

- **Lack of autonomy**, in which the implementing agency (or department) required the consent of too many other parts of government in order to get reforms through.
- **Technical complexity**, which overwhelmed staff and made reforms difficult for implementers to justify within domestic political processes.
- **Communication**, (often linked to complexity), in which politicians had an insufficient grasp of the detail of a reform package to defend it to cabinet colleagues, parliament, constituents or the private sector. This difficulty is particularly acute in SIDS where ministers often have diverse portfolios in which tax reform plays a small part, and was harder when reforms were presented as a package, such that ministers (and senior officials) had to defend the details of a variety of reforms together, any one of which could undermine the credibility of the overall programme.

[4] The perceptions of implementing agencies was tested directly through surveys, whereas a content analysis process was used to determine whether each reform would be considered transformational or transactional "in the traditional North American context" (p169). This is expected to tally with the perceptions of experts delivering technical assistance and recommendations. Details of the context analysis are given in Appendices 8.1 and 8.2 on pp184–189.

- **Interdependence with other reforms**, where linking multiple reforms together in order to counteract the negative effects of individual reforms led to the easier elements failing because the entire package was rejected.
- **Inappropriate technical assistance**, which too often revolved around intensive country visits that did not allow enough time for officials and politicians to master the necessary detail of proposals. Longer term approaches using techniques such as mentoring were seen as preferable by recipients.

These various constraints came up to a different extent depending on the thematic area of the reform.

- **Exemptions** provoked the most significant political economy opposition, since the removal of tax exemption has a clear, visible impact on individual firms, who often know one another and have means of coordinating political opposition. However, this was not the only insight. Successful reforms first rationalised the process by which exemptions decisions are made such that the process appears transparent and reasonable. Subsequently, the importance of robust communication of the reasons for exemption reform was emphasised — unsuccessful reforms often lacked clear messaging to make a clear and consistent case in favour of a more impartial system, and did not prepare clear statements to explain rejections in advance. Exemptions reform was more successful when bundled with changes favourable to taxpayers such as rate reductions.
- **VAT** consistently worried implementing officials due to its technical complexity and its general air of mystery in countries with no experience of it (especially in US Compact countries such as FSM where it is alien to the origins of their tax system). Implementers often perceived the administration of current systems to be inadequate, and saw proposals to add complexity in that context as retrogressive.
- **Policy of revenue administration**, in other words, rationalising and formalising the process of revenue collection, often splitting or redistributing powers between tax and customs agencies. This was considered a substantial reform in itself, and attempts to bundle this type of reform with wider tax reforms were perceived to be too much to tackle at once. The biggest political economy challenges consisted of internal disputes when tax and customs functions were separated (even within a single overall organisation) and acted competitively.
- **Communications administration** such as improving customer service and disseminating better information about tax compliance, was often hampered by an organisational culture heavily focused on revenue generation — the difficulty of quantifying revenue gains from improved customer service focus made it difficult for managers to divert resources. Adverse island geography often hampered communication efforts further. Successes tended to be based on an individual with

exceptional interpersonal skill or an expatriate or returning staff member with experience of the benefit of customer service in developed contexts.

3.2 Value added tax in Kiribati and other Pacific islands

In 2014, Kiribati[5] became the latest Pacific island to introduce a value added tax (VAT), with the support of AusAID and the Pacific Financial Technical Assistance Centre (PFTAC). The move came as part of a broader tax modernisation initiative that collectively increased government revenue by 9 percent between 2013 and 2014[6] and eliminated a budget deficit that had persisted from 1999 until 2012.[7] In addition to raising revenue, the introduction of VAT aimed to improve compliance more generally.[8]

The introduction of VAT was a safe reform for Kiribati because so much evidence had already been accumulated through similar measures in the majority of the Pacific island countries, starting in the early 1990s.[9] None of these new taxes has been reversed in the Pacific, although the few failures from elsewhere have provided good evidence of which implementation errors have the greatest impact. Tellingly, of the countries globally that have implemented and then removed a VAT, all five have subsequently re-implemented the tax at a later date.[10]

The Pacific VAT reforms have been consistently successful. Everywhere that they have been implemented they have become a major source of revenue, varying from 19 percent in Papua New Guinea to 49 percent in the Cook Islands. On average, Pacific island countries have achieved a higher level of proportional revenue from VAT than the global average.[11] The same is true for the global group of small island states. This suggests that VAT is more suited to application in small island countries than many other forms of tax.[12] The smallest Pacific island to have introduced it is Niue, with a population of 1,610.

Probably the most important lesson from international experience is to establish a threshold below which companies are exempt from VAT, and ensure that this threshold is not too low. This ensures that administrative resources are focused on the few large taxpayers who contribute the most, and resources are not wasted on smaller firms who pay little VAT relative to the cost of compliance. In Kiribati, the threshold for registration is currently set at a turnover of AUD 100,000 (US$133,000), approximately 70 times the per capita GDP.[13] Both Fiji and

[5] Pronounced "keer-e-bahss".
[6] AusAID, 2015, p2.
[7] AusAID, 2014, p8.
[8] The introduction of new free trade agreements is sometimes given as a reason for many Pacific islands' interest in introducing VAT, although the agreements currently in force, the PICTA and MSGTA, have had minimal impact on government revenues as they cover a small proportion of their members' total trade.
[9] VAT has been implemented in the Cook Islands, Fiji, Kiribati, Niue, Papua New Guinea, Samoa, Tonga and Vanuatu (Grandcolas, 2005 and Deloitte, 2016).
[10] Grandcolas, 2005, discusses the reintroduction of VAT in Ghana, Malta and Vietnam; Deloitte, 2016, indicates that it has since been reintroduced in Belize and Grenada.
[11] As a proportion of total government revenue.
[12] Grandcolas, 2005, p1.
[13] Government of Kiribati, 2013, p8.

Samoa have had to increase their thresholds soon after implementation.[14] It is a surprisingly common error for governments to set the threshold so low as to cause problems in implementation.[15]

VAT has brought additional benefits to small island states. It commonly achieves levels of compliance that far exceed those for other taxes, because of the inherent incentives for firms below the threshold to register voluntarily.[16] In Vanuatu, for instance, 38 percent of all VAT registrants are small taxpayers who voluntarily applied to join the system.[17]

Also important is the evidence that VAT can be a catalyst for organisational and cultural change. Grandcolas (2004, pp16–21) argues that the introduction of VAT in many Pacific islands has successfully prompted a range of administrative and process improvements that themselves have increased efficiency within the tax administration, and improved accounting practices by firms. He lists the following benefits:

- using a new registration and taxpayer identification number (TIN);
- standardizing invoices and books of accounts;
- simplifying filing and payment obligations, based on self-assessment procedures, and implementing effective collection monitoring systems;
- establishing a Large Taxpayer Unit to monitor the large taxpayers identified mainly as those who need to register for the VAT;
- developing comprehensive audit programmes; and
- developing a modern computer system to streamline the operations of the tax administration.

However — largely because these things are so often necessary — implementation can be slow. The introduction of VAT in a small island takes considerable planning over the course of two or three years.[18] Even with a realistic timetable and support from international partners, the introduction of VAT in Kiribati was delayed by six months.[19]

[14] Grandcolas, 2004, p15.
[15] Ebrill et al, 2001, p117. "[E]xperience shows that many countries have not found entirely compelling the case for a high threshold that [available empirical evidence] would seem to imply. Quite why is not always clear. In part, there seems to have been a belief that a lower threshold than that advised would prove more productive of revenue."
[16] The main incentives are (a) for firms that produce zero-rated products, who can claim back VAT on inputs, and (b) firms that predominantly supply firms above the threshold, since these customers will wish to reclaim tax paid on their own inputs (Ebrill et al, 2001, p120).
[17] Grandcolas, 2004, p14.
[18] Grandcolas, 2005, p10.
[19] AusAID, 2015, p5.

4. Immigration

Within large countries, domestic migration of labour is a consistently important phenomenon that enables the economy to adjust to expanding and declining industries and shocks. In the US, for example, almost a third of the population has relocated across state lines at some point during their lifetimes, and each year more than five percent move far enough "to make a meaningful difference in their local housing and labour market environment."[20] In SIDS, migration is no less important, yet much more visible because (due to their small size), movements of this type are usually international, and therefore influenced to a greater extent by government policy.

SIDS are frequently reliant on a narrow economic base that is subject to global economic shocks, yet their size often makes diversification an impractical strategy for mitigating these risks. Inward migration is critical as a means to relieving binding constraints on growth, while outward migration is among a small set of viable strategies for dealing with negative shocks. The historical significance of outward migration is illustrated by SIDS such as the Cook Islands and Niue, each of which now has a larger diaspora in New Zealand than its domestic population.[21]

Recently, interest has grown in SIDS to facilitate greater international migration with reduced government control. CARICOM has been at the forefront of these efforts, abolishing the need for work permits for various skilled workers for CARICOM citizens working in any member state. The Pacific island countries concluded a trade in services protocol covering labour mobility in 2012, although it has not yet entered into force.[22]

However, other SIDS have benefitted from migrant labour on a substantial scale under conventional domestic law without the need for treaty arrangements. Countries such as the Cook Islands, Seychelles and Maldives have long benefitted from migrants, especially in the tourism sector.

In St Helena, even before commercial air access has begun, anticipatory investment has led to both inward migration and a severe tightening of the labour market. In the fiscal year 2015/16, unemployment has been seven people or less.[23] Economic growth will be severely constrained unless government policy enables sufficient immigration to meet tourism demand, as indicated by the general equilibrium model considered in section 4.2. The first case study in this section examines Seychelles' decision to limit the benefits extended to migrant workers, and the effects on the country's labour market. The second looks at a startlingly successful example of tourism growth — at least when viewed purely in terms of visitor numbers and revenues. In the Galápagos, immigration policy has been extremely liberal, which has created

[20] Molloy et al, 2011, pp7–8. In England and Wales, more than 2.5 million people move between local authorities every year (ONS, 2016, p3).
[21] Statistics New Zealand, 2006, p5.
[22] WTO, 2014, p17.
[23] St Helena Government, 2016, p3.

environmental and social challenges for a country that attracts tourists for very similar reasons to St Helena.

4.1 Political economy of precarious labour in the Seychelles[24]

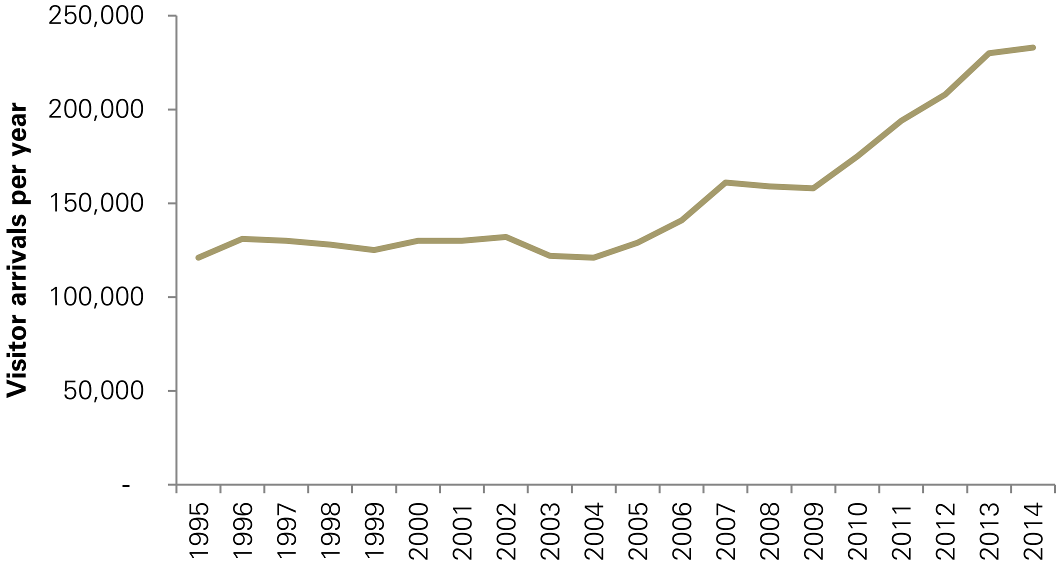
SIDS' small populations very often mean that success in a labour-intensive sector such as tourism quickly leads to policy challenges surrounding immigration. In the process of addressing these challenges, SIDS governments must balance the competing interests of domestic and migrant labour, and foreign and domestic investors. Examining the political economy of the tourism industry in the Seychelles sheds some light on these conflicts, and also how they can be mitigated or exacerbated by government policy in linked economic sectors.

SIDS' small size and consequential lack of diversification leaves them vulnerable to external shocks. Diversification, the traditional economic remedy, has clear limitations for small economies, especially for the many SIDS who have very clear comparative advantages in narrow sectors (and insurmountable comparative disadvantages in others[25]). Indeed, the Seychelles has consistently chosen the opposite path, progressively concentrating on tourism at the expense of other sectors, now accounting directly for 25 percent of GDP, and 61 percent when indirect effects are included. The sector is expected to continue to grow by more than three percent per year over the next ten years.[26] The other main policy options available to SIDS to manage fluctuations in tourism demand are sovereign wealth funds that can support aggregate demand during shocks (as in Tuvalu) or labour migration policies which enable the size of the workforce to adapt to labour demand.

However, Figure 2 illustrates that tourist arrivals in Seychelles have been remarkably stable over a period that spans the Asian crisis, the 9/11 terrorist attacks, SARS outbreak, the Second Gulf War, 2004 tsunami, steadily increasing piracy in the region and the global financial crisis and recession. The fact that the Seychelles is positioned as a high value tourism provider (with tourists spending on average US$150 a day) may give the country greater protection against demand shocks than mass-market destinations subject to strong international price competition, as in the Caribbean.

[24] This case study is primarily based on Lee et al, 2015, with additional material from Campling et al, 2011. Where only a page number is given in reference, it refers to Lee et al.
[25] Winters and Martins, 2004.
[26] Lee et al, 2015, p206. The percentages for employment are almost identical.

Figure 2: Tourist arrivals in Seychelles since 1995



Source: World Bank Development Indicators

Two stylised facts are at the heart of the Seychelles experience. The first is the dominance of foreign investment in the tourism sector with a growing majority of GST receipts from accommodation coming from 5-star hotels.[27] This has been encouraged by the government through proactive zoning of prime land for tourism use, accompanied by various liberalising reforms. This foreign ownership and concentration around large luxury hotels has probably increased the use of migrant labour, including the highest skill management positions. It may also have contributed to the consistently low linkages between tourism and domestic value chains such as agriculture and fishing (although other factors are also important). It may even have influenced legal changes that have enabled migrant labour to be offered less social protection than domestic labour. On the other hand, international investors appear satisfied to smooth out seasonal variation in demand by employing workers year-round; it is possible that capital constrained SMEs built with local investment may be more inclined to hire unskilled workers on a temporary, seasonal basis.

The second important factor has been the government's reform of employment law to encourage the use of migrant labour on temporary contracts, with fewer sickness and holiday benefits compared to local workers. The number of migrant workers in the sector has increased from 8 percent to 23 percent between 2001 and 2010.[28] This has created a two-tier labour market in which employing foreign workers is more profitable. Consequentially, although the Seychelles has a tourism academy, 85 percent of Seychellois graduates do not seek employment in the sector.[29] The academy focuses on customer service skills rather than

[27] Table 7 on p214.
[28] p214, citing the government's Tourism Master Plan 2012–2020. Across the entire economy, foreign workers accounted for approximately 11 percent of the workforce in 2007 (Campling et al, 2011, p93).
[29] p215.

the business skills appropriate to better paid positions, and upward social mobility within the sector is limited. It may simply be impossible to achieve significant growth in the tourism industry of a small island economy without relying on migrant labour to meet rising demand and skills shortages. However, one interpretation of the Seychelles experience is that if migrant labour is denied the rights and benefits accorded to local workers, domestic labour may cease to be competitive in the longer term. An alternative interpretation is that migrant labour has afforded local workers the ability to choose better paid, more secure jobs,[30] and the temporary contracts frequently offered to migrant workers has allowed the economy to maintain flexibility in the face of international economic shocks. To give an example from a similar economy, during the financial crisis of 2007–09, 44 percent of migrant workers were made redundant in the Maldives. For local workers, the figure was only 10 percent.[31]

Table 1: When indirect effects are taken into account, some SIDS rely on tourism for more than half of their employment

Importance of tourism for employment in SIDS	
Country	**Direct plus indirect share of total employment (percent)**
Aruba	58
Antigua and Barbuda	56
Seychelles	53
Bahamas	45
The Maldives	42
Vanuatu	37
Barbados	35

Source: Lee et al, 2015, table 1, citing World Travel and Tourism Council Travel and Tourism Economic Impact 2013 Country Reports.

The linkages between the Seychelles' successful tourism sector and other sectors are remarkably underdeveloped. The agricultural sector has declined rapidly alongside the growth of tourism, reflecting low government prioritisation and liberalising reforms, but also competition for land and labour from the booming tourism industry. Fisheries have been particularly segregated from the wider economy, first with majority foreign ownership of the single canning factory and an "international trade zone" which reduces the tax benefits of the industry, and increasingly through the use of migrant labour from the Philippines. Finally, the travel sector is a source of some uncertainty for the economy. Although more than 95 percent of travellers arrive in the Seychelles by air, the minority that visit on cruise ships create more opportunities for SMEs providing port services to ships and passengers. Further, the reliance on air access creates a source of vulnerability that (unlike most) the government can and arguably should control. When Eithad[32] bought a 40 percent stake in Air Seychelles and began operating the airline, direct flights from critical European markets ceased in favour of less frequent flights routed through the UAE. Field research conducted in the tourism industry in

[30] According to the Central Bank of Seychelles, unemployment has averaged only 2.7 percent since 2004.
[31] p202.
[32] Eithad is the second largest airline in UAE.

2012 revealed that almost all stakeholders perceived this to be the biggest problem facing the tourism industry at that time,[33] although visitor numbers have continued to grow.

4.2 Uncontrolled immigration in the Galápagos Islands[34]

The Galápagos Islands form one of the 24 provinces of Ecuador. As such, for most of its post-war history, there has been no effective control on immigration from the mainland. It also differs starkly from most SIDS in that self-governance has been limited, with most policy decisions being made by the central government in Quito.

Since the 1960s, Galápagos has experienced extremely high levels of growth in both population and GDP. Between 1999 and 2005 it was one of the fastest growing economies in the world, with an average rate of 9.6 percent per year.[35] Immigration was partly drawn to the rapidly expanding tourism industry and higher wage levels than the mainland, but just as important were the serious economic and social maladies affecting Ecuador from the 1980s onwards. Highly reliant on oil exports, the low prices of the early 1980s began a series of economic problems, and the currency lost 98 percent of its value. Militarisation followed a short border war with Peru, incursions of Colombian rebel groups and the continued growth in the regional drug trade. Inflation continued, interest rates reached 70 percent and the national debt ballooned until dollarization and an oil price boom initiated a recovery in 2000. Against this backdrop it is unsurprising that so many Ecuadorians emigrated to Galápagos (many more moved to Spain or the United States) and there were good reasons that the central government was reluctant to stem this migration.

However, the environment of the islands suffered. Rapid growth, coupled with insufficient urban planning and administrational capacity, posed serious challenges to the local government's ability to supply adequate basic services. Public infrastructure, waste disposal, sewage treatment, and safe and abundant drinking water became difficult to supply. This hindered investment and the business environment when, for example, several hotels on San Cristóbal were closed due to a lack of water. The education system is under-resourced and overcrowded, which results in islanders struggling to compete with mainlanders for work as guides, on ships and as administrators.[36] Furthermore, despite strong growth in GDP, real per capita income has been stagnant, and immigration is cited as the main reason for this.

Following escalating civil unrest, stemming largely from fisheries conservation measures, reform began in 1998, with the enactment of the Special Law for Galápagos (SLG). Amongst other things, this legislation restricted immigration from the mainland, although implementation was not rigorous. In 2007, UNESCO placed the archipelago on its list of endangered World Heritage sites.

[33] p213.
[34] The main source for this case study is Epler, 2007. Unqualified page numbers are from that report.
[35] Taylor et al, 2006, p14.
[36] p40.

In an effort to combat these challenges, the Ecuadorian government under President Correa initiated an anti-immigration policy called “Zero people of irregular status in Galápagos”, aiming to deport the 5,000 people that officials believed to be living in Galápagos without residency or work permits. The legislation gave illegal workers 48 hours to leave and repatriated a few hundred people to the mainland, banning others from returning.[37]

The policy included implementing a system of transit control cards (TCCs) for visitors, more transparent procedures for granting permanent and temporary residency status, and penalties for those who could not demonstrate their residency status.[38] The TCC cost US$10 from 2008, and its price was further increased to US$20 in 2015. This fee is meant to cover the maintenance of the new immigration system and required technological equipment. The new residency procedures were described as follows:

> Ecuador now treats any Ecuadorian not born on the Galápagos, or married to someone from the islands, as an illegal immigrant who can be found and deported. Since this policy began, thousands of Ecuadorians have been told to move off the islands.[39]

The success of the policy in reducing immigration has been mixed. In 2009, it was estimated that 20 percent of the total population lived on the islands without appropriate documentation,[40] even though security measures to control illegal migration were improving. However, the total population figure was estimated at a similar level in 2006 and 2010 by some sources, and most agree that population growth has at least slowed down since 2006.

Although the governance and status of the Galápagos is very different from that of most SIDS and overseas territories, it provides a powerful illustration of the impact of uncontrolled immigration on a destination reliant on its ecosystem for its attraction to tourists. Economic growth on the scale seen in the Galápagos would have been impossible without a rapid influx of labour, but the consequences in terms of degradation of the environment, breakdown in public services and civil unrest imply that a more managed approach is indispensable. The difficulties faced by the Correa government since 2007 in salvaging the situation illustrate how difficult unbalanced immigration can be to correct after the fact.

Hawaii presents an interesting alternative model of a tourist destination also dependent on limiting its domestic population and tourist numbers to preserve its appeal. The state faces the same inability to restrict either travel or inward labour migration from the United States that was the de facto relationship between the Galápagos and Ecuador until the late 2000s, although it has never suffered from the same wage differential or political turmoil on the mainland. Nevertheless, a mechanism to limit tourist numbers is needed, and Hawaii relies on “land use, permitting and availability of public infrastructure. For example, Hawaii zoning laws severely restrict new hotel construction.”[41] Although enormous in comparison to Galápagos and most other SIDS, research on the Hawaiian economy can offer insight into broader

[37] UNESCO, 2010, p27.
[38] Galápagos Conservancy, undated.
[39] Kayyem, 2012.
[40] COHA, 2009.
[41] Konan, 2010, p2

questions about the relationship between immigration, visitor numbers, visitor experience and domestic income. For instance, a computable general equilibrium model estimates that without inward migration, the maximum growth in real tourism expenditures that would be possible for Hawaii would be 1.6 percent — and this at the expense of visitor inflation of 5.2 percent.[42] In contrast, the same model predicted that with a flexible policy towards inward migration, an increase in nominal tourist expenditures of 10 percent would result in an increase in real expenditures of 4.2 percent.[43]

> A key limiting force in the growth of the visitor industry is the availability of labour. Without a responsive labour force, the increase in demand that tourism dollars generate are highly inflationary and likely unsustainable for the industry.[44]

[42] Konan, 2010, p20.

[43] Konan, 2010, p16. The model is used to examine two hypothetical scenarios. With no inward migration permitted, it found that almost all additional tourist expenditure resulted in inflation rather than an increase in the real value of receipts. "The simulation results indicate that the maximum real growth in visitor expenditures (1.6 percent) is reached at [a growth in] nominal expenditures of 7.0 percent. One could consider this to be Hawaii's 'carrying capacity' as visitor expenditures beyond this point generate inflation levels that dominate income effects. Note, that this does not define the 'carrying capacity' in terms of a fixed number of visitors but rather in the economic activity that is supportable by an inelastic labor market." (See p14.) In the alternative scenario, where labour migration was permitted and wages remained constant, a 10 percent increase in nominal tourist expenditures resulted in 4.2 percent real growth in tourist expenditures, a 2.4 percent increase in the labour force due to migration and a 5.4 percent increase in the price index for tourists (p16).

[44] Konan, 2010, pp21–22.

5. Encouraging investment

Many governments feel pressured to ensure the incentives they offer to potential foreign investors are competitive, and small islands are no exception. Despite the lack of evidence of the effectiveness of measures such as corporate tax holidays, the political pressure to win FDI that will create employment and tax revenue has led to their widespread adoption. The lack of transparency around many of the incentives offered has made their effects (both the intended and the unintended) difficult to investigate.[45]

The main theoretical justification for providing FDI incentives is to capture the spillover effects from foreign investment. However, for this to happen, local firms also need to be able and motivated to absorb foreign technologies and skills from new entrants. Granting preferential fiscal incentives to foreign firms is "not an efficient way to raise national welfare" because these spillover effects are not automatic. Providing support to the learning and investment of local firms is more important.[46] The OECD provides guidance to countries considering their investment incentive policy in its *Checklist for Foreign Direct Investment Incentive Policies* (2003). Although its advice is broadly aimed, its particular relevance for administratively constrained SIDS is clear:

> Incentive programmes are resource intensive to finance and manage, and, in particular, most incentives are administratively burdensome…
>
> Negotiation of incentives requires special negotiating skills and expertise in the application of particular instruments… [and] investors… expect… a speed of decision-making that exceeds normal bureaucratic standards.[47]

The first part of this section examines an alternative strategy that might be of interest to St Helena: a focus on investment promotion services, i.e. providing timely and tailored information to potential investors and administrative assistance in dealing with other parts of government. This case study examines two small countries that have used this strategy to great success, and the global evidence that this approach is effective.

The second part considers entrepreneurship, and the ways in which foreign entrepreneurs can bypass constraints to business formation that are common in SIDS. It looks at how the Fiji Government has adopted an innovative policy to encourage foreign entrepreneurs to choose Fiji as the location to start their new business: an immigration process tailored to their needs.

The third part looks briefly at the ways that financial services contribute to an improved investment climate in SIDS, particularly the factors that affect entrepreneurs' access to credit for business formation and expansion.

[45] Thomas, 2007, p4, who also notes that the "jurisdiction 'winning' an investment with incentives may not be unambiguously better-off due to hidden costs that are often ignored (such as the true likelihood the investment would have been made even absent the subsidy, administrative costs, opportunity costs of the money tied up in the incentive, inefficient allocation of investment capital, harm inflicted on existing firms that may even be located in the 'winning' jurisdiction and the pressure placed on competing jurisdictions to offer incentives that will harm one's own companies in the future). Moreover, from the point of view of a country or the world as a whole, the harms elsewhere will likely exceed the benefits to the 'winning' jurisdiction."
[46] Blomström and Kokko, 2003, p21.
[47] OECD, 2003, p29.

5.1 Investment promotion in Grenada and Nicaragua

An often neglected means of encouraging investment is to concentrate on getting basic investor promotion right. Investor promotion activities consist of

- national image building
- investment generation
- investor servicing, and
- policy advocacy.[48]

Evidence compiled by the World Bank on global investment promotion best practices (GIPB) "revealed poor performance of a staggering majority" of investment promotion agencies (IPAs[49]) in the tourism sector.[50] The World Bank's methodology involves assessing the quality of each IPA's web materials against predefined criteria, and then two "mystery shopper" exercises in which the IPA is approached with a set of questions and judged on the timeliness and content of their replies.[51] Across all sectors, 80 percent of national IPAs did not respond to the mystery shopper requests for information *at all*.[52] Even in countries that had selected tourism as a priority sector, barely a third responded to a mystery shopper enquiry about a tourism investment.[53] Of the minority that did, many responses were inadequate, lacking basic information that would be critical to a potential investor.[54]

5.1.1 Small states are among the most effective: tourism in Nicaragua[55]

On the other hand, the same research has showed that small IPAs with limited resources have achieved some of the best results. PRONicaragua achieved the best overall results in GIPB 2012, despite a relatively modest budget of US$900,000 and staff of 25. In response to the GIPB's mystery shopper, PRONicaragua immediately acknowledged receipt, and then provided the following detailed response within a few days:

> Requested macro data on Nicaragua and information about the lodging industry (in line with the investor's focus) with relevant statistics, including the number of rooms in each hotel category, disaggregated average occupancy rates and prices, major hotel brands already established, and a description of key projects in the pipeline.
>
> A comprehensive profile of the city of Managua, the main suggested location for the project, including information on the main tourist attractions in and around the city; short profiles of five individual site options (location, size, price, plot maps, satellite pictures, and descriptions).
>
> Information on the operating environment relevant to the investor's project such as labour wages and benefits, expatriate labour regulations, training programs, utilities and communications costs, and taxes.

[48] Harding and Javorcik, 2011, p1450.
[49] These are known as investment promotion intermediaries (IPIs) in the GIPB literature, although elsewhere various terms are used; for clarity, the term IPA is used throughout this report.
[50] World Bank, 2013, p5.
[51] World Bank, 2013, p9.
[52] World Bank, 2012a, p9.
[53] World Bank, 2013, p11.
[54] World Bank, 2013, p5.
[55] The Nicaragua case study is based on World Bank, 2013, p12.

Lists of construction companies and construction material suppliers with website links; information on construction regulations.

Nicaragua has been successful in attracting FDI in tourism, receiving US$80 million between 2005 and 2012, which is estimated to have created 1,700 new jobs.

5.1.2 Causality and quantifying the benefits

Causality in an individual case is difficult to determine. Does capable investment promotion generate new investment, or does experience with foreign investors (and resources flowing from the tax they generate) stimulate agencies to improve? This question has been tested in research comparing flows of FDI coming from the United States into more than a hundred recipient countries, and the results are clear for developing countries. Sectors targeted by an IPA receive more than twice as much FDI as non-targeted sectors, and it is estimated that a dollar spent on investment promotion leads to $189 of FDI. Similar results are found for employment: for each US$78 spent on investment promotion, one new job is created.[56]

The same authors go on to establish the extent to which quality matters, using the same GIPB measure. They find that a country with an IPA quality score of 60 percent receives an average of 25 percent more FDI than one with a score of only 45 percent. At the margin, an improvement of 1 percent in the quality score can be expected to lead to a 1.5 percent increase in FDI inflow.[57]

The decision to invest in a foreign economy usually starts with a list of potential host countries.

> The long list typically includes 8–20 countries which can be thought of as belonging to three groups:
>
> 1) most popular FDI destinations in the world;
> 2) countries located in proximity to the existing operations of the investor;
> 3) emerging FDI destinations (i.e. countries that the investor may not be initially very serious about but which represent 'out of the box' thinking).
>
> The inclusion of the third category presents an opportunity for IPAs. The potential investor or the consulting firm working on its behalf is likely to include in the third group countries whose advertisements they have recently seen in international media, countries whose IPAs have recently approached them or their colleagues, or countries whose IPA representatives they have met at conferences and industry fairs.

This insight may be particularly relevant to SIDS that have a nascent tourism sector, who are likely to be unfamiliar to large tourism investors, simply because of their smallness, remoteness and distinct cultures and languages. The impact of IPAs is found to be significantly greater in countries where English is not widely spoken, but the authors regard this test as having wider significance: IPAs are most beneficial when information about the market is harder for a potential investor to obtain independently. Whilst the language issue is important in itself, here it acts as a proxy for many features of very small, remote island economies: the

[56] Harding and Javorcik, 2011, p1447. Since the authors' dataset only contains FDI originating in the US, this may be a substantial underestimate, since it does not include investment from other sources that was mobilised by the same IPA spending. The authors find no such relationship for developed countries (p1468).
[57] Harding and Javorcik, 2012, p9.

lack of publicly available information (including third party research), the cost of physically visiting the island and scarcity of people that have visited or lived in the country.

5.1.3 Effective investment promotion in small islands: Grenada[58]

Grenada provides an example of how the IPA concept scales down to very small states. The islands achieved the best score amongst the ACP[59] group of countries in 2012, despite an investment promotion department of only five people, with a single person in charge of research, website maintenance and enquiry screening. Grenada's strategy combines speed as a competitive advantage with the patience to make continual improvements to the information it shares with investors.

Grenada is one of the more remote economies in a region in which there is fierce competition for FDI. Speed provides its competitive advantage, with a commitment to:

- A response to all enquiries within 48 hours, with the CEO copied in.
- For enquiries relating to real investment projects, the first response may be an acknowledgement, with an initial response by a project manager within five days.
- A full response covering "incentives, concessions, and any other critical, project-specific, government-negotiated deals within 20 days."

Consistently providing rapid responses requires a substantial store of high-quality content available to the IPA. Grenada has approached this steadily, accepting that a one-person research department can only amass this material on an ongoing basis, one piece at a time. Whenever new information is requested, the researcher works with other ministries and even private sector partners to generate a tailored response that is nevertheless formatted to be useful for future enquiries. This ethos of shared responsibility and cross-government prioritisation of investor communication is a fundamental requirement of this approach.

In 2009, the Grenadian IPA was approached by a regional light manufacturing company that needed to set up a new plant within eight months. Within this timeframe, the government supported the company from initial enquiry to operation, including constructing a factory, getting all licenses issued and workers hired. The speed and agility of the IPA is all the more valuable because the government as a whole is able to respond to investors in this way, and has therefore built a regional reputation amongst the business community.

[58] The Grenada case study is from World Bank, 2012b, box 1, p17.
[59] The Africa, Caribbean and Pacific Group of States (ACP) is a group of developing countries formed by the Georgetown Agreement in 1975, which includes a large number of SIDS.

Table 2: Examples of strong IPA websites in SIDS

Successful SIDS IPA websites		
Country	**Agency**	**Website**
Antigua and Barbuda	Antigua and Barbuda Investment Authority	www.investantiguabarbuda.org
Fiji	Investment Fiji	www.investmentfiji.org.fj
Jamaica	JAMPRO	www.jamaicatradeandinvest.org
Mauritius	Board of Investment of Mauritius	www.investmauritius.com

Source: adapted from the World Bank's GIPB list of best practice websites. Best practice websites are "those that continuously develop more investor friendly ways to present information. They avoid gimmicky features that might confuse or frustrate visitors and use interactive features to help investors find desired information quickly and simply." Fiji is included as it was highest ranked in the Pacific (World Bank, 2012a, box 4, p24).

5.1.4 What makes a good IPA website?

The GIPB describe what they see as the most important features of a "good" IPA website:[60]

- "As one navigates these investment portals, it is clear that they use their websites as strategic promotional tools and not just virtual bookshelves.
- "The sites are designed to maximize page placement on search engines such as Google. Using web marketing techniques, such as carefully crafted page titles and headers in the site source code and high numbers of links to and from other relevant sites, these IPAs guarantee themselves the top position on Google search results for "Invest in [Country Name]." One may have trouble finding the countries on a map, but not on the Internet.
- "When visitors enter these sites, they are quickly convinced that the IPAs are legitimate partners in the process of investing in those countries. It is clear from the positioning, branding, and language that they are official, government-mandated organizations.
- "Prospective investors will find most of the up-to-date information they need to decide whether a country merits short-listing. This information typically includes:
  - Macroeconomic data and statistics, including trade volumes;
  - Key sector profiles;
  - Operating costs, including labour and utilities
  - Important infrastructure;
  - Taxes and incentives.
- "The visitor will also find a strong business case for investing in those locations, positioned against their competition and reinforced through testimonials and case studies.
- "Finally, a visitor wanting to request additional information or personal service will easily find current email addresses and working phone numbers for the specific staff members specialized in their issues."

[60] World Bank, 2012a, box 4, p24.

5.2 Encouraging foreign entrepreneurship in Fiji

Over the last ten years, a number of developed economies have introduced specific programmes encouraging immigration by entrepreneurs seeking to start new businesses. This has stemmed partly from many governments' frustration at the difficulty of fostering innovation and new business formation through traditional routes, and partly from a realisation that traditional employer-based immigration procedures were poorly suited to entrepreneurs. The key innovations in this new visa type are:

- No requirement for sponsorship by an employer. This is often replaced by a requirement that the entrepreneur have access to investment funds, and sometimes that these funds be provided by qualified financial backers.
- Any skills requirements are appropriate to entrepreneurs rather than traditional "skilled professional" categories. Instead of formal qualifications, countries such as New Zealand review each entrepreneur's business plan.[61]

SIDS also face many challenges in fostering domestic entrepreneurship. They are often particularly acute because of the limited range of educational opportunities available domestically, and because cluster effects are so important in the formation of new businesses in many sectors. In many cases potential investors have insufficient capital to invest, and credit market inefficiencies can prevent them from obtaining loans. In these cases, foreign entrepreneurs with access to credit can bypass a string of constraints.

Despite this rationale, so far SIDS have been slow to experiment with similar policies. However, one notable exception is Fiji, which has introduced an "Investor Permit", which provides investors with the right to live, work and study in Fiji. In order to obtain the permit, the investor needs to apply to the trade and investment bureau with details of their proposed investment for approval. Once obtained, the permit allows one investor to work in Fiji provided at least FJD50,000 (US$24,000) is remitted to the country, and lasts for three years. Additional investors are also allowed to work for the same company — one for each additional FJD50,000 that is invested.[62] An extended seven-year version is also available for investors that remit at least FJD250,000 (US$122,000).[63]

5.3 Financial services

The World Bank's *Doing Business* assessment of countries' business environments devotes one of its eight sections to "Getting Credit". This section comprises two constituent challenges: first, that the legal rights of borrowers and lenders are appropriate to encourage lending, and second that credit information is collected and available so that lenders can predict which loans are likely to be repaid.[64]

[61] Sumption, 2012.
[62] Fiji Government, 2016a.
[63] Fiji Government, 2016b.
[64] Best practice guidance for policy-makers on credit information systems is available in the World Bank's *General Principles of Credit Reporting* (2011).

These factors contribute to the most important business environment concern regarding financial services: can entrepreneurs obtain loans in order to form new businesses, or to expand existing ones? But they are not the only constraints. Borrowers need property that can legally be used as collateral, the financial system requires sufficient liquidity, and lenders need an adequate appetite for risk. Contrary to conventional perceptions of the attitudes to risk of the public and private sectors, in many SIDS national development banks have been established to extend loans that are considered too risky for private lenders. Since governments value not only the private return on investment, but also various externalities, there are instances in which development banks can contribute net benefits to national welfare even when they sustain private losses. However, prudential and apolitical governance of such institutions has been a challenge in some SIDS.

In countries such as St Helena many of these difficulties have been circumvented by providing grant assistance directly to businesses, including 46 in 2015/16 alone (approximately one grant per hundred people).[65] In the smallest SIDS this may be a more efficient use of resources than establishing or improving the complex technical systems required to support an efficient credit market.

On top of more general challenges, financial services entail important economies of scale, both for private sector providers and government regulators. Although banking is frequently supplied across borders, this supply is still hampered more by scale than trade in most goods and services. One popular strategy for lessening the burden of domestic regulation is to come to an agreement with the home-country regulators of foreign banks to share responsibility for their oversight.

The lack of scale economies has been most acutely felt in the Pacific. Many countries have relied on foreign banks from more developed markets such as Australia, New Zealand, the US, France and India. With the exceptions of PNG, FSM and RMI, local banks tend to be either non-existent or government-owned. Nauru had no banking services on island for more than a decade until 2015, and Tuvalu has been unable to attract any foreign banks to its domestic market. One of the benefits of attracting foreign firms has been to take advantage of their home-country financial regulation, which has been a consistent difficulty in the Pacific, due to the cost and technical complexity of providing adequate financial oversight in small islands. Only six of the Pacific island countries have a central bank, and four have no supervisory agency at all. Attempts to establish regional financial supervision arrangements have been rejected by the countries most able to provide technical expertise.[66]

Of the SIDS, the Caribbean islands have found the most success in financial services as an industry and an export. Financial services contributed an estimated 17 percent to CARIFORUM GDP in 2011, and accounted for more than 20 percent of GDP in Saint Lucia,

[65] Budget speech 2016/17, p1.
[66] PIFS, 2008, p3. "[E]xcept within the boundaries encompassed by the Eastern Caribbean Central Bank, there appear to be no international examples of a regional or sub-regional approach to financial sector supervision."

Saint Kitts and Nevis, Montserrat, Antigua and Barbuda, Barbados and the Bahamas.[67] However, the long-term future of the industry is in some doubt, as pressure from developed countries for greater transparency are "driving up the cost of doing business".[68] This pressure is likely to affect UK Overseas Territories disproportionately.

Despite the success of financial services in the Caribbean, developing good credit information systems has remained an elusive challenge. The World Bank has a credit information index in which it ranks countries' systems on a scale of zero (poor) to eight (excellent). Caribbean small states averaged just 1.0 in 2015, compared to a global average of 4.4, despite individual successes in countries such as Trinidad and Tobago (6) and Jamaica (7).

[67] Caribbean Export Development Agency
[68] Martinez, 2015.

6. Engagement mechanisms

Challenges and constraints in public–private dialogue (and even intra-governmental communication) are widely acknowledged in many SIDS. Initiatives to build permanent mechanisms to address these challenges are also common. Countries such as St Lucia have established Doing Business task forces — usually a partnership between government and private sector representatives — to prioritise and oversee measures to improve the business environment according to the World Bank's famous measure. The Enhanced Integrated Framework (EIF)[69] frequently identifies the same gap in national policy making in SIDS, and so the national steering committee of the EIF often becomes a coordinating body for wider trade and investment climate issues.[70] The IFC recognised the particular importance of public–private dialogue for women in its series of studies of gender and investment climate reform in six Pacific islands.[71] The process of reforming the business environment to take into account the particular concerns of women is critically reliant on their voices being audible within the consultative processes that influence reform priorities. It is unsurprising, then, that one of the IFC's main recommendations was to perpetuate the dialogue that it had begun during its assessments by institutionalising both women's dialogue forums and also national PPD forums in which women's associations were adequately represented.[72]

Further information on best practice in gender-sensitive business environment reform can be found in the World Bank book, *Gender Dimensions of Business Environment Reform*.[73] This book explains the process of conducting a robust diagnostic into the ways in which women are disadvantaged by existing features of the business environment, how reform priorities can be identified, and how programmes can be designed and monitored. At the very minimum, all business environment reform programmes should disaggregate all of their monitoring processes by gender to ensure that reforms are not disadvantaging women and to provide a baseline for future analysis.

6.1 Engaging support for WTO accession in Vanuatu

Vanuatu's accession to the WTO provides an interesting case study on the importance and challenges of proper engagement on business environment reform issues, both within government and externally with the private sector and civil society. WTO accession creates possibly the greatest consultation challenge that any SIDS ever faces, due to the wide-ranging impact of WTO rules on the business environment, the highly technical nature of WTO rules and the accession package, and the uncertainty and complexity of negotiating accession terms with so many foreign governments. Vanuatu was the first SIDS to agree the terms of an

[69] The EIF is a collaboration between the WTO, IMF, ITC, UNCTAD, UNDP AND World Bank, which offers a programme of trade-related assistance to all LDCs, starting with a diagnostic study on trade competitiveness and constraints called the DTIS.
[70] E.g. "The [national development planning process]… should utilise the IF-National Steering Committee… as the formal consultative mechanism on productive sector development strategy." (Gay et al, 2009, p24.)
[71] Hedditch, 2010a, chapter 3.
[72] See, for instance, Hedditch, 2010b, p viii and 11.
[73] Simani et al, 2010.

accession package in 2001, and failures in consultation were identified by almost everybody involved in that attempt as a reason that the deal fell apart.[74] Moreover, Vanuatu learned the necessary lessons and successfully acceded in August 2012.[75]

Some of the adverse conditions that Vanuatu faced are not representative of most SIDS. Vanuatu had nine different governments between 1995 and 2004, meaning that ministers were perpetually changing, and constantly battling to grasp even the simplest concepts. In Vanuatu's Byzantine government system, departments are separate from ministries, such that the department of trade answered to three separate ministers, often representing different political parties. A Director General role was created specifically to manage this relationship between the technical department and multiple ministers, as well as to provide a counterbalance to political advisers appointed by each minister.[76]

On the other hand, many of the difficulties Vanuatu faced will be all too familiar to other SIDS. The type of consultation necessary, building on individual talks to discover private views prior to national seminars aimed at narrowing differences of opinion, were often beyond the capacity of a very small staff. The small size of government departments also meant that officials had to switch subject areas in order to obtain promotion, so that hard-gained expertise could not be retained. Of the original five-man negotiating team formed in 1995, three had moved on by 2004, leaving technical expertise "little better" than at the start of the process.[77]

One important development in Vanuatu's process was to create an inter-departmental committee that was chaired by the Environment Unit of the Ministry of Lands. Whereas the Department of Trade may have found intragovernmental consultation to be a drag on the accession process and a low priority for its very limited resources, giving another interested party within government some influence over practical aspects of the consultative process created a balance against the Trade Department's incentive to rush ahead. This provides an instructive lesson to other consultative processes overseeing business environment reform: perhaps an agency with an incentive to provide strong oversight on reform is better placed to take procedural control of the process than one under instruction to complete reform quickly. A chamber of commerce might be a suitable candidate in many SIDS.

The wider message, though, is unsurprising. When done properly, consultative processes are resource-intensive, and when their results are taken seriously they can slow and complicate reform. Due to the capacity constraints in small islands, it is common to underestimate the time and resources required to reach a satisfactory outcome. In practice this often leads to superficial or unsustainable processes.

[74] Gay, 2005, Consultation and transparency.
[75] So far three other SIDS have acceded to the WTO: Tonga in 2007, Samoa in 2012 and Seychelles in 2015. Many other SIDS joined the GATT prior to the creation of the WTO and therefore underwent a much simpler process.
[76] Gay, 2005, Government and public sector.
[77] Gay, 2005, Coping with limited capacity.

The other key component is strong leadership. “Consultations do not mean that all views can be accommodated” and a leader who understands the technical issues and is an enthusiastic communicator can help to bring a group of stakeholders to a common position that all can accept, even where views ultimately differ. “If local players feel that they have been consulted, they are more likely to commit to any final outcome even if they disagree with it.”[78]

[78] Gay, 2005, Consultation and transparency.

7. Land, conservation and climate change

Land policy is an important feature of the investment climate of any country. The way that land is taxed, zoned for different purposes, registered and transferred all have implications for how easy it is to do business. But land policy is often of particular importance in SIDS, because of the scarcity of usable land. Many SIDS' reliance on tourism requires that government is forward-looking in its use planning to ensure that islands' natural beauty is not compromised by economic development, while political sensitivities around foreign and corporate ownership of land can complicate the process of balancing traditional and developmental objectives. Some important land issues for SIDS are considered in section 7.1.

One area in which St Helena differs from many SIDS is in the specific nature of its tourism attractions. Unlike stereotypical SIDS, with their beaches, lagoons and coral reefs, St Helena's unique selling point is an ecosystem quite unlike anything else on the planet. Conservation, excellent land management and a broader commitment to environmental friendliness will therefore be critical to protect the visitor experience that forms the basis of the island's offering, and to ensure that the destination's brand image remains attractive to its target market. The Galápagos Islands provide this section's case study due to the similarity of their attractions to those of St Helena, in section 7.2.

7.1 Land policy

7.1.1 Ownership

Many SIDS have great sensitivity to allowing foreign freehold ownership of land (in some, it is not legal for government or communal tribal owners to sell to individuals, even locals). However, this need not be a constraint to attracting foreign business provided that secure leasehold is available under suitable terms, and the rule of law is credible to investors. In many SIDS, leasehold provides distinct advantages both for the investor and government:

- For SIDS that are seeking to improve their financial sustainability, leasing land can be an effective way of converting assets into a future revenue stream that will retain its real value.
- SIDS governments typically have access to credit on more favourable terms than private businesses (this in effect is particularly true of overseas territories), therefore there are significant gains from trade wherever the government is able to lease to firms.
- It reduces firms' need for liquidity, which is likely to be particularly important to small, local businesses that are credit constrained.
- Leasehold makes speculation inherently less appealing, and requirements to develop land within a defined period are arguably easier to enforce under a lease contract.

There are very few examples of SIDS where Crown Land or equivalent government landholding is as prominent in the land market as it is in St Helena.

7.1.2 Conservation

In all countries, land regulation is partly aimed at preserving the natural environment, although this motivation is much more important for St Helena because of the unusual value of its unique ecosystem, both as a natural asset and as the basis of its tourism industry. The main techniques available are:

- Land zoning, designating the use to which land in different areas of the island can be used. Areas of the greatest natural beauty and the habitat for the most important species cannot be built on for any purpose, whilst land zoned for hotels may be separated from that apportioned to less attractive features such as industry and the airport. It is also important that sufficient land is zoned (in appropriate areas) for the needs of a growing tourism industry and wider economy, including increased residential supply.
- Permits for visitors to access sites which either would be damaged by unlimited or unaccompanied tourist access or require significant maintenance to preserve the natural habitat and visitor experience. Permits can be sold to cover the costs of maintenance and can require tourists to be accompanied by licensed guides that are responsible for ensuring that visitors follow rules that preserve the environment.

Section 7.2 describes how these techniques are used together in Galapagos Islands, which have many similarities to St Helena in terms of their ecosystem and its importance for tourism.

7.1.3 Taxation

A land value tax (LVT) is a tax on the value of undeveloped land. Each freehold owner pays an annual tax based on the value that their land would have without any improvements. The tax is often advocated by economists for two reasons. Firstly, it does not distort behaviour in the way that almost all other taxes do, because the supply of land cannot change in response to the tax. Second, it is relatively difficult to avoid because it does not rely on taxpayers disclosing any information to authorities. The main difficulty in implementation is political. The introduction of a new LVT reduces the current market value of all land, so opposition from existing landowners is to be expected. Jamaica has had an LVT since 1957. Analysis of its administration identified the following lessons for SIDS:

Exclude taxpayers below a certain threshold. As with VAT (see section 3.2), the cost of administration is too high relative to the tax collected to extend to the smallest landowners.

Between land valuations, increase the assumed value of each plot in line with inflation or a higher index rate, to avoid sudden leaps in taxpayers' bills each time its value is assessed.

Adopt a simple system based on a single percentage value, rather than having many rates and caps, since complexity increases the cost of administration and introduces incentives for evasion strategies (such as dividing large plots to move into a lower band).

7.2 Land management and conservation in the Galápagos Islands[79]

The Galápagos Islands share many important characteristics with St Helena, including their volcanic landscape, size, remoteness, and appeal in nature explorations, snorkelling, and fishing. The main appeal of the islands is their natural beauty and unique ecosystem; an extensive eco-conservation system run by the Galápagos National Park Service was set up in order to protect these qualities. Land policy in Galápagos is thus critical not just for conservation but for the economy. It also has a focused objective.

Early studies found that there was immense potential for nature-based tourism in Galápagos, provided that the ecological diversity and environment were protected. Indeed, by 2005 the number of tourists frequenting the islands had increased sixty-fold from a mere 2,000 during the 1960s, and tourism was contributing more than US$140 million to Ecuador's economy by 2006.[80]

The Ecuadorian government's response, spanning over three decades, has focused on regulating activities in the protected areas of the archipelago by limiting the number of licences for tour vessels, designating use zones and visitor sites, and using fiscal policy (less attention was paid to the areas designated for human settlement). Use zones designate activities which can be performed in each area, which do not disturb the ecosystem. Infrastructure such as paths which show where visitors should walk are provided. These prescriptions include diving and snorkelling sites. Fixed itineraries assign the amount of time each tour spends at each site. Visiting vessels pay fees, visitors pay entrance fees, and boats require licenses. These are not only direct measures to conserve the environment, but also ways of financing various government efforts.

An important lesson can be learnt from Galápagos' use of higher entrance fees after it became clear that demand was high, but wages and infrastructure within the park were not competitive. The entrance fee was raised to US$100 for foreigners, and the increased revenues were seen as a way to finance conservation and management.

The Genuine Book of Ecuadorian Laws makes clear the priority placed on the island's ecosystem. The constitution

- "provides that the province of Galápagos will have a Special Regime and that the rights of free residence, property and trade may be restricted in order to protect it…

[79] This case study is based primarily on Epler, 2007, and unqualified page numbers refer to that report.
[80] pp iii and 20.

- “guarantees the right of all persons to live in a pollution-free environment and compels the state to… oversee the preservation of nature”.

There have been marked successes of this policy. A significant increase in revenues was recorded. Only 18 percent of tourists asked about the new entrance fee price considered it “too high”, with three-quarters describing it as “good value”.[81] Tourism remains at a high level. There was, however, a decline in visitors’ satisfaction ranking of Galápagos’ nature and wildlife between 1991 and 2006, suggesting that Ecuador’s policy should not be seen as the upper limit for conservation efforts.

The government is also cognisant that attention to climate change is a necessary part of protecting the holistic brand of the destination. To this end, one of the two airports in Galápagos has been marketed as the “world’s first green airport”. It runs on solar and wind energy, and 100 percent of its energy use comes from renewable sources.[82]

The clear lesson to take from the land policy in Galápagos is that conservation regulation is important for both government revenues and protecting the country’s natural resources. The Galápagos experience also underscores the importance of an empowered national park service, with responsibility not just for monitoring landscape change and environmental degradation, but also for regulating the volume and effect of tourists and recommending changes to entrance fees. As a tourist destination, the Galápagos differentiates itself through its unique assets and high quality tourism experience, not by competing on price. Park fees have been managed with this in mind, set at a level that ensures government has the resources to provide a high-quality experience for visitors. The US$100 entrance fee represented just two percent of the average cost of each visitor’s holiday.[83]

[81] p45.
[82] Airport Industry Review, 2015.
[83] p45.

8. Comparator countries

Figure 3: Summary statistics on comparator SIDS

Countries featured in this report					
Country	**Population (1000s)**	**Distance to major airport (km)**	**GDP per capita**	**Ocean**	**Association**
St Helena	4.80[a]	3,691 (Johannesburg)	5,820[e]	Atlantic	UK OT
The Cook Islands	17.8[b]	3,014 (Auckland)	16,000[f]	Pacific	NZ FAS
The Federated States of Micronesia (FSM)	104	2,986 (Cairns)	3,340[g]	Pacific	US CFA
Fiji	892	2,157 (Auckland)	9,160	Pacific	None
The Galápagos Islands	25.1[c]	1,312 (Quito)	2,989[h]	Pacific	Province of Ecuador
Grenada	107	589 (Caracas)	13,000	Caribbean	None
Kiribati	112	3,851 (Brisbane)	1,860	Pacific	None
The Maldives	409	5,103 (Hong Kong)	12,600	Indian	None
Niue	1.61[d]	2,487 (Auckland)	5,800	Pacific	NZ FAS
Palau	21.3	2,965 (Cairns)	15,300	Pacific	US CFA
Saint Lucia	185	755 (Caracas)	11,000	Caribbean	None
Samoa	193	2,892 (Auckland)	5,920	Pacific	None
Seychelles	92.9	3,758 (Johannesburg)	27,300	Indian	None
Solomon Islands	584	2,126 (Brisbane)	2,190	Pacific	None
Tonga	106	2,005 (Auckland)	5,230[g]	Pacific	None
Tuvalu	9.92	3,200 (Auckland)	3,780[g]	Pacific	None
Vanuatu	265	1,895 (Brisbane)	3,040[g]	Pacific	None

Source: Population and GDP per capita (current US$ PPP) from World Bank Development Indicators 2015, unless noted below. Distances from Prokeraia.

Notes: (a) 2016 St Helena census data, de facto, (b) 2011 Cook Islands census data, de facto population reported by GeoHive, (c) 2012 Ecuador national census, as reported by GeoHive, (d) 2011 Niue census data, reported by GeoHive (e) Authors' calculations based on report of FY 2009/10 GDP in St Helena Statistical Yearbook 2013/14 (f) GDP per capita (current US$), UN Data 2013, (g) WBDI 2014, (h) Income per capita, Taylor et al, 2006, p24, (i) CIA World Factbook, 2003.

Distances do not take currently available routing into account.

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Appendix 1 Terms of Reference

Overview

St Helena is a UK Overseas Territory, which also comprises Ascension Island and Tristan da Cunha. This assignment is primarily centred on St Helena, but may be of value to, for example, immigration approaches on Tristan da Cunha.

Up until mid-2016, St Helena has only been accessible by boat. With its new airport built, and certified to international standard, regular air services should be in place by the end of 2016. With the coming of the airport, both domestic and international investment potential is likely to take a step change, with consequent beneficial impact on economic development and government revenues, and on an eventual reduction in the need for UK aid.

The airport currently accommodates small planes, for example, for medical evacuations. When fully operational, it is expected to accommodate large aircraft offering scheduled services, for example, Airbus 319/320 or Boeings (with the exception of 737-800s). It is therefore anticipated that investors and tourists will be able to get to St Helena.

While there have been some changes in the investment climate of St Helena in the last few years, both of the key agencies involved in economic development, i.e. the St Helena Government (SHG), and its economic development agency, Enterprise St Helena (ESH), are aware that further improvements aimed at attracting investors could be made. Anecdotal evidence from the domestic and international private sector suggests that the need for change is both urgent and important.

DFID Overseas Territories Department (OTD) intends to commission BERF to undertake a review of the business enabling environment (BE) in St Helena with the aim of identifying key reforms and devising a targeted investment promotion strategy for the island. Evidence from comparable small island developing states (SIDS) that have implemented BER programmes particularly with a view to removing constraints to both foreign direct investment (FDI) and local investment, will be a crucial input to the St Helena business environment reform (BER) review.

Objectives

To provide evidence of constraints to, and key factors in, attracting and stimulating investment in SIDS with characteristics similar to those of St Helena; and

To provide evidence from these SIDS of BE reforms, the benefits arising from reforms and incentives offered by government (directly or through enterprise development/investment promotion agencies) to assist in attracting and stimulating investment.

Link with BER/investment/jobs/poverty (Theory of Change)

The DFID/SHG programme "Support to Enterprise St Helena 2014-16" includes a range of support to economic development outcomes, including job creation and skills development. The 2014/15 Annual Review recommended that "a business enabling environment and investment climate assessment should be undertaken with urgency, with prioritised recommendations aimed at SHG, ESH, DFID and the private sector (including private sector membership organisations)". A recent National Audit Office Review into the St Helena Airport project is also likely to make a similar point about the importance of the investment climate. Improving the investment climate on St Helena will lead to additional investments, and a consequent effect on job creation and increases in income, particularly in tourism and tourism-related sectors.

This assignment will provide expert external assistance to SHG and Enterprise St Helena, and will not replace the work of DFID civil servants.

Client and Beneficiaries

The client is Enterprise St Helena as the economic development agency of the St Helena Government. The beneficiaries will be, directly, existing and potential domestic and international investors in St Helena. The indirect beneficiaries will include St Helena residents who obtain part-time or full-time jobs in the business investments made as a result of improving the investment climate and SHG which will raise revenues from taxes and fees arising from additional investment.

Scope

Issues to be addressed in this assignment include:

- Review and set out a list of SIDS which are comparable to St. Helena on the basis of relevant indicators.
- Review BER and ICR reports from St Helena's comparator islands (SIDS) particularly those in the Pacific and the Caribbean which are seen as the closest models to St. Helena.
- Analyse relevant investment climate and business environment reports and policies which have already been produced and implemented (for example, the SIDS Action Platform, the World Bank's Doing Business Reports on SIDS).
- Review the engagement mechanisms that have been utilised in SIDS to build ownership amongst representative groups of stakeholders (for example elected officials, private sector membership organisations, and investment promotion/economic development agency senior and middle level staff).

- Review international SIDS experience in terms of political economy analysis (PEA) and how political economy issues are 'negotiated' in SIDS.
- Review international SIDS experience in terms of gender metrics in BE reforms and the investment incentives offered in relevant SIDS.
- Review and assess the extent to which climate change and the environment is managed as part of the broader BER and investment incentives of comparator SIDS.

Method

The researchers will undertake desk work to:

- Review the evidence from comparator countries (SIDS similar to St Helena) on business enabling and investment climate reform programmes and the incentive programmes that have been put in place. For the purposes of St Helena, key comparators will include tax regimes, immigration laws, incentive schemes or benefits, and similar data.
- Assess the investment incentives regimes that have been utilised in comparable countries for their applicability to the St Helena context.
- Review the engagement mechanisms to build ownership amongst representative groups of stakeholders (for example elected officials, private sector membership organisations, and investment promotion/economic development agency senior and middle level staff).
- Collate and analyse research findings and present these in a BERF Evidence and Learning Note.

Timeframe

The assignment will be programmed for up to a total of 12 days (level of effort) and will be carried out by the Evidence and Learning Senior Researcher with support of a Junior Researcher/Research Assistant.

Deliverables

- An Evidence and Learning Note on BER in Small Island Developing States with specific reference to St Helena.

Dissemination

The Evidence and Learning Note will be an input into the BER and IC Review of St Helena, in the first instance. It will be disseminated by ESH throughout St Helena, and also placed on the existing ESH and SHG websites. It will also be made available on the BERF website, and will be shared by DFID with staff in Montserrat and, possibly, other Overseas Territories. Opportunities to disseminate the findings to other small island states will be utilised via the Commonwealth Secretariat and the United Nations.

Workplan

Week commencing	Item
06 June	ToR reviewed by DFID and comments received by BERF
13 June	Approval received from DFID CO and DFID IC
20 June	Research mobilised
27 June	Draft report finalised and quality assured
4 July	Draft reviewed by DFID CO and comments received
11 July	Report reviewed and finalised; Report submitted to DFID; assignment sign-off

Competencies Required

- Knowledge of business environment reform.
- Experience of research methods and analysing information.
- Experience of small island developing states.
- Completed assignments involving political economy analysis.
- Gender awareness.
- Climate change awareness.

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Feedback Form

Please complete the feedback form below and return it to:

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Details	Please Complete
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Planned dates of assignment (from/to)	
Actual dates of assignment (from/to)	
Name (person providing feedback)	
Job Title	
Organisation	
Your role in the BERF assignment	

Feedback Score

Based on this engagement, how likely are you to recommend BERF to a colleague?

Please give a probability score between 0 (would definitely not recommend) and 10 (would definitely recommend). Mark score with an X.

A guide to scoring is provided overleaf.

10	9	8	7	6	5	4	3	2	1	0

Feedback Explanation	
What is your reasoning behind the above score?	
How could we improve the score?	
Other comments?	

Guide to scoring

Criteria

1) Objectives: how effectively and efficiently did the assignment achieve its objectives and meet your needs?
2) On time delivery: were the initial contact, follow-up, ToRs, mobilisation and assignment outputs delivered on time?
3) Product quality: was the final assignment report/document(s) of a high quality?
4) Service quality: did you receive a high level of service from the BERF team?
5) Overall experience: how would you score the BERF experience overall taking into account achievement of objectives, on time delivery and product and service quality?
6) VfM: Did the assignment provide good value for money for the resources used?