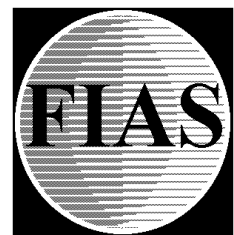


Review of investment incentives

Solomon Islands

December 2005

FIAS
Leaders in Investment Climate Solutions
International Finance Corporation and
The World Bank Group



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About this report

This report provides an independent review of investment incentives in the Solomon Islands. We prepared this report on behalf of the Solomon Islands Department of Finance and Treasury, and Ministry of Commerce, Industries and Employment.

The review encompasses an assessment of the Solomon Islands “location offer” to investors, the operation and effectiveness of the current system of investment incentives (tax and otherwise), and the appropriateness of special economic zones within the “location offer”. We framed this assessment in the context of how any changes to the investment incentives system might complement and/or impact on economic development in the Solomon Islands. It also takes account of the broader financial, taxation, legal and administrative reforms under consideration.

In preparing this report, we commissioned additional technical advice, in confidence, from specialist consultants from the Centre for International Economics with relevant experience of investment incentives:

- Ross Chapman – Senior Associate
- Lee Davis – Senior Economist.

Note that we finalised the review prior to the passage of the new Foreign Investment Bill (2005) through parliament on November 15, 2005. As a result, we base our assessments of the investment approval process in the context of the former Investment Law (1990).

We would like to thank to all those who contributed to the review either in form of spending time on interviews, providing information and/or giving comments to drafts. We especially want thank the staff of the Economic Reform Unit, Department of Finance and Treasury for their cooperation and contribution.

Geoffrey Walton Senior Investment Policy Officer FIAS	Sean M Duggan Regional Program Coordinator – Pacific FIAS
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Executive summary

The need for much greater private sector investment

To improve living standards the Solomon Islands economy will need to grow much faster than the current rate of about five percent annually. At this rate, it is estimated that it will take 25 years to return to living standards enjoyed before the civil disruption that occurred between 1999 and 2003. Increased private sector investment is the key. Without it, jobs will not be generated fast enough to absorb growth in the workforce. The government's tax base will not grow fast enough to finance increasing demands for government-provided services.

Investment is inadequate despite the tax based incentives available in the Solomon Islands

Tax based incentives for investors are embedded in tax and customs laws. Generous tax exemptions of up to ten years are available for some types of investment. For some investors these provisions are supplemented through individual agreements between investors and the government. Yet aggregate investment, as far as it can be measured, is inadequate.

An improved business-operating environment is essential to increase investment

International studies on the effectiveness of incentives show that while they can tip the balance for some investors deciding between different locations there are other factors that are more important in attracting investment. These include:

- a stable political and macro- economic environment;
- a simple and fair tax system;
- access to markets inputs and reasonable quality services at competitive prices;
- easy business set up conditions with few administrative barriers; and

- secure property rights based on well drafted investment, company, land and bankruptcy laws.

These factors influence expected profitability, the speed with which investors recover invested capital, and the riskiness of the investment project.

Incentives, in the form of tax holidays, accelerated depreciation, expenditure allowances and subsidies, can also affect after tax profits. However, there is international evidence that suggests that incentives are often redundant for those who choose a particular country in which to invest. They would invest anyway. Redundancy in 60 to 80 percent of cases is revealed in two major studies.

Incentives cannot substitute for fundamental reform in the existing business environment

There are many serious deficiencies among the things that matter most to investors. This is despite recent achievements in stabilising the Solomon Islands budget, capable monetary policy by the Central Bank, and the passage of a new Foreign Investment Act,. Some of these things cannot be changed by government action – a small domestic market and high transport costs due to remote location for example. Others can be changed, and should be.

Under the former Investment Act, foreign investors faced an uncertain approval process before being allowed to invest and were excluded from a list of reserved activities open only to indigenous investors. The new Foreign Investment Act will improve this situation. However, barriers to setting up a business remain costly and time consuming – it costs nearly 50 percent of per capita income to establish a business. Investors cannot easily gain access to leasehold land and it is difficult to use leasehold land as security in credit transactions. Traditional title creates barriers to plantation development. Company law and bankruptcy provisions need review.

The indirect tax system (principally comprising the goods tax and import duties) is a major source of problems and some so-called incentives are no more than attempts to reduce the impact on investors' input costs of 'cascading taxes' (goods taxes of up to 15 percent imposed on top of import duties which already average 15.4 percent). Widespread exemptions from goods tax and import duties are made selectively available to members of the community, going well beyond producers who compete on world markets. Tax rates for those who *do* pay are higher as a result. The tax/exemption system is neither simple nor fair. There is a danger that unless there is a major review of indirect tax exemptions, unjustifiable exemptions will carry over even when the tax system is modernised.

An export-processing zone (EPZ) is unlikely to be successful and may delay fundamental reform

There are suggestions that Solomon Islands should establish an export-processing zone (EPZ) or some other form of special economic zone (SEZ) as a means of overcoming these impediments. Typically, packages of incentives in these zones include fast tracked business approval, tax holidays, customs duty remission and freedom from other taxes on goods and services, guaranteed access to land and priority connection to electricity, water and other services. There are many failures world wide in attempts to establish successful EPZs. This report concludes that the conditions required for success with such zones are not present in the Solomon Islands. There is a danger that such an experiment could delay fundamental reform.

A case for retaining incentives while removing obstacles to investment

The effectiveness of incentives in promoting investment in the Solomon Islands will not improve greatly while these tax complexities and administrative barriers remain. Change is urgently needed. But even urgent tax reform and corporate and other legislative changes will take time. Meanwhile, the high-risk premiums required as part of the return for investing in the Solomon Islands will take time to subside. Incentives may be justified while these changes occur. However, they need to be ‘best practice’ incentives.

Two large scale investment projects recently commenced in the palm oil and gold mining sectors. Both investors secured substantial tax incentives. These inducements may have served their purpose in the post-tensions environment. However, they do not necessarily provide a good model for how incentives should be offered in the future, and in what form.

The features of best practice incentives

Authorities on incentives sometimes differ over their effectiveness. However, there is widespread agreement about the desirable characteristics of a ‘good’ incentives scheme. Incentives should be:

- linked to a clear investment policy with the role for incentives spelled out;
- administratively simple with eligibility and approval based on clear rules and objective criteria;

- equitable and consistent in their treatment of investors;
- transparent, including transparency in their cost to revenue;
- performance based, delivering benefits in return for actual investment;
- not biased towards encouraging short term investment that is ‘incentives driven’ rather than investment attracted by long term prospects; and
- supporting access to markets at world prices.

Deficiencies in the current incentives regime

The current incentives regime in the Solomon Islands fails most of these best practice tests. It does so because of the lack of policy development underpinning it, the legislation on which it is based, the way it is implemented, and the types of incentives used.

- There is no clear investment policy statement linking government policy with incentives. Tax based incentives are the primary form of assistance. In legislation, they discriminate between different sectors (export, primary industry, tourism, manufacturing, etc) and different sized investments. However, there is no stated explanation for these differences.
- The approval system is discretionary – not rules based and with uncertain outcomes for investors. Approval of tax exemptions under current legislation involves judgements and interpretation of eligibility criteria by the Inland Revenue Division¹, Customs Exemption Committee, and an ad hoc Goods Tax Exemption Committee. To bypass this process, Memorandums of Understanding (MOUs) between investors and government were the preferred mechanism for a number of individual investors seeking tailor made arrangements and greater certainty.

¹ Under the previous Investment Law, the Investment Board made decisions about a range of incentives. The authority for these decisions has now passed to the Commissioner for Inland Revenue.

- The guidelines for administrators determining eligibility and generosity of incentives are loosely worded. The legislative wording in many cases is ambiguous, adding to complexity and forcing policy interpretation on Inland Revenue and Customs officials. Tax officials should decide what is meant by ‘substantial’ expansion investment for it to be eligible for tax incentives. Customs officials must decide which goods might be intended for ‘investment purposes’ rather than other uses.
- There is no guarantee of equitable or consistent treatment for different investors given the discretionary system used. Tax holidays for some investors exceed legislated provisions. Smaller local investors are not accessing incentives. Foreign investors face higher corporate tax rates than locals (35 percent versus 30 percent) after tax holidays expire. Established enterprises without tax holidays feel discriminated against.
- The total cost to current or future revenue is unknown. The total budgetary cost of incentives in the Solomon Islands is difficult to assess accurately because data is generally poor, and recipients of tax holidays are not required to file tax returns. However, FIAS estimates that of the total foregone *indirect* taxes in 2004, as much as SBD63.5 million (or 21 percent of actual collections) was directly attributable to investment incentives.
- The use of corporate tax holidays, with their monitoring difficulties and other deficiencies, means that these corporate tax incentives are not necessarily performance based – that is, based on actual investment. They are open to abuse through new company formation and the re-routing of incomes through exempt companies. They are attractive to footloose ‘quick profit’ companies. Accelerated depreciation and tax credits based on actual investment do not have these problems.
- Inappropriate incentives are leading to unintended consequences. Relief from timber export duties for landholders is provided with the intention of compensating for poor contracts with timber companies and to encourage reforestation. This policy is largely ineffective.

Recommendations for change

The Solomon Islands long-term investment strategy should be one of gradually reducing incentives while improving the underlying tax and business environment through fundamental reform. Meanwhile the type of incentives on offer, and the way they are offered, should be changed.

To clarify the role of incentives in investment policy

Recommendation: *Publish a clear statement of government investment policy and the role for incentives in that policy, including their role in individual sectors (primary industry, manufacturing, tourism, other services). To achieve this, the government should review and revise the poorly defined eligibility criteria as set out in Section 10 of the Investment Act.*

To move towards a simple-to-administer, rules-based approval system

Recommendation: *Provide the Commissioner for Inland Revenue with clearer, more tightly defined and objectively based guidelines for deciding whether an applicant for incentives granted under the Commissioner's powers qualifies for those incentives. The guidelines should include a minimum size threshold. The guidelines should be embodied in Ministerial Orders requiring the Commissioner to follow them. They should be widely publicised.*

Recommendation: *Issue a statement recognising the Commissioner for Inland Revenue as the sole, responsible decision maker in applying eligibility criteria for corporate income tax-related incentives.*

To deal with inappropriate criteria and poorly worded incentives legislation

Recommendation: *Remove reference to local value adding as a criterion for granting and scaling incentives from the Schedules to the Income Tax Act. It violates WTO requirements.*

Recommendation: *Establish a minimum size threshold for all investments- new or expansion- qualifying for corporate tax incentives in the guidelines to the Commissioner. Reference to 'substantial expansion' investment as it relates to eligibility for income tax based incentives should be taken to mean all eligible investments that exceed the quantitatively determined SBD threshold.*

Recommendation: *Revoke investor exemption from import duties made available under s.18 of the First Schedule of the Customs and Excise Act and replace it with a low uniform tariff rate on defined capital items. If this recommendation is not taken up, then the wording of s.18 should be tightened to stop potential abuse and revenue leakage.*

To assist investors in export industries get inputs at competitive prices

Recommendation: *Remove duties on imported capital inputs for all users or introduce a low uniform rate on capital goods. Given that such inputs are likely to be exempted from import duty already, the revenue implications would be minimal.*

To assess effectiveness and improve transparency of incentives' costs to revenue

Recommendation: *Make provision within the Inland Revenue Division (IRD) to monitor all current and future recipients of fiscal incentives for compliance with the conditions on which they are granted. IRD should be adequately resourced for this task.*

Recommendation: *Make filing of an annual tax return an approval condition for all new investors or expansion projects receiving tax privileges in the Solomon Islands. There should be automatic disqualification from current holidays and from consideration for future extension of privileges (on basis of expansion investment) through failure to file a return in the current year, in response to a written request from the Commissioner.*

Recommendation: *Establish a register of all entities enjoying tax holidays as an investment incentive, drawing on Investment Board (formerly) and IRD records. The register should be publicly available.*

Recommendation: *Undertake a systematic independent review of all categories of exemptions from customs duty and goods tax prior to introduction of any new indirect tax structure. Those holding exemption certificates from whatever source should be required to present them for evaluation and possible renewal.*

Recommendation: *Consider removing duty exemption for imports by government because of potential revenue leakage and abuse.*

To use best practice types of incentives and remove bias towards short-term investments

Recommendation: Amend the Income Tax Act within 12 months to replace reference to income tax exemption for new and expansion investment with income tax credits. The rate of these credits should be struck with both the objectives of these incentives and budget capacity in mind. Until the amendment takes effect do not issue tax holidays of more than five years duration.

Recommendation: Review existing provisions and rates for accelerated depreciation as part of the wider review of taxation. With removal of tax holidays for future investors, the scope for amending the Income Tax Act to extend accelerated depreciation in some sectors should be examined. A future review of the Income Tax Act should examine the case for indefinite loss carry forward.

To establish a reputation for equitable and consistent treatment of investors

Recommendation: Honour existing agreements. With the replacement of tax holidays by accelerated depreciation and tax credits, existing time bound holidays should be honoured, subject to IRD being satisfied that the exempt income stream can continue to be shown to be from the investment that attracted the exemption.

Recommendation: Avoid extending existing tax holidays. Further incentives should only be granted where additional investment occurs and they should be in the form of tax credits and/or accelerated depreciation rather than tax holidays. All future expansion investment incentives should be in the form of tax credits and/or accelerated depreciation.

Recommendation: Reduce the corporate tax rate for foreign companies that applying to domestic companies — at present 30 percent.

1 Investment location decisions and the Solomon Islands investment environment

The Solomon Islands economy is only now starting to recover from the social unrest experienced over the period 1999 to 2002. The four years of unrest were characterised by a collapse of law and order, a contraction of economic activity as businesses closed or scaled down operations, a fall off in investment, rising unemployment, and falling government revenue that saw government defaulting on its financial obligations, and deterioration in government service delivery. Weak economic fundamentals saw four years of economic contraction, with GDP falling by nearly 24 percent between 1998 and 2002. The Solomon Islands was virtually a collapsed state by 2002.

Recovery coincided with the arrival of the Regional Assistance Mission to the Solomon Islands force in mid 2003. Law and order has greatly improved, macro economic stability is being restored, needed economic reform is being undertaken, government is once again functional, and economic activity is recovering.

It is against this backdrop that the review of investment incentives in the Solomon Islands was undertaken. Readers of this report should keep in mind that only two years ago the Solomon Islands was a failing state, and it has come along way in the last two years.

Despite these encouraging signs, the IMF notes that the Solomon Islands still faces some major challenges.²

Recent evidence on investment in the Solomon Islands

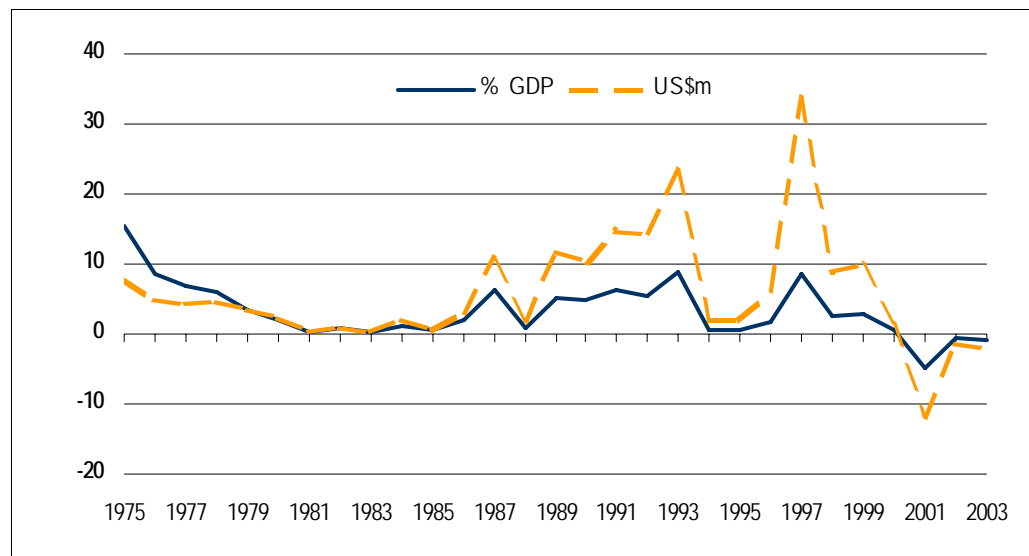
Investment — and foreign investment in particular — will play a crucial part in any sustained recovery of the Solomon Islands economy from the setbacks created by the tensions of the recent past. The sketchy evidence currently available suggests that while there is some pick up in economic activity, and some encouraging return of natural resource based foreign investment, the investment climate remains fragile.

² IMF Article IV Consultations, Concluding Statement, October 2005.

Reported growth in real gross domestic product estimated at 5.5 percent for fiscal 2004 and forecast to be over four percent in 2005.³ Though encouraging, growth would have to be significantly greater and sustained for long periods to restore per capita real incomes to their pre-tension levels of the late 1990s.⁴ For this to happen, investment will need to recover significantly.

Data on aggregate investment is not readily available. National Accounts, which routinely report investment levels as a component of aggregate annual expenditure in larger economies, are not yet available for the Solomon Islands. Only a partial picture of investment can be gained. Foreign direct investment, as measured by balance of payments financial account figures, was negative in three successive years since 2002 (see Chart 1).⁵ In addition, in 2004 the Investment Board, the body responsible for approving all foreign investment projects, approved only SBD53 million worth. Even if all such projects were to be implemented, they would represent only around 2.6 percent of GDP⁶. Moreover, approvals notoriously overstate implemented projects.

Chart 1: Net foreign direct investment inflow



Source: World Bank World Development Indicators.

³ Central Bank Solomon Islands, 2004 Annual Report, pp. 6 and 10.

⁴ IMF Article IV Consultations concluding statement, October 2005.

⁵ Central Bank Solomon Islands, 2004 Annual Report, table 8, p. 30.

⁶ While this rate is higher than, for instance, southern African rates of around 1.5 percent in the 1990s, it compares unfavourably with rates for some other small island economies, eg the 10 percent rate for the Seychelles achieved by the end of that decade. See Dahl, J. 2002 *Incentives for Foreign Direct Investment: the Case of SADC in the 1990s*, NEPRU Working Paper No 81.

These figures do not include two ‘flagship’ commitments in 2005 by foreign owned firms to redevelop key gold mining and palm oil plantation and processing ventures. The re-opening of the Gold Ridge mine by Australian Solomon Gold and the proposal for Guadalcanal Plains Palm Oil Limited will involve estimated investments of SBD413 million and SBD320 million respectively over the period 2005 to 2015.

In the post tensions weak investment climate, these two projects have a positive value that goes beyond their immediate value adding and job creation effects. Unfortunately, as discussed in Chapter 4, they have reinforced the perception of the Solomon Islands as a business environment driven by ‘special deals’ from government rather than through a transparent, rules-based approach to attracting investment.

No reliable published series of annual applications and granting of foreign investment approvals by the Investment Board are available. This prevents any meaningful assessment of apparent demand for investment access by foreign enterprises. This is a major deficiency in the area of transparency. Some investors’ representatives criticised the Investment Board for failing to demonstrate evenhandedness in dealing with approval applications. The new Foreign Investment Act will help to remedy these deficiencies. It will replace a highly discretionary and opaque approval system with simple registration of investors, with annual follow up of investors through a survey conducted by the Department of Investment within the Ministry of Commerce. These changes will help to reduce the uncertainty facing prospective foreign investors about approval to invest, reduce the time taken for this and allow government to track actual investment.

There are few examples of large-scale *domestic* investment emerging. Discussions with the local commercial banking sector and the CBSI both point to lending concentrated towards established enterprises.⁷ This may reflect a lack of *demand* for credit for new local enterprise as much as bank prudence. Banks report low and decreasing levels of delinquent loans.

The Central Bank aptly summarises the current situation when it says:

Future credit expansion must target new investments and [be] channelled into sectors the country has comparative advantage [in] so that the productive and export base of the economy can be expanded.⁸

However, domestic credit availability is only one of a suite of influences on investment. In addition, for foreign investors, it is overshadowed by other factors, a number of which relate to government performance.

⁷ Central Bank Solomon Islands, 2004 Annual Report, p. 35.

⁸ *ibid.*

Factors influencing investment location decisions

To understand the link between investment-targeting policies — including incentives — and private sector investment performance and prospects it is important to recognise what influences an investment decision. This is especially relevant for those investors with an option to locate in the Solomon Islands or elsewhere. What are the elements of a ‘location offer’ that matter to investors? Table 1 provides a summary and approximate order of importance of these factors as revealed by investor surveys elsewhere.

Two features are noteworthy from the Table 1. First, political and macro stability, market size and access (affected in turn by communications infrastructure quality) and resource (including land) availability all outstrip incentives in influence. Second, each of the influences (apart from quality of life factors) can be thought of as affecting one or more of the following: expected revenue, expected costs, after tax profits, and risk. As such, they influence the risk-adjusted expected returns to the investment.

As the Table 1 suggests, the determinants of an investment decision can only be described in broad terms. Because every investment decision is unique the role that incentives will play can never be forecast. Profitability (involving market/revenue and cost considerations) and risk tradeoffs are affected by the list of factors in Table 1. Profitability adjusted for risk translates into required rates of return on capital invested and acceptable payback periods for the investor. However, incentives are only one factor that affects profitability. Relative profitability and risks become important in regional choices of location. The OECD observes:

Evidence on the effects of incentives on corporations’ real investment location decisions, particularly for major new investment projects, is consistent with the view that the decision is normally a two stage (or multi stage) process in which investors first draw up a short list of acceptable sites on the basis of the economic and political ‘fundamentals’ of the alternative sites, largely irrespective of the availability of fiscal and financial incentives from potential host governments, and only later after the short list is drawn up on the basis of the investment ‘fundamentals’, do the investors consider — and often seek out — investment incentives, sometimes playing one government off against another at this stage of their location decision.⁹

⁹ Oman, C. P. 1999, *Policy Competition for Foreign Direct Investment: A Study of Competition Among Governments to Attract Foreign Direct Investment*, OECD, p. 4.

Table 1: Factors affecting decisions on investment location

Location criteria	Main location factors in order of importance
Political and macroeconomic stability	<ul style="list-style-type: none"> • Absence of risk to sunk capital and normal operations from social unrest, opportunism • Stable exchange rates, interest rates and domestic prices requiring fiscal restraint and good governance
Market opportunities	<ul style="list-style-type: none"> • Size, nature and purchasing capacity of local demand • Access to regional and other international markets • Openness to trade and investment; absence of entry barriers • Existence of clusters of foreign investors or activity
Communications and transportation	<ul style="list-style-type: none"> • Availability, quality and cost of communications and transport infrastructure (road, rail, port, air) — supports accessibility to market
Labour issues	<ul style="list-style-type: none"> • Availability, quality, flexibility and cost of labour • Availability and quality of education and training facilities • Issues of productivity, turnover and militancy
Operating infrastructure	<ul style="list-style-type: none"> • Availability, quality and cost of basic utilities (electricity, gas, water, waste management, etc)
Property	<ul style="list-style-type: none"> • Location, availability and quality of land and/or commercial property • Property costs and contractual conditions
Supplier access	<ul style="list-style-type: none"> • Availability, quality and cost of suppliers for critical resource inputs
Taxation and incentives	<ul style="list-style-type: none"> • Level of corporate taxation • Availability and nature of specific grants, low-interest loans, tax breaks or other offsets
Environment and quality of life factors	<ul style="list-style-type: none"> • Availability and quality of the physical and social facilities and their attractiveness – especially for expatriate staff and staff recruitment • Cost of living — including housing and schooling

Source: FIAS.

An assessment of the Solomon Islands from an investor perspective: Location offer characteristics

There is no broad recent survey of investors as to the relative importance of these factors in their decision to invest – or not invest - in the Solomon Islands. However, the outflow of capital during the tensions, and the hesitancy of renewed foreign investment since, supports the view that political stability and government credibility is a necessary condition for ongoing private investment, and foreign direct investment (FDI) in particular.

Domestic investors, who may be more reliant on local finance, suffer from inability to manage the economy during a period of social and political instability. This led to failures in government debt servicing to the commercial banks and the National Provident Fund (NPF). This, in turn, reduced the capacity for lending to the private sector and the appetite for risk on the part of bank lenders. Failure to service government debt is contributing to high interest rate spreads — the difference between the return on deposits and the cost of borrowing — being high at 14 percent. Local debt financing costs for private business are raised through these effects.

Other location offer characteristics in the Solomon Islands are not favourable. In a recent report for the ADB, the Enterprise Research Institute (ERI) said:

Virtually none of the characteristics of a good business environment are in place. Public goods [specifically property rights applying to land leases, and commercial dispute resolution procedures] are weak or non-existent, political uncertainty clouds the future, the already inadequate infrastructure has deteriorated further, income has fallen making a small market even smaller, and corruption is widespread.¹⁰

The ERI report (op. cit) also cited the time consuming and costly business start up process. The World Bank ‘Doing Business in 2006’ report estimates it costs 48.4 percent of per capita income to start a business in the Solomon Islands.¹¹ A dysfunctional business registration process contributes to this. Local government licensing requirements are onerous.

¹⁰ Enterprise Research Institute 2005, *The Solomon Islands Private Sector Assessment: Recovery through Private Sector Growth*, Asian Development Bank, p. 22.

¹¹ Compared to an average of 38.1 percent for the countries listed in Appendix A.

Operating costs are inflated by inefficient state owned and operated monopoly power and telecoms utilities. Transport is expensive and inter island transport can be unreliable. The indirect tax system is ‘cascading’, with goods taxes at 15 percent imposed on top of goods’ prices which already had import duties (average 15.4 percent) imposed and which were further marked up to reflect a wholesale margin of 30 percent. This in turn led to a highly discretionary exemption system. This exemption system goes well beyond the task of relieving exporters and the health and education sectors of this indirect tax burden.

These deficiencies increase the set up, operating and transaction costs of potential foreign and domestic investors alike. For some, market entry, even if attractive, is precluded by a reserve list restricting activities to the Solomon Islands enterprises. This can mean in practice restriction to existing operators. The new Foreign Investment Act will significantly reduce these restrictions. This does not imply that increased investment will follow, but it reduces one further obstacle.

While the size of the domestic market (estimate as GDP minus exports) is larger than that of the smallest Pacific Island Countries, it is significantly smaller than those of PNG and Fiji. This means potential investors in enterprises producing import competing goods or non-traded services, and who have a regional alternative, may not include the Solomon Islands in their short list, even if other location offer elements marginally favour the Solomon Islands.¹²

Abundant resources underpin a country’s so called comparative advantage – the basis for specialising in some sectors and activities rather than others. For potential exporters, comparative advantage conferred by natural resource abundance and favourable production or extraction conditions must translate into *competitive* advantage for investment to occur. A combination of distance from markets, high cost utilities and transport, high business establishment costs, labour and property rights constraints and sovereign risk can mean little investment in the very activities in which resource abundance would give the country a comparative advantage.¹³ Securing leasehold rights to land remains a formidable problem in Solomon Islands. It is a major obstacle to any replication of the Guadalcanal palm oil plantation project on, say, Malaita, where customary ownership and the lack of a register of ownership of plots works against large scale plantation based investment.

¹² No attempt has been made to formally compare offers of neighbouring countries, although appendix A to this report documents the investment incentives offered by the neighbouring economies of Fiji, Samoa, Papua New Guinea and Vanuatu.

¹³ See for example Winters, L. A. and Martins, P. M. 2004, *When Comparative Advantage is not Enough: Business Costs in Small Remote Economies*, World Trade Review.

Similarly, administrative delays and excessive ‘conversion fees’ in obtaining extensions of residential permits for foreign managerial labour unnecessarily raises the set up costs for foreign investors seeking out opportunities in resource based sectors. Local labour supplies are heavily biased towards unskilled labour.

Furthermore, the one form of economic activity that showed rapid recovery and the greatest post tension acceleration – logging – was driven by a combination of ‘location offer’ factors where investment incentives had little if any beneficial influence.

Despite a poor *overall* investment climate, other specific resource based projects emerged in the form of the Gold Ridge Mine and palm oil developments. Each was awarded significant investment incentives. Each may be able to argue that without the incentives the project was not ‘viable’.

A series of questions need to be answered before concluding that these recent events support a case for investment incentives in their current form.

- How much are prospective future investments, especially natural resource based ones of a similar kind to these, likely to rely on incentives rather than on profitability ‘fundamentals’ to attract them?
- If commercially based projects are only viable when accompanied by long-term incentives, are they able to demonstrate a satisfactory economic (as opposed to internal) rate of return to justify the cost of those incentives to government funds?
- To what extent are the ‘necessary’ incentives themselves a product of bad policy or poor policy implementation?

2 The rationale for incentives

Investment incentives are adopted by developing countries with objectives and reasons that are not always stated explicitly. The objectives can include simply raising investment and foreign investment in particular, above levels otherwise anticipated. They can also target investment in specific sectors or localities thought to generate greatest community benefits. The additional investment is valued for the benefits it brings – jobs, export earnings, technology, training etc. However, why are they deemed necessary? What types are commonly used and what are their pluses and minuses? Do they achieve their objectives? If incentives continue to be employed in the Solomon Islands what are the desirable characteristics of the incentive regime?

Incentives - no substitute for fundamental reform

Based on international evidence there is a difference in the importance placed on incentives by potential investors and governments who offer them. As Chapter 1 suggests, incentives are often of marginal importance to investors but governments continue to offer them. Investors, especially large investors, find it relatively easy to convince governments that incentives are not marginal but critical and thereby encourage a bidding mentality between countries competing for the investment dollar. By pointing to other countries' incentives this 'game' can be easily perpetuated, with fear of losing an investment as the driving force which helps to install incentives as a costly part of government policy. A further factor is the political imperative. Government needs to be seen to be doing something to attract investment. Investment incentives are visible, regardless of their cost effectiveness.

An ideal approach to encouraging investment is to improve a country's investment climate or 'location offer' by addressing the most important factors that influence investment decisions. The preferred investment environment is widely recognised as one where distortions are minimised. This is best done by avoiding reliance on incentive measures and adopting instead:

- credible and consistent macro economic policies, with government expenditure redirected where possible away from government consumption and towards infrastructure improvement and provision of public goods, including improved security and laws governing companies, investment, land and property rights;
- a uniform corporate tax rate whose level is set as low as possible given budget responsibilities;

- broadly based indirect taxes on consumption, possibly of the value added type, with the tax net having minimal exemptions;
- uniform import tariffs or tariffs in few bands with few high rate tariff items and uniformly low rates imposed on inputs to production;
- access to imported productive inputs for exporters at or close to world prices; and
- minimum administrative barriers (and attendant costs) to establishing or expanding a business; non-discriminatory regulations.

For the Solomon Islands, this ‘first best’ approach would bypass the use of explicit incentives. It would rely instead on significant and urgent tax reform of the type advocated by PFTAC and in a paper prepared by DOFT.¹⁴ Import tariff rationalisation would also be needed. Administrative barriers to business would need to be minimised. Based on the premise that there is not the administrative capacity to reform direct and indirect taxes simultaneously and as advocated by PFTAC, one approach would see indirect taxes modernised prior to an overhaul of the Income Tax Act. The Solomon Islands Government has announced its intention to pursue a range of tax reform, taking the first steps with the Ministerial announcement of 23 February 2005.

Best practice in attracting investment requires fundamental reform. There is no alternative to this reform if the Solomon Islands is to provide the best possible investment environment in the medium term. Any delay to progressing along this path will come at a cost of foregone investment. Incentives are not a viable long-term alternative to this reform. However, they may have a supporting role in the medium term while government enacts the fundamental reforms required.

Better laws will take time to introduce and to affect investors. In the meantime, if a pragmatic case can be made for retaining some incentives, what types are there to choose from and what characteristics should the incentives possess?

¹⁴ Pacific Financial Technical Assistance Centre 2005, *Solomon Islands: Modernization of the Tax System*, Grandcolas Aide-mémoire; and Department of Finance and Treasury 2005, *Scoping Possible Tax System Reforms*.

Types of incentives governments offer and the lessons learned

Incentives used by governments to attract investment fall into three main categories. Table 2 covers the main types. Additional investment (over and above what would otherwise occur) is the immediate objective. Incentives variously involve direct outlays, costs to government revenue or assumption of risks by government. In return, the community is entitled to expect a 'dividend' in the form of increased employment, skills, lower costs or better services to other businesses, future contributions to government revenue etc. The objective of these incentives is not always clearly stated. Priorities among these possible benefits are not always made clear.

Table 2: Main types of incentives

<p>1. Fiscal incentives</p> <ul style="list-style-type: none">• Reduction of the standard corporate tax rate• Tax holidays• Allowing losses during tax holidays to be written off against future profits• Accelerated depreciation allowances• Investment (and re-investment) allowances and tax credits• Export tax exemptions; preferential treatment of export income• Import duty exemption on capital goods and other inputs• Duty draw back or crediting of duty paid
<p>2. Financial incentives</p> <ul style="list-style-type: none">• Direct grants• Subsidised loans• Government-funded venture capital or other participation• Government insurance at preferential rates.
<p>3. Other</p> <ul style="list-style-type: none">• Subsidised dedicated infrastructure (roads, power etc)• Subsidised services• Granted monopoly rights• Closing or protecting markets from further competition

Source: UNTAD World Investment Report 1996, Table vi.4, FIAS

Fiscal (tax based) incentives — influencing the cost of capital and after tax returns

Fiscal incentives are designed to provide investors with more favourable tax treatment than they would otherwise get under the tax code. The expected after tax rate of return on an investment reflects the mixture of influences discussed above that form the ‘location offer’. The after tax rate of return on capital invested is sensitive to tax rates applied to inputs, outputs, revenues (turnover), and profits. Various kinds of tax- based incentives can alter one or more of these in favour of the investor, altering the return on capital.

Corporate income tax-based incentives can also alter the terms of recovery, or return of capital — including the speed with which this happens. The intention of offering these incentives is to thereby improve the investment location offer and attract investment that would not otherwise occur.

The fiscal incentives may target:

- favoured types of investment activity (large scale, higher value adding, labour absorbing, export directed, technology transfer, research and development intensive etc);
- favoured locations (least developed areas within a country); and
- new ventures rather than expansion investment.

Unfortunately, the specific objectives and priorities behind such targeting are not often made explicit. This lack of clarity of objective or the pursuit of multiple objectives using the one incentive instrument (for example, some form of tax exemption) can lead to complex and ineffective incentive structures.

Incentives applied through the corporate income tax (CIT)

The effective corporate tax rate faced by investors can be altered in a number of different ways. ‘Approved’ investors who satisfy qualifying criteria (size, sector, location etc) may be offered reduced corporate tax rates or may be exempted for a given period (a tax holiday). Many developing countries indulge in this kind of targeting primarily with tax holidays. Investors are usually not permitted to carry forward any losses made in the tax holiday period. (See Chapter 3 for details of the tax incentives on offer in the Solomon Islands to approved investors.)

Alternatives to tax holidays and concessional tax rates include the following.

- Investment expenditure and similar allowances (which allow, in addition to normal depreciation, a proportion of the expenditure to be immediately expensed, typically accompanied by the carry forward of losses into future tax years).
- Investment tax credits (which allow a proportion of the investment expenditure to be offset against any tax due, usually with provisions for the use of the credit to be delayed until there is income tax to be offset (the investment is generating taxable profits)).
- Accelerated depreciation (which allows new capital to be depreciated more quickly for tax purposes). Rather than reducing overall tax payable over the life of the investment, this has the effect of delaying the timing of the tax revenue receipts.

The strengths and weaknesses of each of these tax privileges are outlined in Table 3. It highlights the significant shortcomings of tax holidays compared to other direct tax incentives.

Table 3: Strengths and weaknesses of direct tax incentives

Type of Fiscal Instrument	Strengths	Weaknesses
<p>Corporate income tax holidays (tax exempt or partially exempt for specified number of years)</p>	<ul style="list-style-type: none"> • Do not tie up tax administrators 	<ul style="list-style-type: none"> • Target profits so may be redundant for high profit enterprises • Biases investors towards equity finance as the benefits of interest tax deductions are lost in the holiday period
	<ul style="list-style-type: none"> • Investors avoid potentially costly dealings with tax administration and tax law 	<ul style="list-style-type: none"> • Biased towards short term projects, especially if no loss carry forward allowed beyond holiday period – ‘wasted holidays’

Type of Fiscal Instrument	Strengths	Weaknesses
	<ul style="list-style-type: none"> Do not bias capital v labour choices 	<ul style="list-style-type: none"> Favour creation of ‘new businesses’ and tax avoidance by bogus investors Costs to govt revenue not transparent unless filing of returns required –negating supposed admin. savings Frequently based on planned investment. Monitoring and compliance can be problematic
<p>Investment allowances (specified proportion of investment expenditure can be expensed for tax purposes in addition to normal depreciation)</p>	<ul style="list-style-type: none"> Use of different rates can target different sectors more precisely than tax holidays; actual investment is the basis, not company creation Budget effects transparent 	<ul style="list-style-type: none"> May induce a capital intensive bias, using shorter lived assets to collect repeat benefits
<p>Investment tax credits (specified proportion of investment expenditure creditable against current and future tax liabilities)</p>	<ul style="list-style-type: none"> Similar to Investment allowances if there is a single CIT rate. Simple to administer as a ‘credit balance’ in the tax file of the investing company 	<ul style="list-style-type: none"> Similar to investment allowances. Requires filing of returns and engagement with tax officials raising implementation costs
<p>Accelerated depreciation</p>	<ul style="list-style-type: none"> Only delays recovery of tax due, so cost to revenue minimised Highly transparent Different rates can target individual sectors 	<ul style="list-style-type: none"> Requires filing of returns and engagement with tax officials

In a comprehensive comparison of these fiscal alternatives, it was noted:

...if tax incentives are to be used at all (irrespective of their objectives), some forms of such incentives are to be preferred over others: as a general rule, tax incentives that provide for a faster recovery of investment costs (eg investment allowances/tax credits and accelerated depreciation) are more cost effective than those that involve reducing the CIT [corporate income tax] rate; CIT (corporate income tax) holidays are the worst among those in the latter category...¹⁵

To follow this advice the Solomon Islands Government would need to change substantially current practices, as Chapters 3 and 4 demonstrate.

Indirect tax incentives: measures to underpin export competitiveness through access to inputs at world prices

Investment in export activities is often targeted for income tax relief in developing countries. However, local indirect taxes, particularly import and export duties, can have the effect of nullifying any such direct tax relief. Import duties distort input prices on imported inputs used by exporters, sustain inefficient import competing businesses and undermine international competitiveness. They can contribute to making imported capital equipment more expensive than in rival locations and raise the ongoing operating costs of new investors and established businesses alike. In these circumstances, indirect tax relief amounts to a removal of such unwanted distortions rather than being itself a distorting incentive.

Relief from import duties and other indirect taxes for investors need not be based on exemptions. (Exemptions are particularly susceptible to abuse.) Many countries successfully operate duty suspension or drawback schemes for exporters and tax rebate schemes for taxes on other inputs, but customs administration must have capacity to accommodate these schemes.

One practitioner on the role of incentives commented:

An investor who is uncertain as to whether high costs will mean no profits is much more likely to be influenced by incentives that directly reduce costs, as opposed to tax holidays, which only benefit the investor if profits materialize.¹⁶

¹⁵ Zee, H. H., Stotsky, J. G. and Ley, E. 2002, *Tax Incentives for Business Investment: A Primer for Policy Makers in Developing Countries*, International Monetary Fund, p. 1510.

¹⁶ Wells, L.T., Allen N.J. Morisset, J and N Pirnia 2001, *Using Tax Incentives to Compete for Foreign Investment*, FIAS Occasional Paper No. 15, p. 58.

This suggests that relief from import duty may be an important influence in investment decisions. Surveys of investor behaviour endorse this view with an earlier study for FIAS of investors in Thailand placing duty relief on inputs as the most important incentive on offer.

Duty and other indirect tax relief for new investors and ongoing operations in export industries are commonplace. What is striking about these concessions in the Solomon Islands is that they are exemptions rather than some form of duty and tax draw back/suspension or tax credit for exporters. In addition, they were made available well beyond relief on productive inputs. All fiscal incentives come at some cost to revenue. Chapter 3 of this report elaborates on the cost to the Solomon Islands Government's revenue.

Financial incentives

Direct subsidies paid by government to cover part of the capital or operating or marketing costs of a business lower the costs to the business and are a budget outlay by government. Through subsidised lending and loan guarantees governments intervene in the capital market in favour of selected borrower/investors.

Direct subsidies impact directly and transparently on the budget bottom line. Loan guarantees create a contingent liability (risk) for government for which provision should be made.

Government subsidised lending and loan guarantees are used by some developing economies as an attempt to correct for the difficulties smaller enterprises face in borrowing from commercial banks. Banks may merely be acting prudently in the face of risks that are hard to estimate for small businesses but the result is restricted or expensive credit for small investors. Some international agencies intervene in capital markets, providing partial loan guarantees in response to these capital market imperfections.¹⁷

Government financial subsidies or loan guarantees put taxpayers' funds directly at risk. Like tax privileges, their effective use relies on future performance of the investor directly or indirectly generating additional tax revenue as a benefit to the community that is funding them. Direct financial subsidies on investments are susceptible to investments absorbing government funds and either failing to reach the production stage or the investor moving on to another location within a few years before the community can benefit fully in return for having provided the subsidy.

¹⁷ For a discussion of this, see for example Freedman, P. 2004, *Designing Loan Guarantees to Spur Growth in Developing Countries*, USAID.

If subsidies are restricted to export industries, they may be in violation of WTO provisions.

Other incentives

These seek to either assist investors by offering them subsidised government owned electricity, transport, water or communications charges or protect them from competition, or from others who might seek to enter the market through investment or via imports. The cost of these measures is either borne through services revenue foregone by the government or by the community, which pays through more costly imported goods or higher domestic prices underpinned by policy driven restrictions on competition.

Special economic zones and multiple objective incentives

Countries with multiple shortcomings in their investment offers and multiple objectives for their investment policy sometimes resort to the creation of specific geographic areas as special economic zones. Firms locating their investments within these can enjoy privileges (often including favourable tax treatment, weaker labour regulation and guaranteed access to services) not available in the wider economy. These special economic zones (SEZs) have their origin in export processing zones (EPZs) which focussed on promoting investment in export directed manufacturing. In some cases, they are a hybrid form, combining an EPZ with privileges for service industry in a hybrid form. They can vary from something as extensive as those occupying substantial parts of a province (in southern China, for example) through export processing zones occupying several square kilometres to smaller industrial parks or estates. While there are some notable successes, there are also numerous failures, particularly in the African economies.

EPZs and SEZs converge to standard offerings of incentive packages for their client investors. These packages tend to be similar in zones that failed and in successful zones. Analysis of successes and failures among SEZs show that the best performed tend to be private sector developed/administered. Cost competitiveness of enterprises locating within them based on facilitation (through good infrastructure etc) and services may therefore be more important than incentives in determining whether a zone succeeds.¹⁸

¹⁸ International Finance Corporation 2005, *Special Economic Zones*, Private Sector Development, Regional Training Powerpoint presentation and FIAS 2004 *Free Zones: Performance Lessons Learned and Implications for Zone Development*.

In some countries, multiple zones were established in response to pressure from regional political interests. In Bangladesh, for example this happened with little interest from investors in the zones away from the key cities.

Evidence on effectiveness / ineffectiveness of incentives

Incentives are only *effective* if they stimulate additional investment over and above what would occur anyway, and that incremental investment generates net benefits over and above the costs of the incentives to the community. Incentives are *efficient* only if these additional benefits are generated at least cost to the community. There is some international evidence on effectiveness or lack of it, little on efficiency.

Limited effectiveness of fiscal incentives

Fiscal incentives are the predominant form used in developing economies,¹⁹ often focussed on *foreign* investment, either as part of an EPZ/SEZ package or more generally. For that reason, they were extensively scrutinized. The effectiveness and efficiency of fiscal incentives as a means of attracting additional (incremental) foreign direct investment to developing countries remains in serious doubt. In a comprehensive review of tax-based incentives, the OECD concluded that there is very little evidence on the incremental effects of these incentives.²⁰

Econometric evidence on effectiveness supports survey findings that investors are most influenced in their investment decisions by market and political factors and that tax policy and hence incentives has little effect on the location of FDI.²¹

Survey evidence on efficiency of fiscal incentives is mixed at best. FIAS survey-based work in Thailand, for instance, shows that in more than 80 percent of cases investment would have occurred irrespective of investment incentives. That is, there is a high level of *redundancy*.

¹⁹ OECD 2003, *Checklist for Foreign Direct Investment Incentive Policies*, p. 19.

²⁰ OECD 2001, *Corporate Tax Incentives for Foreign Direct Investment*, OECD Tax Policy Studies, No 4.

²¹ See Morisett, J and Pirnia, N 2001, *How Tax Policy and Incentives Affect Foreign Direct Investment* in Wells et al, *op cit*.

As another example, the Mid Term Review of the Tax Holiday Scheme in South Africa estimated redundancy rate of the Tax Holiday Scheme was 69 percent – only 31 percent of companies were truly attracted by the investment incentives that were on offer.²²

Incentives are frequently graduated to favour investment in the least developed area of a country. Oman assessed incentives as having limited effectiveness in directing investment to the poorer areas of countries.²³ The OECD also emphasised the difficulty of using general tax incentives to address particular market imperfections.²⁴

Limited technology and skills spill-overs from targeting foreign investment

Incentives are frequently confined to, or favour foreign investors. ‘Spillover’ benefits from multinational firms — technology and skills transfer etc — are sometimes argued to justify this because similar benefits to the local economy are not generated by *domestic* investment. Again, two questions arise — are any positive spillovers likely from such investment and are incentives likely to be effective in attracting it? Research suggests spillover benefits are largely confined to middle-income developing countries, with no such evidence for the poorest developing countries.²⁵ The Solomon Islands economy falls into the latter category. It is one thing to remove obstacles particular to foreign investment — such as unwarranted approval processes But this is quite different from giving FDI special favourable treatment compared to domestic investment.

Desirable characteristics of a sound incentives regime

If incentives continue to be used in the Solomon Islands, they should conform to best practice. Best practice criteria cover the areas of simplicity, transparency, performance and automatic rules based decision-making, equal treatment of investors, assessable cost to revenue, and clear link to policy.

²² SRI International 1999, *Mid Term Review of the Tax Holiday Scheme, Volume II: International Experience and Lessons Learned*, prepared for the Government of South Africa, February.

²³ Oman, C. 2000 *Policy Competition for Foreign Direct Investment*, OECD .

²⁴ *Ibid.*

²⁵ See Blomstrom, M. and Kokko, A. 2003, *The Economics of Foreign Direct Investment Incentives*, Working Paper 168, Stockholm School of Economics.

Specific objectives for incentives and links to policy spelled out

Incentives are only one part of investment policy. To ensure consistency with other legislation the objectives for investment and investment incentives should be spelled out in a National Investment Policy Statement. This would require that the government clarify, for instance, whether and why it sees ‘new’ investment as any more deserving of incentives than ‘expansion’ investment, why incentives for primary industry differ from others, why investment in manufacturing is treated more favourably than some service sector investment etc.

Administrative simplicity, equal treatment and transparency: a rules based approach – not discretion.

Entitlements to incentives and their administration should be *transparent, equitable* and *simple to administer*. Investors should know who is entitled to incentives and why and should be easily able to establish whether they are eligible. The tax code should make this explicit. Like cases should be treated alike. Wording of critical legislation (for example, the Income Tax Act, Customs and Excise Act and Goods Tax Act in Solomon Islands) must not complicate the administrators’ role or require them effectively to make policy.

Eligibility for incentives should not require discretion to be exercised by politicians or officials. ‘Exemptions Committees’ etc should not be required.

Unless a rules based approach is adopted, with incentives granted to all investors who satisfy well-defined objective criteria, the system will require costly administration, with officials making time-consuming subjective approval decisions. Investors will be delayed and face additional costs and additional uncertainty.

Transparent costs to revenue

Governments have little chance of assessing the effectiveness and efficiency of the incentives on offer if they cannot estimate the costs to revenue. Without this ability, they cannot estimate the opportunity costs of offering incentives rather than doing other things to improve the enabling environment for investment. Some incentives such as tax holidays can pose particular problems if investors do not have to file tax returns in the holiday period.

Avoiding waste (redundancy)

Incentives come at a potential cost to revenue. There is a danger with corporate income tax- based privileges that the incentives for some investors are redundant — the enterprise would come anyway because of assessed profitability of the venture — taxes notwithstanding. For other investors, including multinational companies, some forms of tax incentive may be irrelevant because they are cancelled out by their *global* tax obligations and the absence of tax sparing. That is, some investments are not very sensitive to tax privileges offered by the host country. A tax holiday in one country will have little attraction if the income is ultimately taxed ‘at home’.

Performance based incentives

Benefits to investors should only flow in response to actual investment. As mentioned, tax holidays can be abused through the creation of ‘new businesses’ which are simply vehicles for reducing taxes on other income sources. The use of exemptions rather than import credits or duty draw back can also be a particular problem when goods are imported tax and duty free ostensibly for investment purposes but the ‘intended’ investment does not materialise.

Avoiding short-term bias

To be effective the instruments chosen should not favour tax driven, footloose industries at the expense of investments, which may have longer payback periods for investors, but which also deliver longer-term sustained benefits for the host economy. Again, tax holidays are inferior to accelerated depreciation and investment allowances/tax credits in this regard as investors with short payback periods move on after the ‘up front’ benefits of tax holidays are exhausted.

Supporting access to markets at world prices

Taxes distort and trade based taxes (import duties and other indirect taxes on exporters) affect competitiveness. All investors are entitled to removal of these distortions. The ways in which this relief is provided can be more or less effective. Countries with inadequately resourced customs regimes struggle to offer efficient duty draw back or suspension schemes, with exporters penalised through long delays in getting relief. Exemptions, however, can also be costly to administer and lead to widespread abuse and revenue loss.

Conclusions on developing an appropriate incentives regime: Lessons for the Solomon Islands

There are some overriding conclusions that should guide the development of an appropriate set of incentives for the Solomon Islands.

Incentives do not compensate for fundamental weaknesses in the investment climate

The ability of incentives to compensate for shortcomings in other, more important elements of the investment environment is questionable. International survey and econometric evidence confirms this. In trying to offset other disadvantages scarce resources can be wasted in administering a system that is ineffective (investment does not come or generates less benefits than the costs) or inefficient (incentives go to those who would invest anyway). For this reason, countries need to modify their expectations about what incentives can achieve and deliver them in a way that minimises costs to revenue and allows scrutiny of those costs. It also means that investment and incentives policy must make hard choices – for example between widely available but low level incentives (running the risk of limited effectiveness) and incentives restricted to very few sectors (running the risk of redundancy if those sectors are already becoming attractive to investors or wasteful if they include sectors without long term profitability prospects.)

Incentives based on protectionism are harmful

Some impediments to investment such as small local market size cannot be addressed through government action. In addition, misguided government incentives can worsen circumstances. It is counterproductive to try to protect the interests of those already serving a small domestic market by foregoing the benefits of competition. This usually leads to higher costs for some other sectors who are also trying to operate in that same small domestic market environment while encouraging inefficiency in existing businesses. By recently reducing some import duties and paring down the list of activities reserved for investment by indigenous investors in the Foreign Investment Act the Solomon Islands government recognises these dangers.

Special economic zones require special conditions for success

There is a danger with SEZs/EPZs that, while they are introduced as pilot schemes to study the effects of liberalising regulations and trade barriers and providing better infrastructure, this broader reform for the wider economy does not progress. Successful schemes tend to be privately managed and intensively resourced and administered, with strong links to the domestic economy – not just export enclaves. They also require the backing of an effective customs administration.

Given the Solomon Islands economy's areas of comparative advantage, an SEZ is not likely to be a cost effective stimulus to investment and growth. Operated as an export-processing zone, such an SEZ could in principle offer superior infrastructure and hassle free access to land for factory development. But this would not address the prior problems of establishing reliable supplies of production inputs delivered at competitive transport cost to feed processors and manufacturers. Furthermore, activities such as plantation and other agriculture, fisheries and mining do not lend themselves to zone development. Political and land constraints are likely to prevent large parts of a single province being designated as an SEZ, yet this would seem to be required for any approach which targeted more than the very small manufacturing base in the Solomon Islands.

Tourist resorts could, in principle, be operated as part of an SEZ. In the interests of equity however, all existing operators in all provinces may need to be included. The challenges for the Solomon Islands would be how to administer such an arrangement and how to ensure adequate linkages to the local economy. Successful EPZs and SEZs require significant administrative resources.

Incentives granted on a discretionary basis lead to problems

Countries that choose to offer incentives through a complex approval process or which permit individual companies to strike individual agreements on an incentive package rather than through a simple, objective, rules-based process run particular risks. Apart from the costs and uncertainty generated by an approval process which is discretionary, such systems encourage bypass of the process in favour of special deals sought out by investors, especially larger foreign ones.

Of course, investors will always behave strategically and argue for no taxes (exemptions) rather than low taxes if permitted to bargain with government on this point. They will also point to concessions available elsewhere in the region and paint incentives as a make or break investment decision factor. However, an incentives system based around bargaining rather than clearly defined objectives and access rules will be more open to ‘gaming’ behaviour by prospective investors playing off one state against another, corruption on the part of politicians and officials, and suspicion of unfair treatment by existing businesses and smaller scale operators unable to exercise influence.

A case for incentives as a shorter-term accompaniment to fundamental reform –but not a substitute

Incentives cannot and should not try to compensate for a weak investment environment. There are measures which governments *can* take which can improve the location offer and reduce the perceived need for compensating incentives. Mention was already made of the need to address the difficulties and delays and inflated costs of business registration and licensing in the Solomon Islands. Collateral risk and borrowing costs for business can be lowered through legislation to strengthen inadequate property and bankruptcy laws, which raise interest rates and the cost of capital.

However, a sustainable approach to attracting investment through improvements to the enabling environment also relies heavily on the building of government and administrative credibility in the eyes of investors. In addition, it takes time to demonstrate a commitment to treat business investors consistently and equitably. There may be a case for retaining incentives in some form while such reputation effects are built up.

Because political and social instability are a recent feature, risk premiums placed on required investment returns in the Solomon Islands are high and may take some time to subside. Political risk — a product of recent instability — was estimated to have increased required or ‘hurdle’ rates of return on new investments in the Solomon Islands by 10 percentage points.²⁶ Collateral risk through inadequate property and bankruptcy laws raise interest rates and the cost of capital. Better laws to improve this will take time to introduce and to affect investors.

²⁶ Enterprise Research Institute 2005, *op cit*, p. 77.

If investment incentives are retained in the Solomon Islands it will be important that the types used, and the system for accessing them and monitoring their effectiveness, possess the desirable properties described above. Chapter 3 assesses the current system against these benchmarks. Chapter 4 draws further lessons from recent experience in three key sectors of the economy – timber, mining and palm oil. Chapter 5 provides recommendations for improving incentives in the Solomon Islands.

3 Incentives in the Solomon Islands — current practice and shortcomings

Investors in the Solomon Islands can either access incentives currently available under standing legislation, or ‘negotiate’ tailor made incentives directly with the Government via a Memorandum of Understanding. Incentives are broadly defined as any instrument that, directly or indirectly, has the purpose of increasing/encouraging investment.

The range of incentives on offer to investors

Fiscal incentives are the main investment incentive for private sector investors in the Solomon Islands. Domestic and foreign investors can access incentives through relief from direct and indirect tax exemptions. The latter are also accessible by all businesses, not just new investors and those expanding their enterprises. Since the suspension of operations of the Development Bank of Solomon Islands and the Investment Corporation of Solomon Islands, there is little use of subsidised credit or commitment of government equity in private sector joint ventures. Continued closure of markets to foreign investors in some sectors was the main overt example of use of these other incentive measures.²⁷ This approach may be driven more by the objective of shoring up the interests of existing businesses rather than stimulating investment in the sector. Along with import protection, it is likely to raise costs for other business rather than promote investment

Exemption and other relief from direct taxes

Domestic and foreign investors can access investment incentives under the Income Tax Act (Part III and Schedules 1 and 2). Strictly speaking, this is the only standing legislation under which direct tax exemptions can be granted in the first instance. Investment incentives available under the Income Tax Act are shown in Table 4.

²⁷ Various examples of government subsidy assistance to part or fully government owned *public sector* enterprises can be found in the Solomon Islands. Types of assistance include initial equity through contributed assets with no subsequent requirement for a commercial return, loans throughout the life of the business at less than market terms (in airlines, fishing, printing and housing finance businesses), government loan guarantees or directed lending from the NPF, exemption from tax for long periods (forestry). In many cases, this kind of assistance has been more in the nature of propping up struggling enterprises rather than stimulating new investment.

Table 4: Exemptions and other relief from corporate tax

<ul style="list-style-type: none"> • Tax holidays – exemption from income and withholding tax on dividend and interest payments for: <ul style="list-style-type: none"> • 3-6 years depending on share of local value adding; • 5-10 years if initial investment is greater than SBD10 million; • 5 years out of the next ten years if enterprise engaged in agricultural production, reforestation or fishing; • 5 years if 100 percent export orientated enterprise; and • 5 years if tourist orientated activity (subject to size requirements).
<ul style="list-style-type: none"> • Tax credits – for expenditure incurred by mining companies in constructing approved infrastructure development schemes (subject to conditions).
<ul style="list-style-type: none"> • Accelerated depreciation – 50 percent annual depreciation of capital expenditure of approved tourist orientated investment.
<ul style="list-style-type: none"> • Allowances – increased deductions allowed for: <ul style="list-style-type: none"> • costs incurred in promoting and marketing of exports (150 percent); • training/education costs (200 percent); and • costs incurred in inter province transport of raw materials/qualifying products (150 percent).

Not all activities are entitled to (all of) these incentives. For example, s.15B of the Income Tax Act explicitly precludes (approved) mining companies from accessing tax holidays made available to foreign investors under Part III (Investment Incentives) of the Income Tax Act.

Investors who have already received a tax holiday under the Income Tax Act could apply for an extension of that tax exemption under the previous Foreign Investment Act, Section 9 which allowed for an extension — for up to five years — of the tax holiday period providing certain conditions were met, namely:

- substantial additional investment is proposed (‘substantial’ is undefined);
- the enterprise satisfies conditions stipulated in relation to the original investment;
- there is some reinvestment of earned profits; and

- where the additional investment is of a kind beneficial to the Solomon Islands.

Criteria used to judge ‘benefits’ were specified in s.10 of the former Investment Act. In assessing the benefits of a particular investment proposal, the Investment Board took into consideration indicators such as the number of Solomon Islanders employed and trained; the extent of technology transfer; use of locally produced production inputs; capacity to export/displace imports; dispersion of benefits to provinces, and equity and debt financing arrangements. The criteria were qualitatively rather than quantitatively defined.

Exemption and relief from indirect taxes

The existing indirect tax system in the Solomon Islands comprises duties on international trade, and goods and sales taxes. The current indirect tax system suffers from a number of problems, most notably:

- high import duties deny producers access to imported production inputs at world prices, while export duties hinder international competitiveness;
- there are cascading taxes, as taxes are levied on other taxes; and
- there are a multitude of different duties, making the system difficult to administer given the current capabilities of Customs and Excise.

A range of legislated standing and discretionary exemptions arose as a means of addressing some of the shortcomings associated with the current indirect tax system (which in turn detracts from the wider location offer). The tax revenue foregone as a result of the indirect tax exemptions is substantial — estimated to be SBD169.3 million in 2004 (see further below).

Import and export duties concessions for investors

The Solomon Islands levies imports and certain resource based exports with either ad valorem or specific duties. There are currently four bands of ad valorem duties levied on imports — 5, 10, 15 and 20 percent. In 2004, the value of imports for home consumption totalled SBD831.8 million, with import duties of SBD127.9 nominally liable (had there been no exemptions). The average nominal tariff is therefore 15.4 percent, which is relatively high by international standards.

There are four main products on which export duties are levied (fish, logs/timber, minerals and shells). In 2004, export dutiable products were valued at SBD459.7 million, with export duties of SBD96.2 million being nominally liable (had there been no exemptions). Exports of logs/timber account for the greater part of the export dutiable value (81 percent) and the nominally liable export duty (98 percent).

High import duties deny producers access to imported production inputs at world prices, while export duties hinder international competitiveness.

The incentive offered investors is the partial or full exemption from import and export duties. This sees businesses, and especially exporters, having either (or both) access to productive inputs at or close to world prices, or exports unencumbered by taxes. Such duty exemption improves the competitive position of the recipient.

A prescribed list of import duty exemptions is contained in the First Schedule to the Customs and Excise Act 2003. There are currently 27 standing general import duty exemptions, which exempt either specific products from import duty or the end user of an imported product (goods of all kinds, but typically excluding firearms, alcohol, tobacco etc). There is also a general partial exemption from import duties in excess of two percent for raw materials used in manufacturing operations, and for production inputs used in/by certain primary sectors (agriculture, horticulture, aquaculture, fishery, forestry and mining). Certain imports sourced from other Melanesian Spearhead Group countries (Fiji, Papua New Guinea and Vanuatu) also benefit from (some) duty exemption under the MSG free trade agreement.

In terms of investors getting access to imported production inputs at world prices/duty exempt, the relevant Customs Act duty exemptions include:

- s.18 — goods forming part of the initial capital investment together with goods required for the first two years of operations;
- s.20 — goods (except linen, kitchenware, firearms, alcohol, tobacco etc) solely for use in tourism development, with duty exemption being limited to two years from the commencement of operations;
- s.25 — goods of all kind imported by companies with a memorandum of understanding with the Solomon Islands Government; and
- s.26 — raw materials and industrial inputs of all kinds (excluding fuel and bulk goods repackaged for retail sale) imported by a producer for the purpose of manufacturing goods.

These four standing exemptions and the partial exemptions substantially lower the effective import duty. Table 5 shows the nominal and effective import duty incurred for products imported under each of the exemptions (relevant to investors).

Table 5: Nominal and effective import duties (2004)

Exemption	Nominal duty	Duty exempted	Effective duty
	Percent	Percent	Percent
s.18	17.5	100.0	0.0
s.20	13.4	100.0	0.0
s.25	11.7	98.9	0.1
s.26	11.6	100.0	0.0
Partial exemptions	11.9	82.5	2.1

Source: FIAS calculations based on data provided by Customs and Excise.

Import and export duty exemptions are accessed by applying to the Customs and Excise Exemption Committee. The Exemption Committee legislated backing under s.8 of the Customs and Excise Act. Granted exemptions typically have a life of 2 years, although this may not be the case for exemptions secured through MOUs. At the end of 2 years, the Exemption Committee is to review the exemption before it is extended. As part of the review, the company is to submit its financial statements from the previous two years to the Comptroller and then the Minister, for their consideration.

Criteria for the Customs and Excise Exemption Committee to use when considering import and export duty exemptions have been specified. However, the criteria are largely qualitatively rather than quantitatively defined. The absence of rules based criteria means the decisions of the Exemption Committee are open to discretion.

Goods tax exemptions

Under s.6(1) of the Goods Tax Act all manufacturers and wholesale merchants are required to be registered with Inland Revenue for goods tax. However, the Commissioner for Taxation, may, use his discretion to exempt manufacturers and wholesalers from the requirement to be registered, if that person only engages in operations that are goods tax exempt. It is not clear as to what checks/procedures are in place to ensure that unregistered manufacturers/wholesalers continue to undertake only goods tax exempt activities, and do not move into activities that attract goods tax.

Goods tax is levied on the wholesale value of goods manufactured in the Solomon Islands and all goods imported for home consumption, and is paid at the point of wholesale. In the case of imported goods, goods tax is either levied on the recorded wholesale price or a ‘determined’ wholesale price of 130 percent of the landed duty paid price. (The formula for calculating the sale value of imported goods on which the goods tax is levied is specified in s.21 of the Goods Tax Act 2003.) Goods tax is applied at the rates of five percent (rice), 10 percent (locally manufactured goods) and 15 percent (imports).

The Solomon Islands Government collected SBD121.7 million in goods tax revenue in 2004. Of this amount, 41 percent (SBD49.4 million) was raised from goods tax levied on imports for home consumption and collected by Customs and Excise (on behalf of Inland Revenue). When determining the goods tax liability, Customs and Excise uses the determined wholesale price approach to calculate the applicable tax base.²⁸

The legislated approach to calculating the wholesale value of imported goods results in cascading taxes — goods tax is being levied on import duty (which was inflated by 130 percent). Table 6 provides examples of the cascading tax incidence for imports levied with varying rates of import duty. Note that the ‘determined wholesale price’ reflects the base on which the goods tax is levied, and not the actual price of the good ex customs. The latter is given by the sum of the value for duty, the liable import duty and the liable goods tax duty.

With the average nominal rate of import duty being 15.4 percent (assuming no duty exemptions), the nominal tax rate on imports is estimated to be over 37 percent by the time the imported good enters the Solomon Islands.

These high nominal tax rates provide a strong incentive to seek exemption from goods tax (and import duties). Exemption from goods tax can be granted through three routes (two direct and one indirect/consequential) namely:

- standing exemptions — Schedule 1 of the Goods Tax Act list 71 exemptions that exempt persons (or organisations etc) and goods from goods tax liability;
- Ministerial discretion — under s.37(2) of the Goods Tax Act the Minister of Finance has the ability to exempt any person or class of goods from goods tax liability; and

²⁸ The goods tax liability on goods imported for home consumption is given by: (value for duty + paid duty) * 130% * 15%.

- goods receiving import duty exemption — due to the way in which the formulae for calculating goods tax on imports is specified, imports receiving some import duty exemption also (indirectly) receive some goods tax exemption.

Table 6: Cascading taxes

Steps in value chain	Import duty			
	5%	10%	15%	20%
Value for duty	\$100	\$100	\$100	\$100
Import duty (%)	5%	10%	15%	20%
Landed duty paid price (SBD)	\$105	\$110	\$115	\$120
Wholesale price mark up (%)	30%	30%	30%	30%
Determined wholesale price	\$137	\$143	\$150	\$156
Goods tax	15%	15%	15%	15%
Price at which import leaves Customs	\$125	\$131	\$137	\$143
Taxes paid				
Import duty	\$5.0	\$10.0	\$15.0	\$20.0
Goods tax	\$20.5	\$21.5	\$22.4	\$23.4
Total taxes paid	\$25.5	\$31.5	\$37.4	\$43.4
Nominal tax rate on imports	25.5%	31.5%	37.4%	43.4%

Source: FIAS calculations.

Absence of a tax credit/invoice system (such as that underlying a VAT system) and resource constraints in Inland Revenue mean there is currently no mechanism to refund goods tax paid by entities that should otherwise be exempt from goods tax. For example, a business unregistered for goods tax is, by definition, goods tax exempt (due to only carrying out activities that are not liable for goods tax). If that business then purchases some locally produced aids/inputs to manufacturing from a wholesaler, then those purchases will attract a goods tax of ten percent. This will occur despite those aids to manufacturing being goods tax exempt under s.49–51 of Schedule 1 of the Goods Tax Act.

The current arrangements for accessing goods tax exemptions are therefore biased against local manufacturers, who have no way of benefiting from goods tax exemptions that others could use when buying their products. This may act as a disincentive to local manufacturing.

The only way in which goods tax exemption can be used in practice is through purchasing manufacturing inputs prior to the levying of goods tax. This is principally achieved through manufacturers *importing* required manufacturing inputs, and then accessing their duty exemption when clearing the goods through customs. In 2004 the nominal goods tax liability on imports totalled SBD177.8 million. Of this amount, Customs and Excise collected SBD49.4 million while Inland Revenue collected SBD48.9 million.²⁹ The difference, some SBD79.4 million, was foregone because of various goods tax exemptions. Administrative shortcoming could also contribute to this cost to revenue.

As noted above, goods tax foregone on imports totalled SBD79.4 million in 2004. This equates to around SBD405 million worth of imports (around 49 percent of total imports) entering the Solomon Islands goods tax exempt. The scope and size of the goods tax exemption on imports is therefore substantial.

Of the imports valued at SBD405 million entering the Solomon Islands goods tax exempt, it is estimated that:

- imports valued at SBD118 million enter goods tax free due to discretionary exemptions granted by the Minister of Finance; and
- imports valued at SBD287 million enter goods tax exempt due to standing exemptions identified in Schedule 1 of the Goods Tax Act.

Schedule 1 of the Goods Tax Act identifies certain goods/persons exempt from goods tax. Standing exemptions include drugs, medical and surgical goods; educational, scientific, religious and cultural goods; goods for use by governments and public bodies; containers; and various ‘miscellaneous’ goods. Such exemptions are conferred under s.37(1) of the Goods Tax Act.

Under s.37(2), the Minister can use his discretionary powers to exempt any person or goods from goods tax liability. To implement this provision, an ad hoc Goods Tax Exemption Committee was established (comprising the Commissioner and other IRD staff). Importantly, there is no legislative backing to this Exemption Committee. Applications for goods tax exemption, under either s.37(1) or 37(2), are routed through the Goods Tax Exemption Committee, with the Tax Commissioner recommending to the Minister as to whether to grant the goods tax exemption.

²⁹ These figures have been provided by Customs and Excise. It should be noted that Inland Revenue consider that the goods tax revenue collected by them from goods tax registered importers is somewhat higher — in the vicinity of SBD57 million.

How investors get approval for incentives and how they access them³⁰

Investment incentives are open to both foreign and domestic investors. Currently, foreign investors must first apply to, and be approved by and be registered with the Investment Board. Once approved by the Investment Board the foreign investor is issued a certificate of approval. This entitles the foreign investor to commence operations and to apply for investment incentives and tax exemptions. Domestic investors do not have their investments approved by the Investment Board but can approach it for incentives.

Two main routes for getting incentives: legislative and MOUs

Once approved, investment incentives can be accessed in one of two ways. Legislated investment incentives made possible under the Income Tax Act and exemptions from indirect taxes levied under the Customs and Excise Act and Goods Tax Act can be accessed by the investor applying directly to Inland Revenue and the relevant Exemption Committee. Alternatively, investors can endeavour to negotiate incentives directly with the Solomon Islands Government, and in so doing enter into a Memorandum of Understanding. (Note that if going the MOU route, investors typically negotiate incentives first and then seek approval/rubber stamping from the Investment Board.) Chart 2 summarises the approaches to accessing investment incentives, and highlights the areas requiring discretionary decision-making.

Difficulties in identifying incentive beneficiaries

Unfortunately, it did not prove easy to compile a list of investment approvals. The Investment Board does not currently have the capability to easily produce a list detailing the number of investment applications, approvals granted and incentives accessed by investors. There is even less information available on the number of MOUs currently in place with investors. Table 7 provides some detail on foreign investment approvals granted by the Investment Board during 2003 and 2004.

³⁰ The analysis in this section relates to the situation under the former Investment Act which was repealed on November 15, 2005, after this review had been completed.

Chart 2: Obtaining investment incentives (under the former Investment Act)

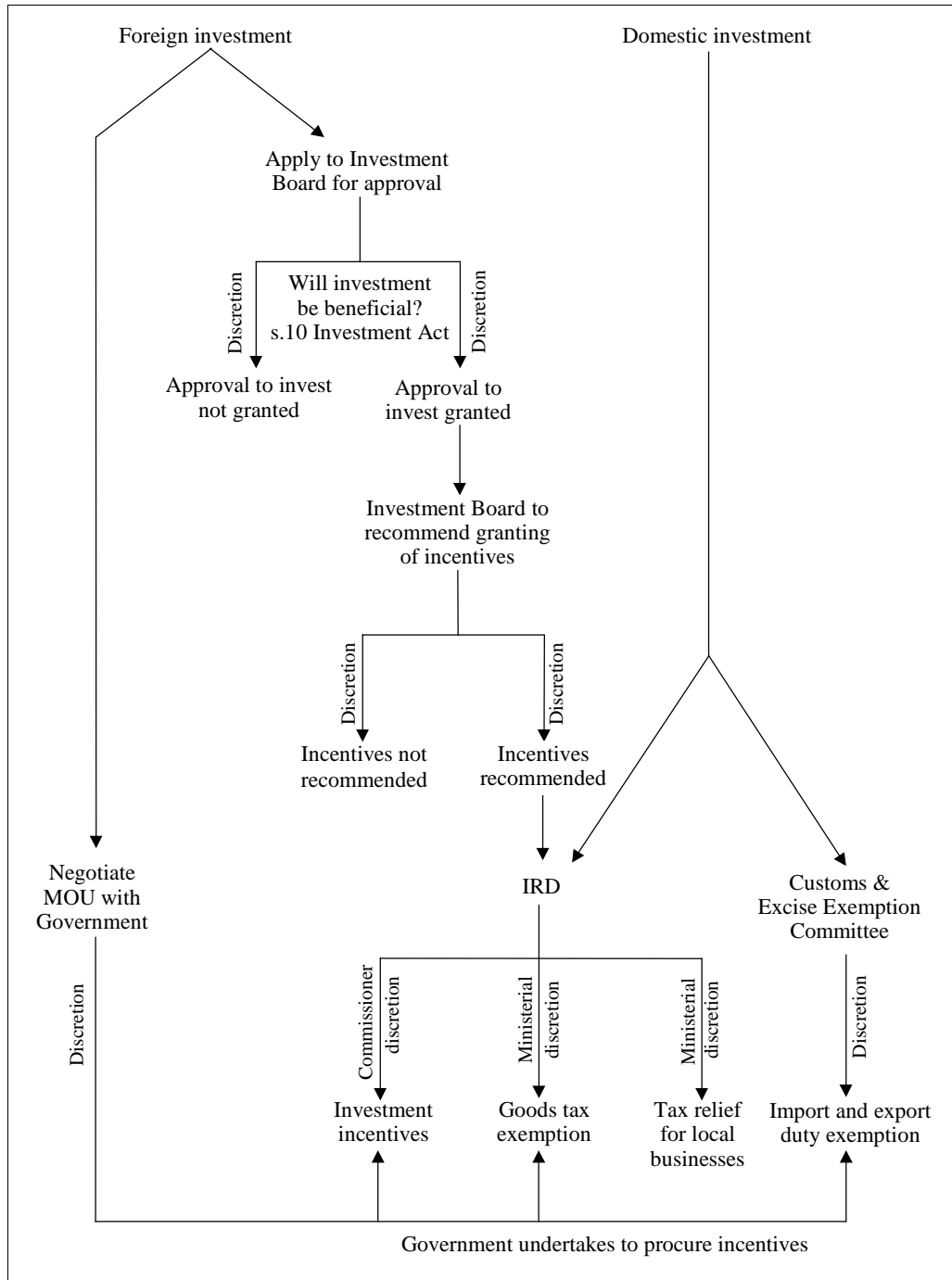


Table 7: Foreign investment approvals (aggregate 2003–04)

Sector	Active approvals	Inactive approvals	Status unknown	Total approvals
Agriculture	0	1	1	2
Fisheries	3	3	1	7
Forestry	10	3	6	19
Manufacturing	4	0	0	4
Transport/shipping	1	0	0	1
Services	12	2	8	22
Tourism	3	2	4	9
Wholesale/retail	2	2	1	5
Total	35	13	21	69

Source: FIAS review of data provided by Investment Board Secretariat.

The absence of even the most rudimentary data on investor numbers and what they were offered by way of incentives, combined with the failure to require investors to lodge tax returns during tax holiday periods, means the government is severely constrained in its ability to cost the investment incentives. This inability also means the government cannot undertake a comprehensive and rigorous assessment of the current incentive regime and determine whether it is delivering ‘value for money’ (foregone tax revenue).

The legislative route to incentives: process shortcomings

Under the previous Investment Act, foreign investors had to be approved by the Investment Board before being able to initiate operations and seek investment incentives. The Investment Board exercised discretionary power when deciding whether to grant investment approval, with approval being dependent on meeting certain criteria, namely:

- the foreign investor was not intending to undertake an activity reserved for Solomon Islanders; and
- the investment would be ‘beneficial’ for the economic development of the Solomon Islands.

Schedule 1 of the Investment Regulations 1999 listed the activities that were reserved for Solomon Islanders. Schedule 1 identified more than 82 economic activities from which foreign investors were excluded.

Approval criteria and uncertainty of approval

Criteria used to judge the ‘benefits’ flowing from a foreign investment were specified in s.10 of the previous Investment Act. In assessing the benefits of a particular investment proposal, the Investment Board took into consideration indicators such as the number of Solomon Islanders employed and trained; the extent of technology transfer; use of locally produced production inputs; capacity to export/displace imports; dispersion of benefits to provinces, and equity and debt financing arrangements. These were open to significantly varying interpretation.

Even if a foreign investor was not intending to undertake an activity on the reserved list and locals were to be recruited and trained, investment approval, let alone incentives approval was not assured. For example, the FIAS mission was informed of a recent case where a foreign investor was denied approval to invest. The investor was to import, wholesale and distribute consumables and potentially export copra. The investor was intending to invest several million SBD, and recruit/train locals to fill most positions within the company. The company was already undertaking similar operations in several other Pacific countries. The Investment Board reportedly denied approval because there were already many wholesale distributors within the country, and the body responsible for copra exporting (the Commodity Export and Marketing Authority) did not get back to the Investment Board prior to deliberations. The implication of the latter ‘rationale’ is that poor administrative capacity elsewhere may have been hindering greater investment.

Uncertain powers and unreasonable administrative burdens for Inland Revenue and Customs

Once approved by the Investment Board the investor is issued a certificate of approval. Once in possession of the certificate the investor is then able to commence operations, including applying for investment incentives and tax exemptions. Investment incentives made possible under the Income Tax Act and exemptions from import and export duties levied under the Customs and Excise Act are accessed via the investor applying directly to Inland Revenue and the Exemptions Committee (respectively).

Exemptions dealt with by Customs officials continue to be based on ‘intended use’ of the imported goods rather than on objective characteristics of the goods themselves, or simply on their tariff code. This means Customs officials are faced with a difficult job of deciding on the intention of the exemption.

The exact role of the Investment Board and Inland Revenue in the granting of investment incentives appears to have been muddled under the Investment Act. For example, the Investment Board Secretariat reported that the Investment Board had no legislated authority to set the magnitude or duration of any granted investment incentives — its role was limited to recommending whether an investor, on a ‘yes’ or ‘no’ basis, should be granted an incentive.³¹ However, Inland Revenue had a somewhat different perspective of the Investment Board’s role/authority. Inland Revenue officials reported that they were often instructed by the Investment Board as to what investment incentive to grant to an investor, undermining in the Commissioner’s legislated role to grant/issue investment incentives.

Even if the Commissioner was left to grant investment incentives (specifically, tax holidays) without interference, there was a question over the capacity of Inland Revenue to determine the *appropriate* tax holiday period. For example, tax holidays can be granted for a period of three to six years depending on share of local value adding; or five to ten years if the initial investment is greater than SBD10 million.

The provision for basing the tax holiday period on the share of *local* value adding would appear to be inconsistent with the national treatment provisions of the World Trade Organisation’s Agreement on Trade Related Investment Measures.³²

Inland Revenue reported that the criterion for tax holidays based on value added percentage was only calculated for indigenous Solomon Islander investors. Even then, no actual calculation was performed (despite being required under Schedule 1 of the Income Tax Act). Rather, the share of local value adding was based on that achieved by existing firms as a proxy for the newcomer. There was no capacity to check whether the ‘assumed’ value adding was met, or whether the proxy was realistic/actually being achieved. For investments of greater than SDB10 million, there are currently no guidelines as such to direct the Commissioner when deciding whether a five, six, seven or ten year tax holiday is warranted.³³

³¹ Note that under s.9 of the Investment Act, the Investment Board can recommend to the Commissioner of Inland Revenue and the Comptroller of Customs and Excise that an approved enterprise gets a continuation of tax exemptions for up to 5 years if substantial additional investment is proposed (and other criteria met).

³² The Solomon Islands has been a member of the WTO since 26 July 1996.

³³ Note that the Economic Reform Unit is in the process of drafting guidelines for the application of discretion by the Commissioner of Inland Revenue when determining the period of tax exemption.

The current investment incentive and tax exemption arrangements place a large administrative burden on the agencies responsible for implementing those incentives/exemptions. When combined with capacity constraints within the agencies, this renders some aspects of the current incentive and exemptions arrangements unworkable. Ensuring compliance is an ongoing problem.

The administrative burden associated with the current incentive arrangements is well illustrated by form IR44. This form is for use by domestic investors who want to apply for tax relief made possible under s.9 of the Income Tax Act. Under s.9 the Minister can exempt the business operations of a person or company from tax on income of up to SBD25,000, or up to SBD100,000 with the consent of Cabinet. Applications for exemption must be made (on form IR44) within six months of business starting, with any income tax exemption expiring after five years (or ten years with Cabinet consent).

Form IR44 is only four pages long, and requires relatively straightforward commercial/financial information for completion. Hence, the administrative burden associated with completing and then administering the form is not anticipated to be overly large. Given the low-income ceilings and (in theory) administrative ease of obtaining the exemption, it is expected that the tax relief would favour small-scale businesses, assuming they were registered with IRD.³⁴

A large uptake of these provisions would be expected. However, IRD estimates that only 10 (or so) domestic businesses have ever accessed a tax exemption under s.9 of the Income Tax Act. IRD suggests that this dramatically low uptake rate reflects the fact that domestic businesses do not know about the availability of the tax relief, as IRD does not ‘promote’ the exemptions. However, in discussions with local businesses it was reported that IRD simply ignored lodged IR44 forms — a case was reported where a local business had submitted the form on three occasions and is still waiting to hear from IRD. Both of these factors suggest that IRD does not have the capacity to administer a clumsy, discretionary and non-rules based incentive regime and is torn between its responsibilities to protect revenue and administer incentives.

³⁴ PFTAC report that in 2003, 203 of the 423 registered taxpayers whose income is known had turnover of up to SBD350 000 — it is this group who are expected to apply for tax exemption under s.9 of the Income Tax Act (PFTAC 2005, *op cit*, p. 22).

Incentives through an MOU: process shortcomings

Some investors, typically the larger or flagship investments, choose to access investment incentives by entering into an MOU with the government. The demand for MOUs likely results from two factors. Firstly, the demand/desire for incentives greater than that allowed under standing legislation; and secondly, to remove some of the uncertainty and speed up the process associated with the granting of investment incentives by IRD.

The discretionary power within IRD as to who gets what incentives creates uncertainty for investors — will they get an incentive or not? Under the MOU approach the government undertakes to procure incentives from IRD (and others such as the Exemptions Committee etc), and this translates into improved certainty with respect to accessing investment incentives. The level of discretion exercised in granting investment incentives should not be underestimated. As was shown in Chart 2, there are numerous stages in the process where unwarranted discretion could stop foreign and domestic investment. Entering into an MOU as a means of eliminating this discretion represents rational decision making by investors.

The investment incentives accessed under MOUs often exceed those allowed under standing legislation. For example, relative to what is provided under standing legislation, some MOUs provide longer tax holidays, more favourable loss carry forward provisions, larger import and export duty concessions and infrastructure provision. (See Chapter 4 for examples of incentives accessed under MOUs by two flagship investments). Despite the apparent contradiction with standing legislation, once the MOU is attached to a signed investment approval certificate (issued by the Investment Board), the MOU is understood to have a legal standing that supersedes legislation.

There is no set limit to the matters dealt with in these MOUs. The MOUs vary in force, with some taking the form of a contract-like arrangement between the investor and the government (with the MOU stipulating what each party will do). Despite the contract-like nature of some MOUs, such as that between the Solomon Islands Government and New Britain Palm Oil Limited (see Chapter 4), the ‘contracts’ appear to be poorly specified in terms of what will happen if one party — typically the investor — defaults on its obligations/commitments.

Failure to publicise the provisions of some MOUs is a problem for administrators. For example, IRD officials report that they are often unaware of MOUs until they are presented at tax time.

The existence of MOUs creates difficulties for the investment environment. The Solomon Islands will not be able to administer a coherent investment incentive program if there are ‘open ended’ MOUs acting as a defacto incentive program. The *pursuit of* MOUs by investors could be restrained by moving from a highly discretionary to a rules- based investment approval and incentive approval process. This will help to reduce uncertainty on the part of prospective investors.

Estimating the cost of incentives

Direct tax exemption costs cannot be estimated currently

Calculating the cost of direct tax exemptions is data intensive. At a minimum, detailed information is needed on the number of firms currently enjoying tax holidays plus the annual tax returns of those firms. This information would enable calculation of the foregone revenue due to tax holidays, exemption from withholding tax etc. Unfortunately, this information is not available. It proved difficult to even comprise a list of foreign firms approved for investment, let alone establish what investment incentives were granted to these firms. Furthermore, under s.57 of the Income Tax Act recipients of tax holidays are not required to lodge tax returns (during the tax holiday). Therefore, even if it were known what businesses had what incentives, it would not be possible to calculate the foregone (direct) tax revenue attributable to the investment incentives.

The only data that was accessible regarding the cost of tax holiday provisions (direct tax exemptions) is that contained in MOU agreements between the Solomon Islands Government and two recent ‘flagship’ investments. (See chapter 4 for further details of the investment incentives offered to New Britain Palm Oil Limited and Australian Solomon Gold.).

Investors can also receive indirect tax — import and export duties, and goods tax — exemptions as part of their investment incentive package. In terms of foregone indirect taxes, the data (collected by Customs and Excise) is considerably more extensive and allows the foregone indirect taxes to be calculated.

The cost of import and export duty exemptions

Import duty can be exempted under a range of standing exemptions, partial exemptions, and on goods imported under the Melanesian Spearhead Group free trade agreement. In 2004 imports (to market) in the Solomon Islands were valued at SBD831.8 million with the duty on these imports nominally being SBD127.9 million, hence an average import duty of 15.4 percent. Just over 62 percent of the nominal import duty (some SBD79.8 million) was collected, with the rest (SBD48.2 million) foregone/exempted. After exemptions, the effective average import duty was 9.6 percent. Table 8 reports the import duty exemptions during 2004.

To cost investment incentives account must be taken of exemptions under s.18 (goods imported as part of investment incentives), s.20 (goods imported for development of tourism operations), s.25 (goods imported by companies holding MOUs) and potentially s.26 (raw materials or industrial inputs used in manufacturing). As can be seen from Table 8 investment incentives were associated with between SBD4 million (s.18 and s.25) and SBD12.7 million (s.18, s.20, s.25 and s.26) in import duty revenue being foregone in 2004.³⁵

Table 8: Import duty exemptions (2004)

Exemption type	Import value	Nominal duty	Duty collected	Duty foregone
	SBD m	SBD m	SBD m	SBD m
Standing exemptions s.1...27				
s.18 Investment incentive	1.43	0.25	0.00	0.25
s.20 Tourism	7.73	1.04	0.00	1.04
s.25 Goods imported under MOU	32.09	3.77	0.04	3.73
s.26 Raw materials/inputs	66.75	7.71	0.00	7.71
Other	179.40	24.95	0.00	24.95
Sub total	287.41	37.72	0.04	37.68
Partial exemptions	57.20	6.80	1.19	5.61
Melanesian Spearhead Group	32.73	5.65	0.76	4.90
Total	377.33	50.18	1.99	48.19

Source: Customs and Excise Division.

³⁵ A range in estimated import duty foregone exists due to not knowing what share of imports under s.20 and s.26 are attributable to investors accessing an investment incentive. For example, duty exemptions under s.18 and s.20 have a finite life, after which it could be possible for an investor to access the same/similar duty exemptions under s.26.

Note that import duty foregone under s.18 is currently very low (only SBD0.25 million). This most likely reflects the recent social tensions impact on investment rather than 'low cost' of investment incentives. Under duty exemption s.18 goods forming part of the initial capital investment, together with goods required for the first two years of operation, are exempt from import duties. The drop off in new investment over the period 1999-2003, together with the finite life of the s.18 exemptions, means that there will be little in the way of current imports that could qualify for the s.18 duty exemption. As investment activity picks up it is expected that the foregone import duty under s.18 will increase correspondingly.

Over 45 percent (SBD377 million) of total imports (SBD831 million) to the Solomon Islands get some form of import duty exemption. Duty exemptions cannot in themselves be criticised — investors, and indeed all producers, need access to production inputs at world prices in order to be competitive, promote economic efficiency and to maximise the community's welfare.

However, exempting such a large quantity of imports from duty has likely resulted in substantial revenue leakage. For example, under s.2 the Solomon Islands and Provincial Governments are exempted from paying import duties. In 2004 foregone import duty because of s.2 exemptions amounted to SBD6.2 million, or 13 percent of total foregone import duty. Discussions with Inland Revenue and Customs officials suggest that imports exempted under s.2 often find their way to other end consumers. In this case, such leakage problems could be addressed through eliminating the s.2 exemption. This would not impose any additional cost on government, as paid import duty could be recycled to those government bodies importing the goods.

Similarly, other leakage problems could be addressed through either replacing current exemptions with a uniformly low tariff rate, or levying a low duty on only capital items etc. Replacing some/all exemptions with a uniformly low tariff rate would go some way to reducing the administration burden associated with duty exemptions. Customs and Excise charge SBD10 for administering each duty exemption. In 2004 the revenue collected from such charges amounted to SBD157,940, equivalent to 15,794 instances of duty exemptions being administered. The administration burden associated with processing such a large number of exemptions would be substantial, especially when the resources of Customs and Excise are taken into consideration.

Export duty exemptions/remissions amounted to SBD32.2 million in 2004. As shown in Table 9, the majority of the export duty exemption was accounted for by log and timber exports. When calculated across all exports which get some duty exemption, the nominally liable average export duty is 27.3 percent. The export duty actually paid is 12.9 percent on average.

Table 9: Export duty exemptions (2004)

Commodity exported	Export value	Nominal duty	Duty collected	Duty foregone
	SBD	SBD	SBD	SBD
Fish	2,300	460	0	460
Logs/timber	222,260,805	60,939,551	28,775,908	32,163,643
Minerals	1,345,800	94,335	29,641	64,693
Total	223,608,904	61,034,345	28,805,550	32,228,796

Source: Customs and Excise Division.

As with the case for import duties, no objection can be raised in principle to exempting exports from duty. In an increasingly competitive global market, export duties adversely affect the competitive position of exporters. However, given the budgetary difficulties currently facing the Solomon Islands Government, the need for international competitiveness might need to be traded off against the short-term need for greater revenue/fiscal prudence.

Furthermore, if export duties represent some form of royalty payment, (eg on native forest logs harvested from communal land) then duty exemption is paramount to the public getting a lower return for utilisation of 'publicly owned' assets. If this were indeed what is happening then there would seem to be little justification for the exemptions.

A further concern with the export duty exemptions/remissions, especially with respect to log exports, is that the exemptions are unlikely to be wealth creating for the wider public. As is discussed in detail in chapter 4, the export duty remissions are a perverse investment incentive, as they allow loggers to appropriate a larger share of the value of exported logs. Reinvestment via new plantings is sparse. The duty remission acts to encourage more landowners to sign up to logging, leading to unsustainable resource extraction and loss of a future source of wealth. The rents generated on traditional land are likely captured by a few individuals and not widely distributed. Hence, in the case of investment in the forestry sector, the duty exemption contributes to an increase in activity, but in a wealth destroying sense.

The cost of goods tax exemptions

Goods tax exemptions can be accessed under sections 37(1) (standing exemptions) and 37(2) (Ministerial discretion) of the Goods Tax Act. Data from Customs and Excise allows calculation of the goods tax revenue foregone on imports because of these exemptions.

If goods tax liable on imports is paid at the port, then Customs and Excise use the following formulae to calculate the liable goods tax:

$$\text{Goods tax on imports} = (\text{value for duty} + \text{duty paid}) * 130\% * 15\%.$$

Basing the goods tax on the value for duty (VFD) plus duty paid, as opposed to VFD plus nominal duty liable, results in a situation whereby if an importer receives an import duty exemption, then they also receive some goods tax exemption. This goods tax exemption may arise even though they did not access an exemption under the Goods Tax Act. Across all imports, the nominal import duty is 15.4 percent; but this falls to 9.6 percent once import duty exemptions are accessed. This differential in import duty sees the liable goods tax being five percent (around SBD9 million) less under the VFD plus duty paid approach compared to the VFD plus nominal duty liable approach. Hence even before a goods tax exemption (on imports) is given, some SBD9 million in goods tax revenue is already foregone due to import duty concessions and the way in which the 'Goods tax on imports' formula is specified.

The liable goods tax on all imports in 2004 was SBD177.8 million. Customs and Excise collected (on behalf of IRD) goods tax of SBD49.4 million, while IRD collected SBD48.9 million. Foregone goods tax on imports therefore amounted to SBD79.5 million. Of this amount, 71 percent (SBD56 million) was exempted under the standing exemptions, while 29 percent (SBD23.5 million) was exempted under Ministerial discretion.³⁶

Foregone goods tax revenue as a result of import duty exemptions granted as part of an investment incentive is estimated to lie between SBD6.6 million (duty exemptions under s.18 and s.25) and SBD21.1 million (duty exemptions under s.18, s.20, s.25 and s.26). No data is available on the goods tax exemptions conferred via ministerial discretion. Table 10 provides a summary of foregone goods tax on imports.

³⁶ Strictly speaking, Customs and Excise identifies goods tax exemptions on imports receiving import duty exemption under s.1-27 of the First Schedule of the Customs and Excise Act. Customs and Excise report that the import duty exemptions of s.1-27 broadly correspond to the standing goods tax exemptions identified in Schedule 1 of the Goods Tax Act. Hence an imported product receiving import duty exemption and goods tax exemption is assumed to have received the latter under s.37(1) (standing exemptions) of the Goods Tax Act.

Table 10: Foregone goods tax on imports (2004)

Exemption type	Value of imports^a	Goods tax foregone
	SBD	SBD
Standing exemptions corresponding to		
Import duty exemption s.18	1,432,891	279,414
Import duty exemption s.20	7,731,889	1,507,718
Import duty exemption s.25	32,137,766	6,266,864
Import duty exemption s.26	66,745,643	13,015,400
Other Schedule 1 exemptions	179,400,431	34,983,084
Sub total	287,405,853	56,052,481
Ministerial discretion	120,001,631	23,400,318
Specification of formulae	Na	9,397,268
Total	407,450,252	88,850,067

a As measured at landed duty paid prices. Value of imports therefore given by value for duty (at cif prices) plus import duty paid.

Source: FIAS calculations based on data provided by Customs and Excise Division.

The aggregate revenue loss

Total foregone import and export duties and goods tax on imports is estimated to have amounted to SBD169.3 million in 2004, comprising foregone import duties of SBD48.2 million, export duties of SBD32.2 million, and goods tax revenue (on imports) of SBD88.9 million. Of the total foregone indirect taxes, it is estimated that between SBD42.8 million and SBD66.0 million is directly attributable to investment incentives.

Summing up incentive performance: failure against good practice benchmarks

Not enough is known about investors in the Solomon Islands (in terms of level of activity, profits, employment etc), the incentives offered to these investors and the cost of those incentives. This lack of data makes it virtually impossible to quantify incentive performance.

Given this, an alternative approach is to assess qualitatively the current incentive regime against a range of 'best practice' criteria. In this way, a judgment can be made about the likelihood of current incentives effectively and efficiently attracting investment. The desirable characteristics of an incentive regime were identified in Chapter 2. Key characteristics include:

- rules based decision making for granting incentives clearly linked to investment policy; clearly defined and guaranteed incentives (if minimum performance is met) with automatic (but performance based) eligibility for incentives without need for discretionary decision making;
- transparent, consistent and equitable treatment of investors; simple to administer from both the investor and government sides;
- avoidance of types of incentives which favour short term investors who move on when incentive benefits are exhausted avoiding short term bias);
- avoidance of waste and granting incentives to those who would invest anyway (avoiding redundancy);
- incentives which assist access to markets at world prices.

Measured against these criteria, performance of the current investment incentive regime in the Solomon Islands can only be described as poor, as Table 11 shows. Few of the above criteria are met. The current incentive regime is based on discretionary decision making, from investor approval to the granting of incentives.

The presence of MOUs and ‘specially negotiated’ incentives means consistent and equitable treatment of investors is almost impossible to achieve. With foreign firms paying corporate tax at the rate of 35 percent compared with domestic investors who pay 30 percent, there is also inequitable treatment of investors at the foreign/domestic level. The preference of investors for MOUs also indicates that investors are not confident, due to the discretionary decision-making, about getting legislated incentives that they might well be entitled too.

The time taken to get investment and incentive applications through the Investment Board, IRD and the Exemption Committee(s) suggests that administration of the regime is difficult and places a large burden on government and investors. The administrative burden is heightened by a need to ensure that incentives dependent on a certain performance measure, such as share of local value adding, are continually being met in order to justify that incentive. It is unlikely that such ‘check ups’ occur in practice.

Table 11: Scoresheet for Solomon Islands incentives

Best practice features	Present	Comment
Incentives linked to clear investment policy	no	No clear, accessible statement of investment policy linked to intended role of incentives. Unhelpful ambiguous language and directions in tax legislation.
Administratively simple, rules-based and transparent	no	Approval of investment and incentives based on discretionary decisions by committees and other authorities with unclear powers. Uncertain outcomes. Individual MOUs-not all made public.
Equitable treatment and consistent	no	No guarantee of equal treatment given discretion and use of MOUs. Smaller local investors not accessing incentives. Foreign investors face higher corporate tax rates.
Transparent cost to revenue	no	Cost of tax holidays unknown. No complete list of beneficiaries. Tax filing for holiday beneficiaries not required during tax holidays.
Performance-based and avoiding waste	no	Use of tax holidays and indirect tax exemptions open to abuse.
Avoiding short term bias	no	Use of tax holidays rather than accelerated depreciation and tax credits likely to favour footloose, short-term investment.
Supporting investors' access to markets at world prices	yes	Exemptions from indirect taxes for investor and some exporters. But difficult to administer. Policy interpretation forced on Customs officers.

Furthermore, incentives are not performance based, and are subject to redundancy and short-term bias. For example, tax holidays make loss carry forward provisions ineffective. Only losses arising through earning income 'chargeable' to tax can be carried forward. However, under a tax holiday there is no income chargeable to tax, hence any losses incurred during the tax holiday period cannot be carried forward. Tax holidays are also biased against firms with long payback periods — by the time profits are realised, the tax holiday will likely have expired. Holidays are granted to resource-based companies. If offered to other mining companies in future there is a risk of redundancy.

While there is a minor role for investment allowances and other expenditure allowances and accelerated depreciation, tax holidays remain the predominant means of manipulating the corporate tax rate facing approved investors in the Solomon Islands. These holidays are likely to be an inefficient means of stimulating investment, especially given the non-transparent and discretionary way in which they are currently conferred and administered.

The Solomon Islands use customs duty and goods tax exemptions as the main means of delivering access to production inputs at world prices and relief from distortions introduced by indirect taxes. Exemptions under Sections 18, 25 and 26 of the First Schedule to the Customs and Excise Act and Section 37 of the Goods Tax Act are justified and are potentially a more effective form of incentive than income tax relief. However, the complex and inefficient tax structure makes them unnecessarily difficult to administer.

Problematically, these exemptions are much wider in their scope than simply levelling the playing field for exporters or indeed for investors more generally. The objectives of such sweeping exemptions are not clearly specified. As an example, any holder of a Memorandum of Understanding with the Solomon Islands Government can access customs exemptions.

Nevertheless, some form of ongoing relief from indirect taxes on productive inputs for exporters will be a requirement in the Solomon Islands as it is elsewhere. In the Solomon Islands, the problem is what form that relief might take without undermining scarce tax revenue sources.

The lessons which emerge through this assessment of the current incentives regime are underscored by considering the experiences in three of the Solomon Islands sectors in some detail. These sectors are timber, palm oil and mining.

4 Sectoral development and the role of incentives

Sectoral illustrations and lessons

Economic activity in the Solomon Islands is dominated by the primary sectors. It is estimated that the agriculture, forestry, fishing and mining sectors account for around 44 percent of (monetary) GDP.³⁷ In terms of exports, the contribution of the primary sectors is even larger, accounting for 92 percent of foreign exchange receipts in 2004, and 94 percent on average over the last ten years.³⁸

Given the importance of the primary sectors to the Solomon Islands, three sectors — forestry, palm oil and mining — are investigated in terms of the investment incentives offered to investors.

Forestry

The forestry sector is the mainstay of the Solomon Islands economy and is estimated to account for around 17 percent of (monetary) GDP, 65 percent of export receipts and 10–12 percent of employment in the formal sector.³⁹

Current resource utilisation

Commercial log production in 2004 was estimated at 1,043,150 m³ (based on recorded log exports). Production in 2004 was the highest level to date, up 46 percent on production in 2003 (714,000 m³). Of total production in 2004, 8.2 percent was sourced from plantations, the rest coming from natural forests.⁴⁰

As reported extensively elsewhere, the current level of forestry utilisation is unsustainable. The sustainable natural forest yield over the period 2004–49 is estimated at 255,000 m³ per year.⁴¹ The log harvest in 2004 (1,043,150 m³) was therefore 4 times the sustainable level (255,000 m³).

³⁷ FIAS calculations based on GDP statistics published by the Central Bank of Solomon Islands.

³⁸ Various Central Bank of Solomon Islands annual reports.

³⁹ FIAS calculations based on statistics published by the Central Bank of Solomon Islands.

⁴⁰ Central Bank Solomon Islands, 2004 Annual Report, p. 17.

⁴¹ URS 2003, *National Forest Resource Assessment*, Solomon Islands Forestry Management Project, Phase 6, p. vii.

The current rate of log production can only be sustained for a short period before the natural forests become exhausted. If logging were limited to an annual rate of 550,000 m³, a strategy identified by the Solomon Islands Government in its National Forest Policy Statement, then the natural forests would support logging to 2018. If logging continued at the average rate achieved over the last ten years (around 650,000 m³ per annum), then the natural forests would be exhausted by 2015.⁴² If the 2004 rate is maintained, then the natural forest base will be exhausted by around 2010. Hence, there is possibly only five years logging activity remaining.

Log exports and investment

The bulk of forestry production is exported as round logs. In 2004 over 1 million m³ of round logs was exported, versus 8,040 m³ of rough sawn timber exports. Foreign contractors undertake the clearing under agreements with landowners. The investment required to support this activity, largely in the form of timber felling and transportation equipment, has few linkages to the domestic economy. Replacement investment — plantation establishment on cleared lots — is at best tentative.

Export duty and incidence

Round log exports attract an export duty. The export duty is applied to the 'determined value' of the exports, with the actual duty being based on a sliding scale. In 2004 the applicable export duties were:

- determined value below SBD680/m³ — 25 percent of determined value;
- determined value of between SBD680/m³ and SBD1,040/m³ — SBD170/m³ plus 40 percent of the value above SBD680; and
- determined value more than SBD1,040/m³ — SBD314/m³ plus 60 percent of the value above SBD1,040.

The export duty is levied on the determined value (or price) rather than the reported (free on board) export price. The determined price system, in use since September 1998, is aimed at ensuring that export duty is paid on a fair market price for the exported logs. If regularly updated and applied, a determined value/price system can go some way to counteracting export duty avoidance achieved through the under reporting of export prices or transfer pricing.

⁴² *ibid*, pages vi–viii.

Determined prices are set/gazetted by the Comptroller for Customs and Excise, based on recommendations from the Commissioner of Forests. The last determined price review was undertaken in December 2003. While some commentators considered that no change in the 2003 determined prices was justified, the Commission of Forests, on directive from the Minister for Forests, Environment and Conservation, recommended a return to September 2001 determined prices less five percent.⁴³

Log exports and determined prices are specified in US dollars. However, the export duty payable is based on the value of round log exports denominated in SBD. Hence, an exchange rate needs to be specified with which determined prices (in USD) can be converted to SBD and the liable export duty calculated. The exchange rate used in 2004 saw 1USD buying 6.8SBD — the exchange rate from June 2003. Today (October 2005) 1USD buys 7.5SBD. Despite the over 10 percent depreciation of the SBD against the USD since June 2003, the June 2003 rate is still being used to convert determined prices into SBD. Failure to use a current exchange rate sees the Solomon Islands Government foregoing around 10 percent of the potential export duty that could have been raised in 2004 from log exports.

A significant share of government revenue is raised from export duties levied on log (and/or timber) exports. In 2004 around SBD66.5 million was raised from export taxes, of which SBD63.1 million (nearly 95 percent) came from log exports. Export duties on logs accounted for 12.7 percent of total Solomon Islands Government tax revenue in 2004 (and averaged 16.5 percent over the 12-year period between 1993–2004). Hence, logging operations, and the duty raised from log exports, are critical to the Solomon Islands from a budgetary perspective.

Given this, the Solomon Islands Government is expected to encounter severe financial difficulties if, as expected, forestry resources are exhausted within 5 to 10 years. There is a strong imperative to stop revenue leakages and broaden the tax base to address the looming financial difficulties.

Loggers are contracted by licensed landowners to fell and export round logs. Getting a license to harvest logs involves an administrative process rather than an assessment of sustainable yields — the Forestry Division cannot refuse to license an applicant if all licensing steps are completed correctly. Once licensed, the landowner contracts a (typically foreign) logger to fell and export the logs.

⁴³ URS 2004, *Independent Determined Price Review*, Solomon Islands Forestry Management Project, pp.4-1.

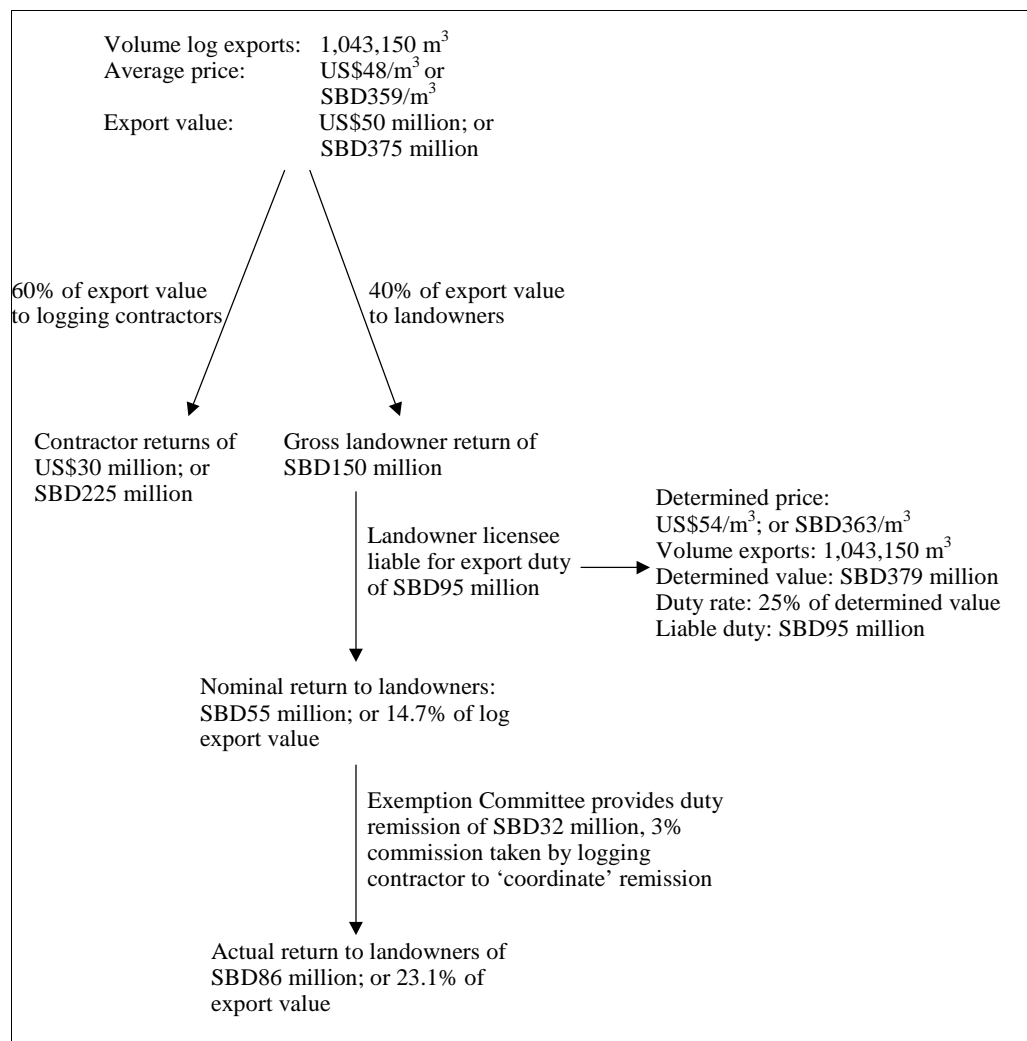
Export duty remissions and misdirected incentives

Strictly speaking, the licensee (that is, landowner) is liable for the export duty. In 2004, round log exports were valued at SBD374.7, generating SBD94.7 million in liable export duty. The Customs and Excise Exemption Committee remitted around 34 percent (some SBD32.2 million) of the liable export duty to landowners. The cited reason for the duty remission is to provide an incentive for landowners to undertake reforestation to address the current rate of unsustainable log harvest. That is, remitted duty is to be used to fund the reforestation of logged areas.

There is a general perception within the community that landowners receive an inadequate return from logging operations. Hence, the duty remission could be seen to have the additional role of increasing returns to landowners (to the extent that remitted duty is used for activities other than reforestation). As the Forestry Division does not currently have the capacity to monitor reforestation funded via duty exemption, or to implement a more efficient performance based duty rebate system, it is likely that compensation of landowners for perceived poor returns is the practical outcome of the export duty remission. Essentially, the export duty remission is being used to compensate landowners for a bad incentive structure and poor contractual arrangements between landowners and loggers.

Chart 3 shows the returns to landowners from logging operations in 2004 (data is presented in aggregate and on average). As can be seen, the export duty remission had a substantial impact on landowners, raising returns from 15 percent of reported export value to 23 percent of export value.

Chart 3: Return to landowners from log exports in 2004



The reforestation incentive

Duty remission on log exports totalled SBD32.2 million in 2004. It is estimated that reforestation costs run at around SBD4,200 per hectare reforested (with a high value species such as teak and mahogany).⁴⁴ If used for its intended purpose of reforestation, the duty remission should therefore be associated with around 7,500 hectares of logged forests being reforested during 2004.

⁴⁴ Dan Raymond, Forestry Division, personal communication, 24 August 2005. Note that this cost reflects the total life cycle cost (up to the point of felling) associated with reforestation.

Due to limited capacity within the Forestry Division, the extent of reforestation (of logged areas) cannot be quantified with a high degree of certainty. However, it is estimated that only around 1,000–2,000 hectares per year of plantation stands are being planted.⁴⁵ This figure includes both new plantations and reforestation of already logged areas (with the latter being the assumed ‘official’ intention of the export duty remission). The current level of reforestation suggests that duty remissions are not resulting in significant reforestation, and likely represent a large source of revenue leakage. This revenue leakage acts to increase the *immediate* returns to landowners (as opposed to rebuilding the forest ‘capital stock’, which would then generate a return in 20 years time when the trees are felled). In effect, the remissions see a transfer from the general populace to landowners who log.

Going forward

The export duty remissions can be seen as an ‘indirect’ or quasi investment incentive. Remissions act to increase gross returns to landowners from logging, which in turn likely acts to further encourage landowners to engage contractors to fell natural forests on their land. This, combined with the government’s failure to control logging intensities (possibly due to the perceived need to compensate landowners for any property rights foregone) culminates in the Solomon Island’s natural forests being logged at an unsustainable rate.

There is little evidence that the returns to individual landowners and in particular, returns to contractors from extracting the timber resource are being substantially reinvested in the Solomon Islands.

Given the time required for logged over forests to regenerate, or for plantation stands to reach fellable standard, there is no ‘quick fix’ for the forestry sector. Whatever the policy changes made today, there will still be an around 10–12 year period during which wood flows from natural forests will be minimal at best. However, policy changes can be made to address the bad incentive structure and poor contractual arrangements that give rise to the sector’s problems in the first place, thereby promoting an environment that will encourage forestry resources to be utilised on a sustainable basis in the future.

⁴⁵ *ibid* and URS 2003, *op cit*, pp. 20–21.

There is an obvious need to encourage reforestation of logged areas and substitution to plantation timbers. While offering an export duty remission to encourage reforestation conveys the right ‘intentions’, the current arrangements are not seeing reforestation of logged areas. To address this problem, one option would be to eliminate the export duty remission and replace it with a duty rebate based on a performance indicator linked measures of reforestation. Under this scenario, the liable export duty would be paid in full, with some of that duty being rebated if actual reforestation could be demonstrated.

Of late, and especially at the village level, the focus of plantation timber has moved to high valued and easy to grow species such as teak and mahogany.⁴⁶ Export prices for these species are around US\$160 and US\$150 per m³ (respectively).⁴⁷ At these prices, exported plantation logs could be liable for duties of SBD314/m³ and 60 percent of the value in excess of SBD1,040/m³. Relative to natural logs, which typically attract an export duty of 25 percent, there is a disincentive to export plantation timbers due to the significantly higher rate of duty they attract.

While export duties can be manipulated to achieve parity between log exports, a perhaps more important question concerns the justification for levying plantation timber with an export duty in the first place. The use of export duties reflects a form of royalty payment for utilisation of natural resources. Royalty payments are made to compensate the resource owner — typically the government (acting on behalf of the population) — for using or extracting that resource. However, in the case of plantation timber grown on other than government owned land, the justification for a royalty payment is not clear. A strong case could be made that plantation timber represents a private investment decision, and if it utilises privately owned resources only, then no royalty payment is justified. Exempting plantation timber from export duty would provide a strong financial incentive to use plantation timber rather than natural forests.

The export duty remission also has the dual role of increasing returns to landowners. This ‘need’ arises as, legally, it is the logging licensee — the landowner — who is liable for the export duty. Requiring landowners to fund the export duty out of their share of the returns (typically 40 percent of export value) sees landowners capturing around 15 percent of reported export value. This perceived low return then gives rise to a need for duty remission to increase the return to landowners.

⁴⁶ URS 2003, National Forest Resource Assessment, p. 21.

⁴⁷ *ibid*, p. 24.

One option for addressing the case for duty remission is to make the logging contractor, who for all purposes is the exporter in practice, the licensee. (It is believed that the draft Forestry Act, if passed, would do this.) Under this scenario, export duty liability would switch to the logging contractor, thereby removing the burden from landowners. Depending on future revenue sharing arrangements between contractors and landowners, returns to landowners could be larger under this scenario.

Other obvious areas of reform include using current exchange rates and determined prices. To limit month-to-month fluctuations, the applicable exchange rate and determined price could be based on a rolling average over a 12 month (or other suitable) period.

Palm oil

Large-scale palm oil production ceased in June 1999, when SIPL closed down because of the social unrest on Guadalcanal. Prior to its closure, palm oil and kernel exports accounted for 16 percent of foreign exchange earnings (in 1998).⁴⁸

In 2004–05 a new company — Guadalcanal Plains Palm Oil Limited (GPPOL) — reactivated the SIPL site, with a view to starting crude palm oil production within three years (when production volumes are forecast to reach 12,500 tonnes). GPPOL is an offshoot of the PNG based palm oil company New Britain Palm Oil Limited.

The investment associated with GPPOL’s recommissioning, development and operation of the former SIPL site is significant. GPPOL estimate that SBD200 million will be invested in the first 5 years, followed by additional investment of SBD75 million during 2011–13 (construction of second mill) and SBD45 million during 2012–15 (expansion phase of project). If these estimates prove to be correct, then the total investment will amount to SBD320 million over a ten years period.

The investment incentives offered to GPPOL (see below) are contingent on GPPOL making a ‘qualifying investment’. The thresholds for a qualifying investment are substantially lower than the required investment estimated by GPPOL. For example, a ‘qualifying investment’ is made if investment in the first 3 years exceeds SBD75 million, while an ‘additional qualifying investment’ is made if additional capital expenditure of at least SBD30 million is made within 10 years. There are also employment, production and export thresholds to be achieved.

⁴⁸ Central Bank Solomon Islands, 2002 Annual Report, p. 95.

Incentives via a memorandum of understanding

The investment incentives and assistance provided to NBPOL by the Solomon Islands Government are specified in a MOU between the two parties. The MOU, which stretches to 49 pages, details what the GPPOL project shall comprise, investment incentive application and approval process, land leasing arrangements, investment incentives, recruitment practices and immigration needs, infrastructure to be provided by the government, regulatory and environmental matters, amongst others.

In several instances, the MOU appears to contradict standing legislation. For example, the MOU specifies that the Investment Board shall grant the investment incentives (specified in s.11).⁴⁹ However, under standing legislation the Investment Board can only approve, on a yes or no basis, whether the applicant should receive incentives. The Investment Board does not have power to actually confer incentives, or to determine their size/length etc. Another example concerns loss carry forward. Under s.19(2) of the Income Tax Act losses (excluding any depreciation component) incurred in generating a *chargeable* income can be carried forward for a period of five years. In the case of loss carry forward, the MOU dictates that any losses incurred during GPPOL's tax holiday period (up to 15 years) can be accumulated and used once the tax holiday period has lapsed.⁵⁰ Hence, any losses incurred over the first (up to) 15 years could be used in years 16–20 to lower the company tax burden.

Specific incentives offered to GPPOL

Section 11 of the MOU specifies the investment incentives that are to be conveyed to GPPOL. Notable investment incentives include the following:

- exemption from company tax for a period of 10 years with a further five year exemption if additional qualifying investment is made, with exempted aggregate taxable income capped at SBD275 million;
- exemption from withholding tax on dividends paid by GPPOL in the tax holiday period(s);
- loss carry forward during the tax holiday period(s), with a five year window to utilise those accumulated losses once the tax holiday period has lapsed;

⁴⁹ See sections 4.1 and 4.7 of the NBPOL MOU.

⁵⁰ See section 11.10(b) of the NBPOL MOU.

- exemption from import duties and goods tax on capital assets and spare parts for a period of five years from project commencement and for three years from commencement of construction of the second mill (with import and goods tax exemption lapsing after 15 yrs from project commencement);
- double deduction for expenditure on (approved) training;
- accelerated depreciation, but not available if in tax holiday period or more than 15 years since project commencement; and
- compensation of GPPOL if a new duty/tax regime is introduced by the government and this new regime adversely impacts on GPPOL.

On top of these investment incentives, the government also committed to assist GPPOL in certain areas (such as facilitating residency visas for foreign staff) and to repair/upgrade/maintain road and bridge infrastructure to specified standards. If the government does not meet its infrastructure commitments, then GPPOL will still be able to access the various investment incentives irrespective of whether the minimum performance criteria (see below) are met.

GPPOL's access to the investment incentives is contingent on meeting certain minimum investment, production and employment performance criteria. A qualifying investment is said to have been made, and hence the incentives accessible, if the following performance requirements are met:

- capital expenditure in the first three years of more than SBD75 million;
- employment of not less than 600 employees in the first year, and thereafter not less than 900 employees; and
- production and export of not less than 12,500 tonnes of crude palm oil annually in the third year, and not less than 25,000 tonnes in the sixth year.

An additional qualifying investment is said to have been made, and hence the additional incentives (such as the five-year extension of the tax holiday) accessible if:

- capital expenditure of not less than SBD30 million on a second mill;
- employment of not less than 1,200 employees during each year of the project commencing with the eighth year; and

- production and export of not less than 35,000 tonnes of crude palm oil annually commencing in the eighth year.

These thresholds are poorly defined, and therefore open to interpretation. For example, employment of not less than 600 persons is required in the first year.⁵¹ But does this mean 600 people continuously throughout the year, or just 600 people at some point in the year, perhaps initially? Furthermore, the MOU does not specify what will happen if any of these thresholds are not met. Will, for example, the government retrospectively collect owed company tax, import duties etc?

Cost of incentives

The Ministry of Finance costed the investment incentives offered to GPPOL under the MOU. The estimates of foregone tax revenue vary according to assumptions made about global palm oil prices. At a price of US\$300 per tonne (assumed by NBPOL), the foregone import duty, company and goods tax is estimated to be SBD191 million. At prices of US\$375 and US\$425 per tonne, the foregone revenue is calculated to be SBD205 million and SBD189 million respectively. With a long-term average price of around US\$375 per tonne, the revenue foregone because of the investment incentives offered to GPPOL will be around the SBD200 million mark.

Going forward

The GPPOL project will deliver benefits to the Solomon Islands. It is estimated that the government will collect around SBD350 million in tax revenue, the plant will employ a large number of persons, and landowners will receive SBD115 million in land rentals and royalty payments over 15 years. Landowners will also benefit from dividends from their 20 percent share in GPPOL. Taxation of employees and landowners will generate further revenue for the government.

However, the Solomon Islands Government will forego a substantial amount of tax revenue — SBD200 million — in order to get NBPOL to invest. Given a ‘post conflict’ environment in 2004, the investment incentives offered to NBPOL and the resultant foregone revenue could be justified because as the first investor post conflict, NBPOL faced a significant degree of risk and uncertainty. Hence, some (large) incentives may have been necessary to meet the risk premium element in the firm’s required rate of return.

⁵¹ GPPOL had recruited 400 employees by July 2005.

Furthermore, large investors such as NBPOL have a significant ‘demonstration effect’, which in turn confers large spill over benefits to the economy. That is, a large foreign investor is willing to commit to the Solomon Islands, thereby demonstrating to other potential investors that the Solomon Islands is an acceptably safe place to invest. It is likely that investor confidence in the Solomon Islands will increase because of NBPOL’s presence.

It could therefore be said that the incentives offered NBPOL achieved their objective — a large investor was attracted to the Solomon Islands, and this brings with it a considerable demonstration effect. The foregone tax revenue therefore represents a sunk cost associated with achieving this desirable demonstration effect.

Looking to the future, as larger investors have now started returning to the Solomon Islands there would appear to be little justification for, or need to, offer future investors incentives of the same generosity as that offered to GPPOL. Offering such large incentives in order to achieve the demonstration effect, however, puts the government in a difficult position. Subsequent (large) investors in the Solomon Islands will be looking for equal treatment, and hence incentives of the same order of magnitude offered to GPPOL. As there is little budgetary capacity to and justification for offering incentives of the GPPOL magnitude, the government is potentially open to future claims of unequal treatment of investors.

Mining

During the mid 1990s, Ross Mining undertook a feasibility study into mining for gold and silver at the now named Gold Ridge Mine (GRM). Following the conclusion of three-way discussions between the mine operator, landowners and government, first production commenced towards the end of 1998. Ross Mining, trading as Gold Ridge Mine Limited, produced 110,000 ounces of gold and 66,000 ounces of silver in its first full year of operation.⁵² Gold reserves able to be mined are estimated to be around 1.8 million ounces, equivalent to a ten years mine life.⁵³

⁵² Central Bank Solomon Islands, 2000 Annual Report, pp. 21–22.

⁵³ Mike Christie, Chief Operating Officer, Gold Ridge Mining Limited, personal communication, 22 July 2005.

As a result, of the recent social tensions, Delta Mining, who had merged with Ross Mining in 2000, abandoned the GRM in June 2000. Delta Mining made a successful claim on their political risk insurance, with the end result being that the insurance company overtook the GRM. The insurance company put the mine out to competitive tender, with Australian Solomon Gold (ASG) being the successful tenderer. The Investment Board approved ASG's involvement in the project in early 2005, with production envisaged to commence towards the end of 2006 following ASG's refurbishment of plant and infrastructure.

Investment incentives offered to ASG

ASG did not negotiate a new incentive package with the government. Rather, ASG successfully reactivated the incentives originally negotiated by Ross Mining in 1996. The decision to use previously negotiated incentives as opposed to negotiating their own concessions was taken to avoid excessive time delays associated with negotiating incentives, both those received and those offered to landowners. ASG considered that the entire 1996 agreement would need to be renegotiated if some elements, such as investment incentives, were to be renegotiated. This would open up the area of renegotiating land access arrangements, which would likely introduce a significant delay to production. Hence, the 1996 agreement negotiated by Ross Mining, and which was still binding, was enacted. Poorly defined property rights in land tenure arrangements are therefore influencing incentive arrangements.

The 'cost' associated with the current landownership (and property right) arrangements are best demonstrated by the fact that ASG is entitled to a more favourable company tax regime than that negotiated by Ross Mining. Under the 1996 agreement, the specified company tax rate was 35 percent. However, as ASG is incorporated in the Solomon Islands, the applicable tax rate today is 30 percent. Hence, by using the 1996 agreement ASG is incurring a 5 percentage point higher tax rate than necessary.

The major investment incentives offered to Ross Mining/ASG include:

- reduced export duty of 1.5 percent on the gross value of all gold and silver produced;
- exemption from import duties, with the exemption ending on first commercial production; and
- exemption from fuel duties.

ASG point out that the import duty and fuel excise-equivalent exemptions are the most important incentives. Without these, costs would be 30 percent higher and the project not viable.

The incentives offered to ASG are a combination of existing incentives initially offered to Ross Mining (export duty exemptions) and the re-issuing of incentives (import duty exemption) that should have expired on Ross Mining's first commercial production in 1998. When costing the incentives offered to ASG (see below), a large portion of the estimated foregone taxation revenue is actually attributable to the MOU negotiated in 1996 between Ross Mining and the Solomon Islands Government.

As ASG enacted the still binding 1996 MOU, the cost of the incentives accessed by ASG (with the exception of the re-issued import duty exemption) was effectively incurred when Ross Mining negotiated their incentives in 1996.

Cost of incentives

The Government did not undertake a detailed costing analysis of the revenue foregone because of the incentives offered to ASG. However, some 'ballpark' estimates can be prepared from the available data.

The currently prevailing export duty on gold (in any form) exports is 5 percent. On today's gold price of US\$440 per ounce, the gold reserves at GRM are worth around US\$792 million, or SBD5940 million. The nominally liable export duty is therefore SBD297 million. However, at the concessionary export duty of 1.5 percent, SBD89 million in export duty will be collected. Hence the foregone export duty is SBD208 million (in 2005\$. This calculation ignores the foregone export duty on silver exports).

During the social unrest, the GRM site and surrounding infrastructure incurred significant damage. ASG estimated that recommissioning/refurbishment costs will be around US\$5 million for electricity generation, US\$40 million for plant and US\$10 million for the camp. (Actual costs will likely be higher given recent increases in steel prices.) If it is assumed that half of these costs comprises plant and equipment that must be imported, and that the average import duty of 15.4 percent applies to the imports, then the import duty exemption is estimated to cost around SBD32 million.

Hence foregone revenue from export and import duty exemptions is estimated to be around SBD240 million. (Note that a large portion of this cost was incurred when Ross Mining negotiated their incentive package in 1996.)

Going forward

Having ASG operating the Gold Ridge Mine conveys the same signal to potential investors as does GPPOL's presence — the Solomon Islands offers a place to invest where political and sovereign risks are becoming more tolerable. The Solomon Islands received nine new applications by foreign companies in 2004 to undertake exploration activities.⁵⁴ It is likely that ASG's presence had a positive effect on encouraging (some of) these companies to consider the Solomon Islands for investment. However, some problems of precedent were created in the process.

Lessons to be drawn from the case studies

The Solomon Islands has an area of comparative advantage in resource-based activities. The above case studies investigated the investment incentive regime accessed by three broadly resource based activities. The lessons drawn from these case studies will have relevance to other resource-based activities, whether they are fisheries, mineral extraction or eco-tourism.

One important feature to emerge is the importance of ensuring access to inputs at or close to world prices if investment is to be profitable in the Solomon Islands. Yet this is currently achieved through an inefficient exemptions system.

As evidenced by the three case studies, the current investment incentive regime, and the use of MOUs in particular, has numerous shortcomings, including:

- in the timber sector in particular, poorly structured contracts have constrained returns to the community. 'Compensation' through duty/tax exemptions acts as a perverse incentive and unwillingness to force world log prices on timber companies encouraging even greater resource depletion; related to this
- apparent unwillingness to confront conservation issues and the need to extract natural resources at a sustainable rate when approving timber operations;
- weaknesses of MOUs, which conflict with standing legislation and are poorly specified/vague in terms of what happens if one party to the agreement defaults on its 'contractual' obligations; and

⁵⁴ Central Bank Solomon Islands, 2004 Annual Report, pp. 22–23.

- unknown costs: while the cost to government revenue of incentives granted under MOU to NBPOL and ASG are can estimated, the cost to revenue of incentives conferred under standing legislation and other MOUs is unknown.

These shortcomings have important implications for the Solomon Islands. For example, the failure to log at a sustainable rate means that the natural forest base may be exhausted in five years time. If the resource is depleted, the Solomon Islands Government will encounter severe financial difficulties due to the loss of export duties on logs, which accounted for 12.7 percent of total Solomon Islands Government tax revenue in 2004. The unknown cost to revenue of the incentives offered to investors creates further problems in the budgetary process.

In palm oil and mining, any role that incentives have had in locking in two major investments is difficult to assess, although the importance of exemptions from indirect taxes on inputs was stressed in the case of the gold mining project. There are likely to have been important ‘demonstration effect’ benefits in reassuring subsequent investors. These spillovers help to justify the use of incentives. However, the incentives may also create an expectation for equal treatment for future investors which will neither be justified (as sovereign and political risks continue to subside) nor affordable.

5 Opportunities for improving incentives

Post-tension success in attracting two significant resource based investments, each enjoying generous investment incentives, will be seen by some as vindication of the current Solomon Islands approach to discretion-based incentives. This conclusion is misplaced. Systemic change is required to put in place a more robust environment where incentives are not seen as compensation for a distorted tax system and a risky location offer. There is no substitute for fundamental reform. However, if incentives are deemed necessary in the short to medium term, they can be changed for the better.

Table 11 in Chapter 3 provided a summary of how the Solomon Islands incentive regime measures up against best practice benchmarks. Sectoral examples provide specific illustrations of some of these. What needs to be done to put incentives on a better path?

Opportunities and challenges created by the new Foreign Investment Act

The passage of the new Foreign Investment Act is the first step in a series of necessary reforms that will change the business environment in which incentives operate in the Solomon Islands. However, it is only one part. The broader strategy, of which incentives reform is another component, would require several complementary changes. Tax code modernisation is one of these. Removal of administrative barriers to business establishment and operation is another. Law reform is a third.

Recommendations on tax modernisation are already under consideration by DOFT. FIAS and the ADB respectively are providing assistance in each of the other two reform areas. Realistically, finalisation and implementation of the major legislative and administrative reforms required to replace the Goods Tax in particular may be at least a year away.

Meanwhile, the Foreign Investment Act will necessitate immediate change to aspects of the Income Tax Act. These changes, dealt with in the Income Tax Amendment Act, should address cross references to incentives in the Income Tax Act and the previous Investment Act, now repealed. Approval of the granting of incentives will have to be dealt with differently with the removal of the Investment Board as the body approving investments and recommending incentives on the advice of 'relevant' ministries. Under the new Foreign Investment Act, foreign investment registration at least will now be routine and less discretionary. Application for, and approval of, incentives for foreign investors will pass through the IRD.

By clearly putting approval of income tax based incentives in the hands of the Commissioner for Inland Revenue, there is an opportunity to make the granting of incentives, to both foreign and domestic investors, more rules based and less discretionary, and to change the type of incentive at the same time. However, there are also dangers, as discussed below.

Prior to the necessary modernisation of the tax system, there is a need to change both incentives approval processes and types of incentives on offer.

Moving away from a discretion-based system: Some immediate opportunities

The importance of automatic and transparent incentives can be summarised as follows:

...the granting of tax incentives should be transparent in all its different aspects; legal basis, economic consequences and administrative procedures. It should be based on simple objective qualifying criteria to avoid or at least minimize discretionary application by officials and to ease enforcement and monitoring; and it should include the implementation of some form of the tax expenditure concept (either as an explicit component of the budget or at least through the carrying out of a systematic analysis of the revenue impact of tax incentives).⁵⁵

Similarly, commenting on investment incentives offered with the explicit objective of creating beneficial local spillover effects from foreign investment, it was observed that:

⁵⁵ Zee et al 2002, *op cit*, p. 1510.

...first and foremost...incentives should be rules-based and available on equal terms to all investors irrespective of industry and nationality of the investor.⁵⁶

To achieve these outcomes much needs to change. Change began with foreign investment approval being replaced with simple registration under the Foreign Investment Act. However, incentives still remain highly discretionary. In addition, their objectives are not clearly linked to any clearly stated investment policy.

Clarifying objectives to help establish eligibility for incentives

The Income Tax Act provides for different tax holiday treatments for different sectors but there is no supporting justification for this. Section 10 of the current Investment Act sets out a list of desirable attributes which the Investment Board should take into account in both approving foreign investors' proposals to invest and for approving incentives. These range from a broad 'economic development' attribute through to more specific objectives such as job creation, technology transfer, dispersal of benefits through the provinces, export enhancement etc. Unfortunately, a number of these desirable attributes require judgements that amount to 'picking winners' on the part of those approving incentives. The problem is compounded by the fact that the current system does not provide for effective verification and follow up. In most cases, it will be not be feasible to establish whether the broadest goals of economic development are being met by individual incentive recipients.

The purpose of moving to a small Reserved List under the new Foreign Investment Act is to signal that the Solomon Islands economy would welcome *foreign* investment in all activities other than those reserved for locals principally for cultural reasons, or not prohibited for security reasons. Bearing in mind the limited international evidence on the effectiveness of incentives, one choice for the Solomon Islands is whether some minimum incentive should be available to all investments or whether incentives should be highly targeted and confined to very few sectors.

Recommendation: Publish a clear statement of investment policy and the role for incentives in that policy, including their role in individual sectors (primary industry, manufacturing, tourism, other services etc.) To achieve this, undertake a review to revise the poorly defined eligibility criteria as set out in Section 10 of the previous Investment Act.

⁵⁶ Blomstrom and Kokko 2003, *op cit*, p.19.

Establishing rules-based eligibility, reducing uncertainty and simplifying administration

There are benefits from addressing all fiscal incentives through the tax code rather than through other pieces of legislation. The Foreign Investment Act will move the Solomon Islands closer to this point. It has removed the discretionary role of the Investment Board in recommending incentives and the referral to ‘appropriate ministries’. However, the Income Tax (Amendment) Act shifts discretion of the former Investment Board to the Commissioner of Inland Revenue, with that discretion remaining significant. The discretion relates to:

- whether any exemption from income tax is warranted, and in some cases; and
- how generous that exemption might be.

Sharper eligibility guidelines for IRD’s use

In the interests of reducing discretion and increasing certainty, it will be necessary to provide narrow and explicit guidelines on incentive approval to minimise the decision problem which will in future face the Commissioner for Inland Revenue.

Guidelines would ideally be embodied in Ministerial Orders that would require the Commissioner for Inland Revenue (and the Comptroller in the case of Customs and Excise) to follow them. They would set out:

- any dollar value threshold levels of the investment for qualifying for incentives (there may be a case for excluding investments, either new or expansion, which are so small as to not warrant the costs of administering and subsequently monitoring the incentive arrangement);⁵⁷
- a set of other objective criteria, preferably performance based and verifiable over the life of the investment, such that satisfaction of any one of these would automatically qualify the applicant for at least the minimum level of tax incentive on offer; and

⁵⁷ Thresholds need to be set with caution. Incentives may inadvertently give a competitive edge to new investors over established stable businesses, especially if they are in the form of tax holidays for new but quickly profitable enterprises. Established businesses miss out. There may be a temptation to shelter *smaller* businesses from the risk of this by setting relatively high dollar investment thresholds.

- that the incentives so granted would be conditional on operations commencing, and so would be conditional on all licensing and other business start up conditions having been granted.

An unknown number of investors have effectively bypassed the current approval procedure process by securing agreements with the government in the form of MOUs, which have for the most part been neither transparent nor compliant with standing legislation. Apart from the obvious benefit of negotiating the most generous incentives possible — benefits which go beyond legislated benefits — this approach is encouraged by the uncertainty that goes with an application via the Investment Board process. This uncertainty is reduced if the qualifying conditions are unambiguous and, if satisfied, are known to lead to virtually automatic approval. That is, reduced discretion available to government officials or ministers also reduces one of the pressures for incentives via an MOU.

Recommendation: *Provide the Commissioner for Inland Revenue with clearer, more tightly defined and objectively based guidelines for deciding whether an applicant for incentives granted under the Commissioner’s powers qualifies for those incentives. The guidelines should include a minimum size threshold. The guidelines should be embodied in Ministerial Orders requiring the Commissioner to follow them. They should be widely publicised.*

Furthermore, to eliminate uncertainty about who can grant corporate income tax- based incentives and to minimise the likelihood of inconsistencies between any future MOUs and standing legislation the Commissioner’s powers should be reaffirmed by government.

Recommendation: *Issue a statement recognising the Commissioner for Inland Revenue as the sole responsible decision maker in applying eligibility criteria for corporate income tax-related incentives.*

Dealing with inappropriate criteria and poorly worded incentives legislation

The task of administering incentives is made more difficult by inappropriate criteria and vague language in the existing legislation. Minor changes will help pending thorough overhaul of the tax and customs legislation.

The local value-added criterion governing the length of corporate tax holidays for smaller investments is not performance based, and is apparently little used. Even if tax returns were required for those receiving the holiday, allowing scrutiny of value-adding ratios, these ratios can vary over time, rendering the length of the holiday entitlement uncertain unless it is solely based on 'planned' investment. Furthermore, it is not clear what objective is being satisfied by making local value adding a relevant qualifying criterion only for smaller scale investments or those which are not fully export oriented. Furthermore these provisions violate WTO requirements designed to discourage the use of inefficient subsidies protect local industry.

Recommendation: Remove reference to local value adding as a criterion for granting and scaling incentives from the Schedules to the Income Tax Act. It violates WTO requirements.

The language of the various Acts dealing with investment related tax exemptions places an unnecessary burden of decision making on the Tax Commissioner, Ministers and Exemptions Committees (for example, see Box 1). In numerous places the language/wording of the legislation forces decision makers to use discretion. This can be reduced to some degree by rewording or by including interpretations in the guidelines for tax and Customs administrators. In other cases, changes to import duties levied may offer a practical alternative.

In the Income Tax Act, expansion investment as well as 'greenfields' investment may qualify for incentives but only if it is 'substantial'. Substantial investment is not defined.

Recommendation: Set a minimum size threshold for all investments- new or expansion- qualifying for corporate tax incentive. These should be established in the Guidelines to the Commissioner. 'Substantial expansion' investment as it refers to eligibility for income tax based incentives should be taken to mean all eligible investments that exceed the quantitatively determined SBD threshold.

Box 1 illustrates the problems of interpretation arising from poor wording of the Customs Act as applied to investment incentives. To allow Customs to concentrate on administering policy rather than interpreting it, and to continue to promote competitiveness for Solomon Islands producers, tariff reductions on capital imports may be the best option. Few capital goods are produced locally.

Box 1: Confusing wording – customs and excise exemptions

Section 18 of the First Schedule of the Customs and Excise Act exempts certain imported goods from import duty as an investment incentive. The wording of s.18 is:

Such goods, forming part of the initial capital investment of an enterprise approved under the , as may be agreed by the Comptroller of Customs, together with such part of the goods required for the first two years of operation of such enterprise as may be agreed by the Comptroller.

The poor wording of this exemption is likely to create implementation difficulties for the Comptroller, leading to abuse and revenue (duty) leakage. Areas of implementation difficulty and potential abuse include the following.

- What is meant by ‘such goods’, and are these identified anywhere? If not, does that effectively mean any capital good imported by the investor enters the Solomon Islands duty free? How is it verified that the investor uses the capital goods and does not on-sell?
- What is meant by the ‘initial capital investment’? Does the initial capital investment have a finite lifetime? If so, where is it identified, and is it equal across all industries/activities? How are investments that are rolled out over many years (such as plantations) to be handled?
- What part of the goods required in the first two years of operation are to be duty exempt?
- How will the Comptroller know what quantity of goods are needed in the first 2 years of operation, and how is stockpiling of duty free production inputs to be prevented?

These questions identify several areas where a s.18 exemption is open to interpretation and discretion, and potential abuse with revenue implications. The questions also highlight the need to tighten the language associated with s.18, and to develop some guideline to aid in its administration.

The lack of rule based guidelines on how to implement s.18 exemptions means the Comptroller must interpret what is meant by s.18, its objectives and intent, and in so doing make policy. This would seem to be outside of the role of Customs and Excise, who are best placed to administer policy.

Recommendation: Revoke investor exemption from import duties made available under s.18 of the First Schedule of the Customs and Excise Act and replace it with a low uniform tariff rate on defined capital items. If this recommendation is not taken up, then the wording of s.18 should be tightened to stop potential abuse and revenue leakage.

What else can be done prior to major indirect tax reform and income tax act review?

The policy failure that has led to the depletion of the national native timber resource is both a constraint and a challenge for Solomon Islands. The major source of export revenue and a SBD63 million contribution to government revenue may dry up within five years. (This is despite the suspected widespread transfer pricing and under reporting of profits by timber contractors.) This will limit the scope for moving to a lower tax environment unless other changes are made. However, this looming revenue gap accelerates the need for effective tax base broadening and elimination of poorly targeted tax based incentives.

There are a number of constraints that will limit effective reform of investment incentives, in particular pending major reform of the indirect tax system. The constraints will be faced until an invoice based VAT type tax is introduced (hopefully within two years) and the customs modernisation program is well advanced.

It would be inefficient, for example, to attempt replacement of duty and goods tax exemption for investors with drawback or suspension schemes under current tax structures and customs capacity. However, some amendments are necessitated by the new Foreign Investment Act; for example, consequential changes to the Income Tax Act. It may be opportune to make other immediate changes to that legislation even though full-scale review of the Income Tax Act will be required at some point.

Improving transparency of incentives' cost to revenue and reducing waste

The previous Investment Act provided (if only nominally) for a monitoring and compliance protocol for firms enjoying tax privileges. With responsibility shifting to IRD under the new Foreign Investment Act, provision must be made for IRD to monitor compliance with the conditions under which tax privileges were and will be granted.

Recommendation: *Make provision within the Inland Revenue Division to monitor all current and future recipients of fiscal incentives for compliance with the conditions on which they were granted. Adequately resource IRD for the task of assuming greater responsibility for incentives administration.*

Filing tax returns as a condition for incentives

According to IRD and DOFT there are recent encouraging increases in compliance and enforcement in tax collection. Staffing levels were recently increased in IRD and stand at 66 persons. This suggests growing administrative capacity to rationalise existing tax based incentives, assess costs and remove abuse.

If the Solomon Islands Government continues to offer fiscal incentives to qualified investors in the short term it is important that the costs of doing so are made clear. This applies not only to foregone corporate income tax but also to customs duty and goods tax. There is a need for ‘stocktaking’ to better assess the cost of existing exemptions and calibrate any future offers. Proof of exemption should be tendered by all current beneficiaries.

Introduction of an immediate filing requirement as precondition for honouring existing income tax exemptions, including tax holidays, would be a useful first step. Part IX of the Income Tax Act deals with the requirement to file returns. Section 57(1) of the Act, however only makes this obligatory for those with chargeable income. In addition, income earned (or indeed losses made) while income is exempt is not treated as chargeable. However, Section 57(2) gives the Commissioner discretion to require returns for any income. This should be exercised for all taxpayers enjoying tax holidays.

Recommendation: *Make filing of an annual tax return an approval condition for all new investors or expansion projects receiving tax privileges in the Solomon Islands. There should be automatic disqualification from current holidays and from consideration for future extension of privileges (on basis of expansion investment) through failure to file a return in the current year in response to a written request to do so from the Commissioner.*

Establishing a register of tax holiday investors

If failure to respond to a request for a filed return was deemed a contravention of the Act (it currently attracts penalties under Section 58), then this could provide grounds for withdrawal of exemptions, without necessitating amendment of the Act. Filing of returns will assist compilation and updating of a register of those enjoying income tax exemptions. This would require the use of existing Investment Board records of approvals granted and income tax identification numbers. IRD should have records of all Solomon Island investors who were granted exemptions by the Minister.

Recommendation: *Establish a register of all entities enjoying tax holidays as an investment incentive, drawing on Investment Board and IRD records. The register should be publicly available.*

Conducting a review of Goods Tax and Duty exemptions and exemption holders

The exemptions and rate reductions granted with respect to customs duty and goods tax present further problems. In the absence of further reform, the inefficiencies and inequities create by the tax structure and related exemptions will persist. Exemptions for some come at the cost of higher tax rates for those who do pay. The cost to revenue of the exemptions was shown to be very high. There is a danger that even with significant indirect tax reform — introduction of a VAT and further tariff reform for instance — there will be political pressure to maintain existing exemptions.

Although many indirect tax exemptions were granted under statute, the further exemptions granted by the Customs and Excise Exemption Committee and the Goods Tax Exemption Committee have led to an exemptions maze. As with income tax privileges there is a need for a ‘stocktake’.

Future indirect tax rates under a modernised system can only be determined when the level of exemptions is taken into account. A useful first step would be to conduct a full review of existing exemptions, including those provided as investment incentives. This would allow the Solomon Islands Government to make better-informed decisions about what goals are being achieved through what has become a very ad hoc approach.

There is concern that in some cases those who were granted exemption from import duty on ‘investment’ goods under s.18 of the First Schedule to the Customs and Excise Act, which nominally restricts them to the first two years of operations, may be abusing this privilege. A similar problem is likely to arise with ‘tourism’ goods under s.20. Little information is available on the time span of the various goods tax exemptions given under ministerial discretion prior to the establishment of the informal Goods Tax Exemption Committee.

Recommendation: *Undertake a systematic independent review of all categories of exemptions from customs duty and goods tax. This should be done prior to introduction of any new indirect tax structure. Those holding exemption certificates from whatever source should be required to present them for evaluation and possible renewal.*

If the Customs and Excise, and Goods Tax Exemption Committees were charged with this task, they would have to be properly resourced for such a review, with senior representation from the IRD on each review. A fully independent review would be preferable, with input from both of these bodies.

Unfortunately, there is no single tax identification number that would allow IRD to match up goods tax exemptions with income tax exemptions. Progression towards this will be enhanced as computerisation of IRD accelerates.

Chapter 3 underlined the costliness of exemptions from import duty and goods tax over and above those afforded to investors as incentives. Among these, exemptions for government are significant and prone to leakage.

***Recommendation:** Consider removing duty exemption for imports by government because of potential revenue leakage and abuse.*

Assisting investors in export industries to get inputs at competitive prices

While exporters should be allowed to import capital goods at or close to world prices, international experience suggests that exemptions have led to leakage of (duty free) goods into the domestic market and consequent revenue loss for the government. This is particularly true for products such as cement and steel, which can be readily utilised in other uses compared with specialist machinery. Because of the risk of revenue leakage, neither duty suspension nor exemptions were particularly effective.

***Recommendation:** Remove duties on imported capital inputs for all users or introduce a low uniform rate on capital goods. Given that such inputs are likely to be exempted from import duty already, the revenue implications would be minimal.*

Moving ahead: scope for modifying future incentives

There is some evidence that the political and sovereign risks associated with the civil strife of the early part of the decade are abating as a hurdle for investment in both physical and human capital. The tourist-focussed Western Province has seen the establishment of a small new resort, Sanbis, near Gizo. A PNG-based finance company servicing motor vehicle and other leasing will offer competition to existing bank lending. Larger furniture manufacturers saw former employees branch out in competition since 2002. The Solomon Islands Small Business Enterprise Centre increased its number of trainees from 335 in 2002 to 646 in 2004.

This review acknowledges the gains from attracting two major projects in the past year, albeit with generous incentives attached. However, there are grounds for treating these as special cases. They are certainly not a reason for maintaining an incentive regime dominated by discretion-based MOUs and tax exemptions. Rather, there is a need for recognising the preferences of long-term investors — a low tax rate environment, low levels of uncertainty and consistent, efficient, evenhanded treatment and the irrelevance of incentives when business establishment costs and costs of doing business stifle interest and/or anti competitive regulation prevents entry.

Removing bias towards short term investment and scope for abuse

The Solomon Islands long-term investment strategy should be one of gradually reducing incentives while improving the underlying tax and business cost environment through fundamental reform. Meanwhile the type of incentives on offer should be changed.

Replacing tax holidays with accelerated depreciation and tax credits: performance based incentives

A priority must be the replacement of corporate tax holidays with accelerated depreciation and tax credits as the means of providing income tax privileges to investors. These forms of incentive are recognised as superior on a number of grounds including less bias towards short-term investments and less susceptible to abuse than tax holidays. Such a move, among its other advantages, will remove difficulties in defining exempt income when expansion is involved. These forms of incentive can only be accessed when tax returns are filed. This will increase the administrative load as investment picks up. But as tax administration capacity improves the case for holidays and exemptions weakens and their opportunity cost potentially increases.

Depending on the clarified objectives and revised guidelines for granting incentives recommended in this report, it may be decided that *no* corporate tax incentives are warranted in some sectors, only accelerated depreciation is justified in others, but for some others tax credits which further reduce the effective tax rate are also called for.

In all likelihood, the larger scale investments that may be attracted under gradually normalising conditions will continue to be those in which the Solomon Islands has comparative advantage. That is, they will be natural resource based (including tourism). These are precisely the kinds of investment where incentives are redundant — investment is based around access to resources and will be little influenced by incentives if other elements of the ‘location offer’ are right. There is a weakened case for more generous incentives for larger or export oriented investments in these circumstances. A uniform rate may be preferable.

The level at which tax credits are set (the percent of qualifying investment expenditure credited against tax, any caps on the relief etc) should be framed with budget capacity in mind. If anything other than a uniform rate for all qualifying investors is adopted (for example, a more generous rate for 100 percent export activities) government needs to set out the rationale in a clear policy statement preceding the legislative change.

Recommendation: Amend the Income Tax Act within 12 months to replace reference to income tax exemption for new and expansion investment with income tax credits. The rate of these credits should be struck with both the objectives of these incentives and budget capacity in mind. Until the amendment takes effect do not issue tax holidays of more than five years duration.

Carry forward of losses (for five years in the Solomon Islands) is one of the advantages of normal tax treatment, which is lost under tax holidays (Part V Section 19 (3) of the Income Tax Act). The ability to carry forward losses typically incurred in the early years of an investment project would be reinstated with the introduction of tax credits. In addition, while any provisions for accelerated depreciation lose their relevance during the tax holiday period they can be retained under tax credits.

Recommendation: Review existing provisions and rates for accelerated depreciation as part of the wider review of taxation. With removal of tax holidays for future investors, the scope for amending the Income Tax Act to extend accelerated depreciation in some sectors should be examined. A future review of the Income Tax Act should examine the case for indefinite loss carry forward.⁵⁸

⁵⁸ Indefinite loss carry forward is available only for the ‘depreciation’ contribution to a loss. And, to avoid ‘loss carry forward trading’ loss carry forward is only available when shareholding is ‘substantially’ unchanged.

Equitable and consistent treatment of beneficiaries

Generous tax holidays and indirect tax exemptions for some of the community must be paid for. They have an opportunity cost – foregone revenue could have been used to lower the tax burden of others. Therefore, it is important that they eventually generate net benefits. Replacement of inefficient incentives like tax holidays will help. But those bona fide investors already granted tax holidays for a specific period must be treated fairly. If, as recommended, tax credits and accelerated depreciation rather than tax holidays are offered to new investors from 2007, the ‘grandfathering’ of existing tax holidays scheduled to run beyond 2006 will be necessary to shore up government credibility. In addition, there is the further issue of how to treat expansion investment in future.

Grandfathering becomes an issue if an enterprise A, granted the tax exemption privilege, is taken over by another B whose circumstances are different and which would not qualify it for the same incentives. Certainly, the ongoing tax-exempt income component needs to be restricted to the income stream of A.⁵⁹ Transfer pricing and group accounting practices may make this difficult to achieve in practice. Unless IRD can be satisfied that the tax-exempt income component is properly accounted for, tax holidays should be immediately terminated.

Recommendation: Honour existing agreements. With the replacement of tax holidays by accelerated depreciation and tax credits, existing time bound holidays should be honoured, subject to IRD being satisfied that the exempt income stream can continue to be shown to come from the investment that attracted the exemption.

In practice this may mean that, just as for loss carry forward provisions, substantial change of ownership may extinguish the right to continuation of already existing tax holidays.

In the period prior to introduction of tax credits, no new MOU agreements involving potential extensions to tax holidays should be entered into. There is provision for conditional extension of tax holidays in some agreements struck between investors and the government. Unless there is such provision and all conditions satisfied, in the interests of containing costs to revenue, no further extensions should be granted.

⁵⁹ Similarly, if A diversifies through acquisition of existing businesses a problem may arise.

Recommendation: Avoid extending existing tax holidays. Further incentives should only be granted where additional investment occurs and they should be in the form of tax credits and/or accelerated depreciation rather than tax holidays. All future expansion investment incentives should be in the form of tax credits and/or accelerated depreciation.

Finally, the longer term aim of a lower uniform tax environment which does not discriminate between domestic and foreign investors should be pursued. Given recent success with tax compliance and the contribution of this to revenue, a useful move would be to align the corporate tax rates for domestic and foreign companies.

Recommendation: Reduce the corporate tax rate for foreign companies to that applying to domestic companies — at present 30 percent.

A Incentives offered in neighbouring countries

The Solomon Islands is competing with numerous other countries, but particularly those within the Pacific region, for foreign investment. Ultimately, the decision to invest in a particular country will depend on the (risk adjusted) expected rate of return that investment can earn, relative to returns elsewhere. Hence, anything that can influence the expected rate of return, whether it be through impacting on revenue, costs, after tax profits and risk, can influence the investment decision.

As noted in Chapter 1, investment incentives are but one factor in the location offer. Even then, the available evidence suggests that incentives are not as important as political and macro stability, market size and resource availability in influencing the decision to invest. Nonetheless, to the extent that investment incentives do have a bearing on the expected rate of return to an investment, then it is prudent to see what incentives are being offered by countries competing with the Solomon Islands for foreign investment.

Table 1 provides a summary of the legislated investment incentive being offered by Fiji, Papua New Guinea (PNG), Samoa and Vanuatu. Legislated investment incentives available in the Solomon Islands are provided for comparison. Note that Table 12 simply documents what neighbouring countries are offering, and does not necessarily represent best practice nor suggest/indicate what investment incentives the Solomon Islands should be offering. Also, note that the identified incentives are those that are currently available, and some of these may be in the process of being phased out. For example, during 2005–06 Fiji will exempt 50 percent of export income from taxation. By 2009, no export income will be tax exempt (that is, the incentive will be phased out). Similarly, Vanuatu is planning to phase out its trade taxes by 2015.

A brief overview of the approach taken to investment incentives provided by Fiji, Papua New Guinea (PNG), Samoa and Vanuatu (Van.) *as described by their investment promotion agencies* is provided below.

Fiji — investment policy based on principles of market driven investment, equal treatment of investment irrespective of source, with investment related legislation being transparent, efficient, non-discretionary and minimal use of regulation to achieve public policy objectives. The government is addressing all areas of the location offer (macroeconomic and political stability, infrastructure, competitive tax regime, skilled and educated workforce etc).

Papua New Guinea — investment policy aims to provide transparency, equal treatment and certainty required by investors. The government is also making progress in curtailing regulatory and administrative requirements.

Samoa — the Samoan Government streamlined investment legislation and procedures, and in so doing sought to create an enabling environment to encourage greater investment. The government abolished fiscal investment incentives such as tax holidays and import duty exemptions in favour of wider taxation reform including the lowering of corporate tax rates, abolition of withholding taxes, lowering of import duties and improving the investment environment.

Table 12: Investment incentives offered in neighbouring countries

Incentive	Fiji	PNG	Samoa	Van.	S.I.
Investment promotion agency	✓	✓	✓	✓	
Investment Policy Statement	✓		✓	✓	
Reserved activities	✓	✓	✓	✓	✓
Corporate tax rate					
Resident companies	31%	30%	29%	0%	30%
Non resident companies	31%	30–50%	29%	0%	35%
Direct tax exemptions					
Withholding	✓				✓
Tax holidays	Tourism	Select			✓
On export income	✓	✓			✓
Indirect tax exemptions					
Import/export duties	✓	✓		✓	✓
Duty drawback/suspension	✓			✓	
Loss carry forward	8 yrs		Indefinite		5 yrs
Accelerated depreciation	✓	✓	✓		✓
Industry specific incentives	✓	✓		✓	✓
Double taxation treaties	✓	✓			
Investment allowance	✓				
Inflated tax deductions	✓	✓			✓
Wage subsidy		✓			

Source: Investment promotion agencies of identified countries.

Vanuatu —investment regime is deigned so as to be conducive to the maintenance of existing and creation of new investment. The investment environment is to be effective, efficient, and incorporate the principles of transparency, simplicity and automaticity. The government of Vanuatu offers no specific incentives to encourage investment, other than some import duty exemptions. Importantly, the incentive regime in Vanuatu does not discriminate between investment source countries and affords all foreign investment treatment no less favourable than that accorded to domestic investors.

B Stakeholder consultations

In preparing this report, two missions to the Solomon Islands were undertaken during July–August 2005 for the purpose of consultation with key public and private sector stakeholders, and the identification and collection of data. The stakeholders consulted during the missions are reported in Table 13.

Table 13: Stakeholders consulted

Department/Organisation	Person	Title
Public sector		
Ministry of Commerce, Industries & Employment	Derick Aihari	Director of Investment
	Andrew Nemaia	Director of Tourism
	Atkin Fakaia	Deputy Director of Trade
Department of Fisheries	Eddie Oreihaka	Director
	Sylvester Diake	Under Secretary
Central Bank Solomon Islands	Rick Houenipwela	Governor
Ministry of Finance & Treasury	Shadrach Fanega	Permanent Secretary
Department of Forestry	Dan Raymond	Team Leader
Inland Revenue Division	Ronnie Piva	Commissioner (Acting)
	John Hayes	Manager Compliance
	Elizabeth Kausimae	Assistant Commissioner
	Mark Nipperus	Manager Compliance
Customs & Excise	Daniel Rofeta	Comptroller of Customs
	Clay Kerswell	Manager, Customs Modernisation Project
	Greg Cummins	Adviser
Private sector		
ANZ Bank	Tait Jenkin	General Manager
Gold Ridge Mining Ltd	Mike Christie	Chief Operating Officer
Chamber of Commerce	Peter Goodwin	Managing Director, National Bank of SI
PricewaterhouseCoopers	Wayne Morris	Partner
Radclyffe Barrister & Solicitor	Andrew Radclyffe	Director
Guadalcanal Plains Palm Oil Ltd	Henry Brock	General Manager