TOURISM DEVELOPMENT IN THE KINGDOM OF TONGA

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EXECUTIVE SUMMARY

Before 1965 there was very little tourism activity in the Kingdom of Tonga. In 1966 the government constructed the International Dateline Hotel, thereby becoming the owner-operator of the largest hotel in the kingdom and initiating the first large step toward developing tourism into a major economic sector. In 1988 Tonga received over 19,000 visitors by air, some 10,000 cruiseship passengers, and just over 2,000 yacht visitors. By the end of 1988, the kingdom's accommodation inventory had increased to over 500 rooms. Although growth in visitor arrivals by air has been moderately rapid since 1984, investment in this period, particularly in accommodation facilities, has not been significant. The accommodation segment of the tourism industry is characterized by a predominance of smaller-scale establishments, most of which do not meet international travel standards. If the tourism sector is to become a major sector of Tonga's economy in terms of employment and income in keeping with development goals of the kingdom, increased investment in accommodation and other tourism facilities must be achieved. Part of this investment will likely have to come from abroad, not only because capital is in short supply domestically, but also because foreign investment is expected to bring with it the transfer of management and marketing expertise needed to provide quality accommodation and travel market linkages to maintain growth in visitor arrivals.

Tourism Industry Overview

Growth Trends

In 1988 visitor arrivals by air numbered 19,456 and yacht visitors 2,181. As cruiseship passengers do not stay overnight in commercial accommodations, technically they are not considered visitors, but rather excursionists. Total visitors in 1988 numbered 21,637, an increase of 12.6 percent from the number in 1987. In terms of average annual compounded rate of growth, since 1978 growth in total number of visitors has averaged 5.8 percent, but since 1984 growth has averaged a more rapid 9.6 percent. Cruiseship excursionists have numbered between 9,000 and 14,500 in the 1986-1988 period, a large decline from the over 40,000 excursionists who arrived annually in the 1981-1985 period. Since cruise passengers stay less than a day compared to about 13 days on average for air visitors, the latter is by far the most important source of arrivals by transportation mode.

In terms of visitor accommodations, in 1988 there were 529 rooms in the kingdom, up 108 percent from the 254 rooms available in 1980. About 70 percent of the room inventory is situated on Tongatapu, mainly in Nuku'alofa. While the number of accommodation facilities has grown, there continues to be a general lack of international standard hotel/resort rooms. Accommodations of sufficient quality are needed to give Tonga the exposure it needs to establish firm linkages with the international travel trade.

Visitor Markets

Tonga's principal visitor markets are Australia, New Zealand and the U.S., which together accounted for 61 percent of the total number of visitors in 1988. New Zealand (25 percent share) is the largest market, followed by the U.S. (22 percent) and Australia (15 percent). With respect to purpose of visit to Tonga, in 1987 about half of all visitors were on pleasure, with the next largest group being visitors on business (including government business). Visitors returning to Tonga to visit friends and relatives constituted about 14 percent of the total, and these are believed to be mainly Tongan nationals living overseas.

International Air Access

Among Tonga's major tourist markets only New Zealand is served by direct air service. As of June 1989 fifteen inbound flights per week served Tongatapu, utilizing the kingdom's only international airport at Fua'amotu. Direct air connections to Tongatapu link Apia (Western Samoa), Pago Pago (American Samoa), Suva (Fiji), Nadi (Fiji) and Auckland. Through Hawaiian Air flights from Pago Pago which originate in Honolulu, Tonga is linked indirectly to the U.S. market. Weekly seat capacity is about 1,500, but Hawaiian Air flights from Honolulu have a limited number of seats available for travelers to Tonga; this is because the majority of seats on the twice weekly flights are taken up by passengers destined to Pago Pago. Lack of direct flights from major tourist markets and of lower priced excursion and other promotional fares are considered major constraints to tourism growth.

Tourism in the Economy

In 1987 air visitor expenditures were estimated at TS11.2 million. Taking into account import leakages and multiplier effects, it has been estimated that visitor spending generates about TS0.42 in income for every TS1.00 spent. Therefore, based on the TS11.2 million in spending, resulting income amounted to about TS4.7 million, about 4 percent of Gross Domestic Product. At the end of 1988 total direct employment in the tourism sector was estimated to be 1,432.

Government Policy

The government early recognized the potential of tourism for generating income and employment and thus contributing to growth and diversification of the economy. The government built, and still operates, the largest hotel in the kingdom, and passed legislation to provide a foundation for promoting growth and development of the industry. The Tourism Act of 1976 provided for the licensing of tourism sector enterprises, thereby enabling government to control development of the industry, and defined the powers and responsibilities of the Minister of Labor, Commerce and Industries (LCI) who is responsible for tourism. The Tonga Visitors Bureau (TVB) comes under the Ministry of LCI. The Industrial Development Incentives Act of 1978 (IDIA) was designed to stimulate domestic and foreign investment in manufacturing and in tourism prime facilities, the latter including hotel, resorts and other accommodations, and tourism attraction facilities. The government's infrastructure development program has also increasingly addressed the needs of tourism, especially the expansion and upgrading of Fua'amotu Airport, which in the next few years will gain a new terminal and runway extension.

Although government has been supportive of tourism development, there is a need for more definitive policies and strategies to guide development. These should be reflected in a current tourism development master plan. With respect to industry-government relations, there is also a need to strengthen linkages to provide industry the opportunity for effective input into the policy and planning process. To this end, industry has recommended the establishment of the Tonga Tourist Board, half of whose membership would be private industry representatives, to advise the minister responsible for tourism.

Anticipated Growth in Tourism

With the planned runway extension, a new passenger terminal, and other Fua'amotu Airport improvements scheduled to be completed by 1992, government anticipates annual growth in air visitors to average about 10 percent. With average growth of 4 percent per annum pending completion of airport improvements, about 30,000 air visitors are projected for 1995. However, projected growth is likely to be adversely affected if little or no growth in international standard accommodations occurs. Other significant constraints which need to be addressed include: (1) shortage of capital, land and entrepreneurial/management skills; (2) lack of direct air access from major existing and potential markets; (3) lack of tourist attractions to draw holiday visitors; (4) poor access and communications with outer islands; and (5) weak linkages between private sector and government in policy formulation, promotion and planning of tourism development.

Stimulating Increased Investment in Tourism

Government Policy and Programs to Promote Investment

The promotion of tourism sector investment is part of the government's overall effort to promote industrial development, and therefore the fiscal and other incentives made available under the Industrial Development Incentives Act (IDIA) of 1978 apply to tourism "prime facilities" as well. Prime facilities include hotels, motels, resorts and other accommodation, including vessels with cabin facilities used in Tonga, and tourist attraction facilities such as golf courses, parks, tropical gardens, and sightseeing facilities. The government has explicitly stated that it "welcomes foreign investment which brings capital, employment, technology, managerial know how, and access to overseas markets." A generous set of fiscal and other incentives are stipulated in the IDIA. These include: income tax holiday, tax exemption on dividends, carry forward of losses, accelerated depreciation, exemption from customs duties on imported capital goods, repatriation of profits and other forms of return, residential visas, and other incentives. While foreign investment is welcome, the government has expressly stated its preference for local equity participation, that is, the establishment of joint ventures. The investment and other incentives are available to both domestic as well as foreign investors.

Regardless of whether an investor or enterprise intends to seek specific incentives, it must apply for a Development License (DL) to operate an industrial enterprise or tourism prime facility. Existing enterprises seeking to expand as well as new enterprises must also obtain the DL. An application for a DL is reviewed by a committee, which recommends approval or disapproval based on criteria relating to the economic benefits expected to accrue to the kingdom if the enterprise is established. The applicant enterprise must specifically request the incentives it needs in its application, and these are also reviewed by the committee. The Minister of LCI approves or disapproves each application for a DL.

Domestic Investment

Since enactment of the IDIA in 1978, 41 DLs have been issued to domestic wholly owned tourism facilities. Unfortunately, data on the total amount of investment entailed in these 41 enterprises were not available. However, low household incomes and savings rates, together with data on the amount of lending from the Bank of Tonga (BT), the kingdom's only commercial bank, and the Tonga Development Bank (TDB), indicate that domestic investment in accommodations has been relatively low. In the four-year period 1985-1988, the TDB made tourism sector accommodations development loans of about TS3.3 million. Over TSl.O million of this amount was for two projects, one of which entailed refurbishment and therefore no increase in rooms. None of the bank's loans was for joint venture purposes, thus all were assumed to go to domestic enterprises. Term lending from the BT to the tourism sector has been negligible. Since 1984, such lending is estimated to have been less than TS0.25 million per annum.

It has been estimated that with only moderate growth of 7 percent per annum in air visitors, capital requirements for expanding and replacing accommodation facilities would amount to between TS3.75 and TS4.0 million per annum. While accommodations did increase by some 104 units between June 1985 and December 1988, some of these were funded through foreign investment (including joint ventures), and virtually all units were in smaller scale, budget facilities. The major constraints to increased domestic investment in tourism are a shortage of funding available from both the Tonga Development Bank and the Bank of Tonga, and to a lesser extent (at least in the near term) a lack of entrepreneurial and management skills. Term lending for commercial purposes by the Bank of Tonga has been minimal, largely resulting from a legal interest rate ceiling which is out of line with foreign rates and domestic inflation which has encouraged investment of bank assets abroad and discouraged domestic savings and lending.

Foreign Investment

Since 1978,17 DLs have been issued to joint ventures involving foreign investment, and 8 DLs to foreign wholly owned ventures. While the total amount of foreign investment is not known, for the period 1984-1988 the amount of foreign investment placed in 7 joint ventures and 2 foreign wholly owned ventures totalled about TS1.27 million. This level of investment has not been very significant in relation to estimated expansion requirements, even at an assumed rate of growth of only 7 percent per annum in air visitor arrivals. Those factors which have constrained growth of the industry undoubtedly have negatively impacted foreign investment as well: poor air access from major tourism markets, lack of tourist attractions, weak industry-government linkages in relation to tourism policy and promotion, and poor interisland transportation and communications. However, significant growth in air visitors and budget accommodations since 1984 indicates the potential for greater foreign investment, especially in the accommodations sector.

The lag in increased investment despite the available fiscal incentives is believed to be the result of several constraints which include: difficulty in obtaining land; lack of joint venture opportunities; and absence of well-defined policy on the role of foreign investment. With respect to land availability, under the Tongan land tenure system foreigners typically can obtain land only through leasing. Most Tongans (males 16 and older) acquire land by inheriting it from their fathers. However, with a finite amount of land and growing population, many of those eligible for land allotments have not been able to obtain land. This shortage, in a society which places a high sociocultural value on land, makes it especially difficult for outside investors to acquire land without the intervention of government. In regard to joint venture opportunities, government recognizes the long term benefits to Tonga of having local participation since this is likely to facilitate both the transfer of technology and management skills to residents and maintain a greater degree of domestic control of the industry. However, lack of domestic capital and little or no availability of local institutional lending for tourism joint ventures have been major constraints. There has also been an inadequate effort to identify and promote joint venture opportunities and to provide technical and management services to facilitate formation of such ventures. While manufacturing development has been well supported through government provision of land, factory space and associated infrastucture, the same has not been true with tourism prime facilities. Although government has expressly favored joint ventures, bank funding has not been available. To create a positive climate for tourism foreign investment there is a need for industry and government to agree upon an explicit strategy for promoting such investment. Issues such as the scale of facilities, objectives in terms of local participation, rate of growth, and geographic distribution of activity should be addressed.

Policy Recommendations

Policy recommendations to the Government of Tonga have been grouped into six subject areas. The recommendations are summarized below with discussion and complete text being provided in Section 3.0.

A. Formulate a Specific Policy on Tourism Foreign investment

(Al) Formulate a policy specifically for foreign investment in tourism, defining goals and objectives of investment, kinds of facilities and operations desired, criteria with respect to local participation, and assistance to be made available.

(A2) Include a statement of policy in the Tourism Development Master Plan. The process of formulating tourism policy should include tourism industry representation via the Tonga Tourist Board.

B. Encourage Increased Bank Commercial Lending to Tourism

(Bl) Consider the elimination of the ceiling rate of interest on commercial loans and seek to maintain a structure of interest rates consistent with domestic investment demand and savings. As major shareholder and depositor in the Bank of Tonga, government should encourage greater volume of commercial term lending.

C. Expand Capacity of Development Bank to Assist Formation of New Enterprises

(Cl) Consider the implementation of policy and corresponding institutional changes at Tonga Development Bank to enable an increase in its capital base and actively identify joint venture opportunities in tourism. With expanded responsibilities, the bank also could assume a more active role in taking equity positions in tourism joint ventures.

D. Assist in Formation and Development of Small Businesses

(Dl) Establish a small business development and training program which would include short-term skills and training courses for beginning and established entrepreneurs and management staff in tourism-related activities.

(D2) Seek technical and financial assistance from external agencies such as UNDP/WTO or TCSP in structuring and operating the small business development and training program.

(D3) Increase technical and management services support to tourism investors, and expand programmatic support to include the identification and promotion of new tourism ventures.

E. Facilitate Acquisition of Land for Tourism Facilities

(El) Develop one or more recreational estates which would provide serviced sites in suitable location(s) for hotel/resort and other tourism facilities.

Site parcels would be made available to investors under long-term government leases.

(E2) Involve industry and communities in the selection of locations for recreational estates. This process should be included in the preparation of the Tourism Development Master Plan.

(E3) Implement a distinct site acquisition assistance program for those investors seeking single sites in locations having specified characteristics, such as islets or beaches on larger islands. Services would include identification of candidate sites, determination of availability and ownership of sites, negotiation of lease terms, and government acting as an intermediary to provide long-term leases.

F. Review Industrial Development Incentives Act for Possible Revision

(Fl) Review the fiscal incentives available to investors under the IDIA to determine whether the number of incentives, benefit rate, and period applicable could be reduced without significantly affecting the level of foreign investment.