PIDP

Pacific Islands Development Program

ECONOMIC REPORT No. 1

FIJI: ECONOMIC ADJUSTMENT 1987–91

by
Mark Sturton
Andrew McGregor

EAST-WEST CENTER

Fiji: Economic Adjustment, 1987-91

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Andrew McGregor

April 1991

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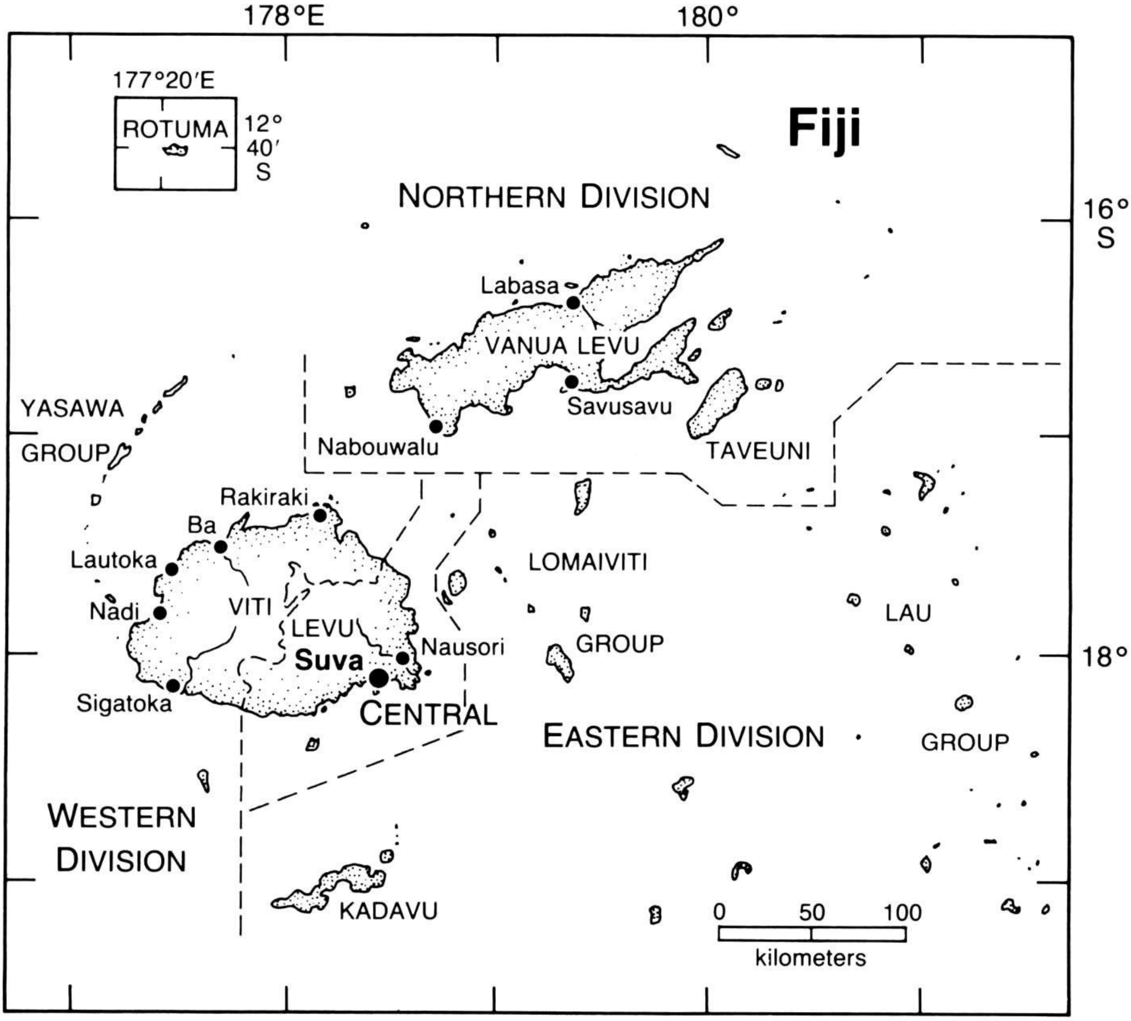
Foreword

This report is the first in a series of country reports relating to the Pacific island economies. The series is intended to fill the existing gap of available material about economic performance, policy, and prospects in the region. Because the economic survey reports issued by international agencies often have a restricted circulation and are not in the public domain, PIDP's new series is designed to improve the awareness of the economic problems and circumstances facing the Pacific island countries today.

The new series will follow a standard format with parallel discussions of economic performance for the island countries. Subjects include analysis of economic growth, sectoral performance, inflation, monetary developments, fiscal policy, and the external sector. Economic prospects for the future are also discussed. In concluding, special sections highlight important economic policy and development issues.

Sitiveni Halapua
Director
Pacific Islands Development Program

Map of Fiji



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Executive Summary

This publication is the first in a series of economic reports on Pacific island countries. This particular report is intended to provide a thorough analysis of the current economic developments in the Fiji economy since the political disturbances of 1987. These events not only precipitated an economic crisis but also marked a radical reorientation of economic policy. Fiji's economy demonstrated a remarkable ability to recover from an adverse set of circumstances and to experience substantial growth in late 1989 and 1990.

After its near collapse in 1987 and early 1988, the economy was successfully stabilized by the implementation of policies of fiscal adjustment, currency depreciation, and foreign exchange constraint. The large depreciation was coupled with strong restrictions on nominal wage movements and the promotion of the Tax Free Factory scheme (TFF). The latter coincided with significant changes in the South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA). All of these elements led to Fiji's strong economic recovery. However, even though the economy showed rates of growth not experienced since the 1970s, domestic investment was minimal.

In mid-1989 the government announced its new economic policies of deregulation, which entailed the replacement of import licensing with a streamlined tariff system. Maximum rates of nominal taxes are to be reduced progressively from a maximum of 50 percent until a new limit of 20 percent is reached in 1993. The high rates of direct taxes are to be reduced, and a broad based value added tax is to be introduced in 1992. The deregulation of the labor market is also a major element of the new policy with a shift toward wage settlements based on productivity rather than on cost of living adjustments. With the successful implementation of these policies and with the return of domestic investment, the economy should be positioned for a period of sustained growth.

During 1987-91 the Fiji economy has experienced important economic diversification, which has helped reduce the structural weakness in the economy. However, sugar still remains the backbone of the economy, and the long-run future for this industry gives some cause for concern.

This report on Fiji discusses and analyzes all these developments in detail. In addition, discussion is devoted to economic growth, sectoral performance, savings and investment, inflation, monetary developments, fiscal policy, and the external sector. Each section analyzes recent developments, new policy, and prospects for the future. The report concludes with a discussion of development issues and economic policy.

Introduction

Economic performance in the 1970s

Throughout most of the 1970s the Fiji economy performed well for a small open economy, despite underlying structural weaknesses. It enjoyed steady growth while job creation more than kept pace with the increased labor force. The balance of payments was healthy and foreign debt was low. The government initiated major power and water supply projects, and the standard of social services continued to improve while internal balance was maintained. The success of the Fiji economy during this period can largely be attributed to the growth of tourism in the early 1970s, the expansion of the sugar industry in the mid-1970s, and the commencement of large infrastructure projects at the end of the decade. Figure 1 indicates the trends in GDP and GDP per capita from 1970 to 1990.

The tourism boom, which began in the mid 1960s, drove the economy until the impact of the world recession in 1974. In response to high prices and the considerable investment in agricultural infrastructure, sugar production expanded substantially. By the end of the 1970s sugar production had grown to over 40 percent above the level reached in the earlier part of the decade, and export earnings had quadrupled. Because of the smallholder structure of the sugar industry, expansion was accompanied by high rates of employment generation and high net additions to foreign exchange.

A major structural weakness of the economy was the concentration of economic activity in tourism and sugar. Attempts at diversification

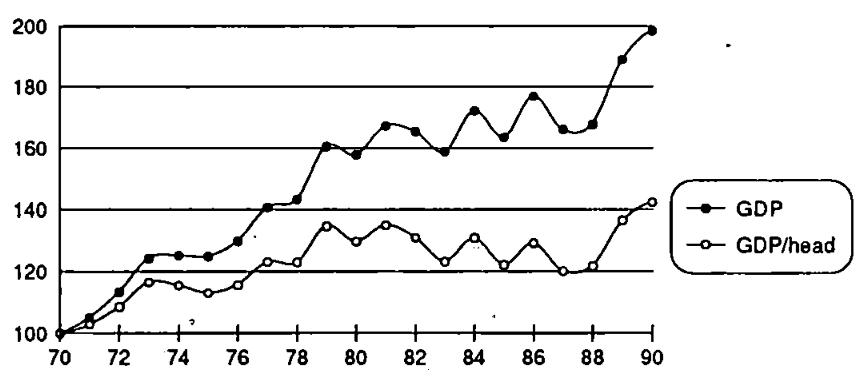

Figure 1. GDP and GDP per capita growth (1970=100), 1970-90

Source: Bureau of Statistics, Current Economic Statistics, July 1990.

led to investment in a substantial pine plantation, a tuna fishing industry, and hydroelectricity production. However, these endeavors did not lead to any significant reduction in the concentration of economic production. Elsewhere in the economy performance was lackluster, non-sugar agriculture made little progress, and industrialization was insignificant.

Economic growth was supported by macroeconomic policy, and fiscal policy responded to increased public expenditures. New revenue measures were introduced, and the public sector deficit was held at a sustainable level. Public sector borrowing was financed mainly from non-bank sources, thus minimizing the inflationary pressure as well as supporting the balance of payments equilibrium. During the latter half of the 1970s the wage growth moderated and grew in line with cost of living increases that occurred after the Tripartite Forum (government, trade unions, and employer's federation) was established. Thus, the rapid growth in wages that was experienced in the early 1970s was avoided.

Developments during the early 1980s

The inherent fragility of the Fiji economy became apparent in the early 1980s when the sugar industry growth faltered due to a series of natural disasters and a prolonged depression in world prices. A slight recovery was made in the tourist sector, and the performance of non-sugar agriculture improved. Measures to encourage import substitution behind protective tariffs were established, which led to high rates of effective protection in many activities. However, these developments compounded the stagnation in the sugar industry. The high level of public investment in infrastructure projects was not sustained into the mid-1980s. Meanwhile, private investment contracted.

Consequently, the first half of the 1980s was a period of erratic overall growth, which averaged less than 1 percent. The labor force growth exceeded the rate of job creation, and per capita income fell. Public consumption continued to grow primarily from wages and debt servicing, with the burden of adjustment being placed on the government's capital budget. Under these circumstances the emphasis on monetary policy was directed at containing inflation and protecting foreign reserves by curbing domestic credit and raising real interest rates.

The economic upturn of 1986

By the end of 1986 the economy was showing signs of significant improvement and recorded a real growth of 8.3 percent. The terms of trade had moved significantly in Fiji's favor with improving sugar prices and declining fuel oil prices. Sugar production increased due to favorable weather conditions, and tourist arrivals experienced a marked upward trend. Gold production underwent substantial improvement, and manufacturing output expanded. With the initial investment in pine during the 1970s reaching fruition, the prospects for the economy were favorable for the first time during the decade. Selected economic indicators for 1986-90 are shown in Table 1.

During 1986 the balance of payments had improved significantly, showing an approximate balance on the current account, and gross foreign reserves reached an equivalent of 4.5 months of imports. During the year the Fiji dollar was depreciated by 5 percent to improve the competitiveness of the economy, which had deteriorated in the early part of the 1980s. However, investment demand remained weak, and with a favorable balance of payments situation the authorities attempted to reduce real interest rates to encourage long-run capital formation.

Post-coup developments

The favorable trends of 1986 continued into the first quarter of 1987 when the coups of May and September changed the economic climate, dramatically plunging the economy into an unprecedented financial

Table 1. Selected economic indicators, 1986-90

		1986	1987	1988	1989	1990
Economic activity						
GDP at constant prices	% increase	8.3	-6.1	0.8	12.5	5.3
Employment	'000s	79.9	78.2	77.7	88.2	89.8
Sugar production	'000 tonnes	502.0	401.0	363.0	461.0	460.0
Tourism	% increase	5.3	-20.0	12.5	27.8	8.7
Money and prices						
CPI	% increase	1.8	5.7	11.9	6.1	7.9
Money supply (M3)	% increase	16.7	3.8	20.6	10.4	22.4
Private sector credit	% increase	5.1	7.1	4.3	31.6	24.2
External sector						
Current account	F$ million	-8.0	-7.0	56.0	51.0	-42.0
Overall balance	F$ million	23.0	-63.0	88.0	-4.0	85.0
Debt service	% exports	15.5	17.8	14.2	11.4	11.0
Import coverage *	months	4.6	5.0	6.0	4.5	n.a.
Fiscal						
Deficit	F$ million	63.3	71.8	6.3	40.8	3.9
Deficit	% GDP	4.8	5.5	0.5	2.6	0.2

Sources: Bureau of Statistics, Current Economic Statistics, July 1990; Reserve Bank of Fiji, Quarterly Review, June 1990; Ministry of Finance, Government Budget Supplement 1991.

* The number of months imports covered by net foreign assets.

crisis. An immediate outflow of capital occurred, and tourist arrivals plummeted. Sugar production fell sharply as a result of a delayed harvest and a severe drought, further exacerbating the severe pressure on foreign reserves and bank liquidity. The Reserve Bank of Fiji took decisive action. In 1987 the Fiji dollar was devalued twice, totaling 33 percent against a basket of currencies. Stringent exchange controls were imposed, and the ceiling was removed on interest rates, which rose to unprecedented levels. In addition, the salaries of civil servants were reduced by 15 percent, and the grants to public sector corporations were severely cut. Thanks to these measures, the financial situation was stabilized by the end of the year, with the external accounts returning to balance and bank liquidity improving rapidly.

While a degree of financial stability had been restored by the end of 1987, the economy had contracted by 6.1 percent. Paid employment had fallen, and business was at a low ebb. Weak labor conditions and the contracting economy kept inflation low, and the consumer price index (CPI) recorded a 6 percent rise. (With sugar production declining by 20 percent, tourism by 26 percent, and investment by 42 percent in nominal terms, together with a drop in money wages and the deflationary impact of a 30 percent devaluation, the GDP is likely to have fallen even further than the official figures suggest.)

Economic recession in 1988

Throughout 1988 the economy remained in deep repression and GDP remained at its 1987 level. Sugar production fell further, reflecting the aftereffects of the 1987 drought, although tourism showed some recovery and gold production was buoyant. Anticipating severe economic conditions government enacted an austere budget. However, revenue proved to be more resilient than anticipated and the deficit fell from 5 percent of GDP in 1986 and 1987 to 1 percent in 1988. During the year the lack of confidence in the economy resulted in a large excess of savings over investment as inventories were run down, and investment demand vanished, which translated into a growing level of excess liquidity and a buildup of foreign reserves. Ironically, the feared financial crisis of one year earlier turned into a comfortable external position, albeit one in which the real economy faltered.

Recovery in 1989

During 1989 the economy saw a remarkable export-driven recovery and reorientation of policy. GDP grew by 12.5 percent, which represented an increase of 6 percent on pre-coup levels in 1986. Paid employment expanded by 13 percent. While sugar remained at 8 percent below its 1986 level, timber production, fish, gold, and tourism all were substantially above the 1986 levels. Of most significance was the very rapid expansion of Fiji's garment industry. Exports of $5 million in 1986 recorded $101 million in 1989, which was 16 percent of total merchandise exports. The emerging new structure of Fiji's export industries is shown in Figure 2.

Deregulation

When the 1989 mid-year mini-budget was developed government announced its new economic strategy—the thrust of development was to be achieved through export-led growth. The mini-budget provided for the gradual deregulation of the economy and the elimination of Fiji's import-substitution protective policies that had dominated development in the early 1980s. These measures were to be coupled with tax reform to promote economic efficiency, deregulate the labor market, and restrain government expenditure in order to avoid the crowding out of private sector development.

These policies—together with the establishment of tax-free zones to encourage manufacturing for export and the large real devaluations of 1987 that amounted to 25 percent—helped Fiji to rebound from the severe economic crisis it suffered in 1987 and 1988. However, although the new policy orientation clearly was appropriate and in the best interest of Fiji's development, the large imbalance between savings and investment remained. Demand for long-term investment credit remained minimal, and although production levels were nearing capacity, the extension of the capital stock upon which future growth depends was absent. Political uncertainties prevailed, and the business sector found Fiji to be a less than secure environment for future investment.

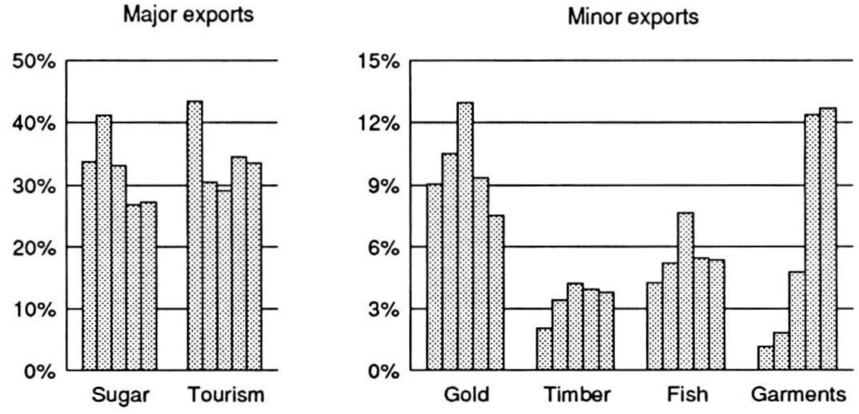

Figure 2. Structural change in exports, 1986-90 (percent of total exports)
Source: Ministry of Finance, Budget Supplement 1991.

Developments in 1990 saw the 1989 trends continue, but at a slower pace. Growth continued in most sectors and policy continued to emphasize economic efficiency, although few new measures were introduced. While strides were being taken in policy, the political environment still failed to encourage domestic investment even though foreign interests were investing in a sizable extension of the tourism infrastructure.

Economic Growth, Sectoral Performance, and Employment

During 1990 the Fiji economy continued to recover and expand as it had in 1989, and experienced real growth of 5 percent. Total paid employment grew by 1 percent, which was a considerably lower rate of expansion than the 13 percent that was recorded in 1989. The production levels of many of the leading economic sectors remained unchanged. Sugar, gold, and coconut production showed no growth; however, fishing, timber, tourism, and garment production reached new heights, but grew at a slower pace than in 1989. Figure 3 shows the economic growth in sugar, tourism, and manufacturing since 1981. Table 2 indicates constant price GDP growth by economic sector since 1986 and also includes projections for 1991.

Sustained economic growth and continued expansion in employment are expected over the next few years. This prospect will, however, be contingent on a peaceful return to parliamentary democracy in 1991. The re-emergence of domestic investment, which is a crucial condition for long-term growth that has been absent since 1987, will be dependent on the acceptance of the new constitution by Fiji's entrepreneurial class. At this point the outcome is unclear. Real economic growth of 3.5 percent is predicted for both 1990 and 1991.

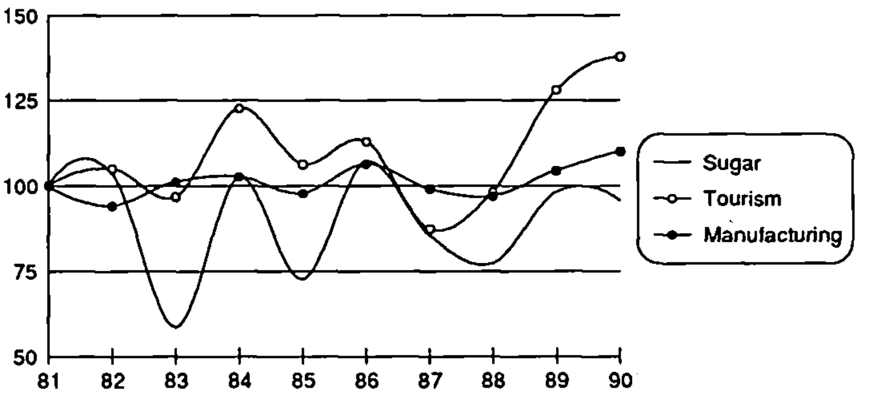

Figure 3. Comparison of sugar (tonnes), tourism (visitor days), and manufacturing output (production index) (1981=100), 1981-90

Source: Bureau of Statistics, Current Economic Statistics, July 1990.

Table 2. Constant price GDP, 1986-91 (percent change)

	1986	1987	1988	1989	1990*	1991**
Agriculture, forestry & fishing	19.1	-6.8	-2.4	12.3	2.7	2.2
Mining & quarrying	53.1	0.0	46.2	0.0	-5.3	0.0
Sugar manufacturing	47.2	-20.1	-9.4	27.0	-0.3	2.3
Other manufacturing	8.3	-6.7	3.0	5.6	7.7	3.9
Electricity	7.4	-1.1	6.7	6.3	3.0	2.9
Construction	5.0	-14.7	-23.2	31.7	5.5	6.3
Wholesale & retail trade	6.8	-11.2	10.3	24.8	16.0	6.1
Hotels	9.0	-25.0	9.5	23.2	6.6	6.2
Transportation & communication	-0.6	-2.3	7.9	15.1	5.1	5.1
Finance, insurance, etc.	0.8	-3.4	0.8	3.1	1.6	1.8
Community & social services	-0.8	4.4	-1.2	2.5	1.0	1.1
GDP at factor cost	8.3	-6.1	0.8	12.5	5.3	3.5

Source: Bureau of Statistics, Current Economic Statistics, July 1990.
* Estimated.
** Projected.

Sugar industry

The export value of sugar and molasses will be less than $240 million, compared with $255 million in 1989. The 1990 sugar production is expected to be around 405,000 tonnes, compared with 461,000 tonnes in 1989. The harvest for the 1990 season extended until February, which is two months later than the normal season. The delay was the result of an industrial dispute over the new cane contract (the Master Award) as well as unseasonably wet harvesting conditions. As a consequence, the tonnes cane/tonnes sugar (TC/TS) ratio by the end of the season had reached the highly inefficient and unprecedented level of around 16. The TC/TS ratio for the season will be around 10, compared with 8.9 for the previous year, which was high by historical Fiji standards. Production probably would have exceeded 470,000 tonnes (approaching the record level of 1986) had harvesting not been delayed. The total loss from the avoidable delays is expected to exceed $20 million.

World sugar prices showed improvement toward the end of 1989, reaching US$0.14/lb. However, these price increases were not maintained into 1990 as had been predicted by the World Bank and other forecasting agencies. During 1990 world market prices stabilized at around US$0.10/lb.

Production expected to remain at current levels

Sugar production is expected to remain at current levels, provided the start of the harvest is not delayed again. However, the sugar industry currently is in an unsettled state and further disputes could be expected. The late finish to the 1990 season will have some adverse effect on 1991 production through soil compaction and a shortened growing period.

Real decline in prices expected

A real decline in Fiji sugar prices can be expected over the next few years. World sugar prices are likely to remain in the range of US$0.08-US$0.15/lb., as has been the case since 1988, and not reach the higher levels suggested by World Bank forecasts. The relative stability of world sugar prices at modest levels can be explained by the structural shift in world demand toward large developing country buyers, such as China, who are more sensitive to price. Such countries tend to leave the market if prices exceed around US$0.12/lb. and reappear when they fall below US$0.10/lb. Thus, while world stocks are relatively low in historical terms (below 30 percent of world consumption), an upward trend in prices cannot be expected. This situation could change dramatically if catastrophic events should occur in a large sugar-producing country.

The price received for the 174,000 tonnes of sugar sold under the Lomé Convention should remain at about US$0.15/lb. despite the pressure being put on the European Commission to reduce the Lomé price by 2 percent. The volume of Fiji sales to the United States will continue to decline with shrinking U.S. sugar imports (now less than 2 million tonnes annually). Fiji has 7 percent of the U.S. global quota, amounting to 14,932 tonnes in 1990-91 compared with 23,490 in 1989-90. At the end of 1991 the U.S. Sugar Act expires. Fiji can then expect to lose a high-price preferential, albeit shrinking, export market. However, the expected movement of the U.S. to a more free trade sugar policy should have a beneficial impact on free market prices.

Copra and cocoa

The coconut industry has not recovered from the sharp decline in copra production in 1987. Copra production in 1989 was 13,400 tonnes and is expected to be about the same in 1990. Despite the absence of any major cyclone since 1985, production has decreased by approximately 50 percent in the past five years. Growers have found that prices paid for copra, although heavily subsidized by government, are not high enough to attract people to grow copra let alone engage in the necessary replanting. In September 1990 the world coconut oil price was US$284/tonne compared with an average price of US$517/tonne in 1989 and US$565/tonne in 1988. Cocoa, the major complementary crop to coconuts, has not faired much better in the face of depressed prices, poor farm management, and inefficient marketing by government's National Marketing Authority.

While the overall Fiji economy will continue to enjoy sustained growth, the coconut-producing areas will remain depressed. Cocoa exports are unlikely to exceed 500 tonnes by 1992 while subject to the prevailing management and expected prices. Further decline is expected in copra and coconut oil production in the face of depressed prices and in the absence of any past systematic replanting. However, some replanting should commence with the expected availability of high-yielding hybrid coconut planting material.

Food crops

Root crop production has enjoyed strong growth in recent years and is expected to continue to grow. During most of 1990 a major diversion of taro production to export markets occurred to take advantage of the exceptionally high prices that resulted from the cessation of Western Samoan taro exports following Cyclone Ofa. This diversion led to a sharp increase in domestic root crop prices, which have since subsided to more normal levels as Fiji's taro exporters again find themselves to be uncompetitive with Western Samoa.

The production of rice, the other major staple, has been very disappointing. Production in 1990 is estimated at 27,000 tonnes, a 15.5 percent drop over the previous year, which is barely 50 percent of consumption requirements. Future growth prospects are expected to be sluggish at best, with the continuing disappointing yield performance of the irrigated rice projects and the reduction of land that was devoted to rainfed rice.

Niche exports

High-value niche agricultural export commodities such as fresh and processed ginger, papaya, vanilla, floriculture products, and coffee for specialty markets are expected to grow in importance. These products take advantage of Fiji's climate, southern hemisphere location, and relatively pest-free and unpolluted environment, and have linkages with a growing tourist sector (which provides outward freight capacity and markets).

Ginger and fresh fruits and vegetables are likely to be the most significant crops in the immediate future. The value of ginger exports in 1990 was estimated at $7.3 million, compared with $5.4 million in 1989 and $3.1 million in 1986. Fresh fruit and vegetable exports in 1990 had an estimated value of $6.4 million, compared with $3.8 million in 1986. A substantial new market has been established for processed ginger in Japan and scope exists for substantial expansion in fresh ginger exports to North America. If production and quality constraints can be overcome, exports exceeding $10 million are achievable. However, the institutional and organizational structure of the industry remains weak as do quality standards and their enforcement. The encouraging participation of private investors in papaya development suggests that export potential of this crop may be realized. A necessary requirement for the immediate future will be the introduction of new generation, commercially operated, post-harvest treatment facilities.

Timber industry

Fiji has significant indigenous hardwood resources and has made substantial investment in pine and hardwood plantations over the last two decades. The marketing focus has been directed toward the supply of multi-purpose wood products for the heavily protected local market. Timber exports in 1986 were only $6 million. In 1987 a major shift in market orientation occurred. The domestic timber market essentially disappeared with the collapse of the construction industry, and exporting became imperative for survival. Exports increased more than fivefold to almost $37 million in 1990. This increase was facilitated by the commissioning in 1987 of a $50 million pine-processing plant and by the temporary lifting of the ban on indigenous log exports, which was subsequently reimposed. The total log harvest has increased from 195,000 m^3 in 1986 to an estimated 493,000 m^3 in 1990.

Notably, no logs were exported in 1990 following the reimposition of a government ban (log exports reached a peak in 1986 when 40,000 m^3 were exported.) Since the commissioning of the pine-processing facilities at Lautoka, pine chip production has continued to increase, reaching 170,000 m^3 in 1989. The estimate for 1990 is 186,000 m^3. However, export earnings have remained stable due to a reduction in the world market price for chips. In contrast, world sawn timber prices increased significantly, partly in response to conservation policies adopted by Asian-Pacific log producers. However, the financial problems of Fiji Forest Industries are a continuing concern for the development of the indigenous hardwood industry.

The forestry sector can be expected to grow over the next few years, but the sector requires major structural change. The region will encounter substantial softwood surplus as the Chilean, New Zealand, and Australian plantations come on stream. This market development could swamp the Fiji industry unless corrective action is taken to exploit Fiji's comparative advantage. The future lies in the export of high-quality specialty timber and in secondary processing, such as furniture, and not in volume mass market timber. Fiji has the resource base of species (pinus caribaea, mahogany, and several indigenous hardwoods) as well as the cost structure to develop a sustainable forestry sector that is as important as the sugar and tourist industries.

Fishing industry

Fish exports showed strong growth in 1990 and are estimated to reach a record $52 million in 1990, compared with a record $44.5 million in 1989 and $25.1 million in 1987. The value of tuna exports in 1990 will exceed $45 million in 1990, compared with $39 million in 1989.

Canned tuna exports have experienced rapid growth over the last few years, after a period of prolonged stagnation. The catching conditions have been good, and expansion at the cannery that is due to be completed by the end of 1991 is underway. Canning capacity will increase by about 50 percent. Fiji's quality tuna product has become highly competitive, and a significant market share has been established in the United Kingdom where Fiji enjoys a 24 percent duty preference under the Lomé Convention.

A major development in 1990 was the rapid expansion of fresh fish exports. Of particular significance was the export of sashimi yellowfin tuna to Japan, taking advantage of the introduction of the Air Pacific service to that market. Sashimi tuna exports in 1990 are estimated by government to be about $10 million. Further growth is anticipated with the expected commencement of a second Air Pacific service to Japan in 1991 and the possibility of a service to South Korea in 1992.

Canned tuna production is expected to stabilize at the 20,000 tonne mark over the next five years. The average value of sales is expected to be around $40 million due to a decrease in prices as catches increase from the eastern Pacific and Indian Oceans and sluggish demand. However, Fiji will maintain its market share because of the quality of its tuna and its preferential access to the U.K. market. The export of miscellaneous marine products may show some decline over the next few years. The level of bottom fish exploitation is thought to have reached its capacity while the current bêche-de-mer exports are above the sustainable level.

Gold and minerals

Gold production from the Vatukoula field showed strong upward growth in the late 1980s and reached 4.2 tonnes in 1989 and 4.1 tonnes in 1990, compared with 2.9 tonnes in 1985 and 1986. This increase can be attributed to the improved management that was introduced with the new joint venture partner, Western Mining Corporation (WMC) of Australia, together with the opening of a new shaft that provided access to a rich ore deposit. Thus, the January 1991 announcement of WMC's withdrawal from the joint venture was a major disappointment. It also was surprising considering the company's operating profit of A$8 million on its Fiji operation in 1989-90, which followed a A$7.6 million profit in the previous year.

The value of gold exports in 1990 is estimated to be $73 million, compared with $76 million 1989 and $82 million in 1988. In the last quarter of 1990 the gold price was US$380/oz., compared with US$407/oz. during the first quarter. The average gold price in 1989 was about US$381/oz. During the year the Vatukoula gold mine's workings extended to rich nearby deposits. Mineral exploration activity, which abated somewhat in 1989, showed an increase in 1990 with expenditures of about $6 million.

A modest increase in gold production is expected in 1991 and 1992 from the existing Vatukoula mine provided an industrial dispute that commenced in February is not prolonged. Gold production in 1991 is projected to exceed 5 tonnes, with an estimated export value of $80 million. One new small project, Mt. Kasi (on Vanua Levu, the second main island), could come into production by the end of 1992. The Mt. Kasi project would produce approximately 1 tonne of gold annually.

An upturn in gold exploration is expected, with $6 million in expenditure projected for 1991. Renewed interest has been expressed in the large Namosi copper mining prospect by Placer Pacific Ltd., operators of the large Porgera mine in Papua New Guinea. Significant increases in copper prices are expected over the next few years. The same company recently discovered a new gold prospect in Vanua Levu where drilling results showed extensive intersections (at 50m) of low-grade gold mineralization. Oil exploration, after years of stagnation, shows signs of revival and is likely to be further spurred on by the Middle East crisis.

Manufacturing

In 1987 government actively promoted a Tax-free Factory (TFF) Scheme to restore investor confidence. This scheme coincided with the significant changes that were made to the South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA), which improved the access of Fiji manufactured goods to the Australian and New Zealand markets. Australian and New Zealand garment manufactures responded rapidly. Fiji now supplies some of the best known brand names in Australian and New Zealand garments. The Fiji garment export industry operates on a "cut-make-trim" basis whereby raw materials and patterns are supplied by the buyer, who often is a joint venture partner.

Since the inception of the TFF scheme until the end of 1990, 253 projects have been approved. Of the 113 projects implemented 74 (65 percent) were in the garment sector. Forty-nine percent of the projects are locally owned, 20 percent are local/foreign joint ventures, and 31 percent are totally foreign owned. The fact that most of the tax-free enterprises are locally owned or are joint ventures is an unusual feature of the Fiji TFF sector. Most local enterprises are owned by Fiji-Gujarati entrepreneurs who often are in joint ventures with New Zealand and Australian investors. Investors from these two countries account for almost 75 percent of the foreign investors. Some developing countries such as South Korea, Malaysia, Hong Kong, and Singapore also have some investment in the tax-free sector. Newly approved projects indicate that the investment base is being widened with new firms from Canada, China, Italy, and West Germany. Ethnic Fijians are marginally involved in the operation of tax-free enterprises, although with government's major initiatives encouraging Fijian participation in the commercial sector, this involvement might increase.

The total new investment in the TFF in the first three quarters of 1990 was $12.6 million, compared with $20 million in 1989 and $13.7 million in 1988. Significantly, 62 percent of the new investment in 1989 was in the garment sector, compared with only 42 percent in 1988. This increase reflects a willingness of garment manufacturers to make some investment in new factory space, which was not the case in the previous two years.

A 40-hectare industrial estate project financed by the European Economic Community (EEC) is planned for the Suva area in 1991. Thus, for the first time in the scheme, government will be involved in making factory space available to export manufactures along the lines of a traditional export processing zone. Yet despite this development, indications are that Fiji is now entering a much more modest phase of export manufacturing expansion.

Employment growth in the TFF scheme has been rapid. By the end of 1990 there were 9,600 jobs in the sector, compared with 4,200 in 1988. TFF jobs currently make up 46 percent of manufacturing employment. The garment industry dominates employment, accounting for 8,000 jobs (83 percent). The wage rates in the tax-free sector are low by international standards. The average unskilled worker earns about $0.75 per hour and skilled workers earn about $1.00 per hour. Wages in the garment industry are also lower than in other types of tax-free production. Hourly wages of $0.50 per hour are common in garment factories with unskilled workers being paid as little as $0.35 per hour. Other conditions of work vary greatly among factories. Some factories, however, are in contravention of established rules governing industrial production. During 1990 these working conditions have been the source of a number of strikes.

Garments biggest export after sugar

The gross value of garment exports in 1989 was $100.7 million and is estimated to reach $123 million in 1990, which would make garments Fiji's second largest export earner after sugar. However, import requirements are approximately 40 percent of sales. Most exports are directed at the New Zealand market and, to a lesser extent, the Australian market. In both cases, the existence of SPARTECA has been crucial. However, the current recession in Australia and New Zealand is adversely affecting the demand for Fiji garments. Fiji also now faces a loss of SPARTECA quota in Australia as other Forum Island Countries (FICs) exercise their entitlement. Garment exports to the United States also are important, currently accounting for 10 percent, and are likely to increase significantly along with the increase in the "voluntary" quota on nightwear exports from Fiji.

Wood and furniture

The wood and furniture sectors continue to grow under the TFF scheme. Currently, 11 wood and furniture projects (10 percent of the total) and 9 footwear projects (8 percent) exist, accounting for 230 and 280 jobs, respectively. However, these sectors have yet to achieve the substantial expansion that is expected of them. The prospects for wood and furniture products remain particularly good; the use of unique high-value timber resources means that the value-added contribution of this industry could be significantly higher than that for garments. An electronics industry has not yet been developed, even though it was expected to have been a major export industry under the tax-free system.

Modest growth in manufacturing exports can be expected over the next few years; new investment is expected to slow down. The weakening of the Australian and New Zealand economies will restrain demand, at least in the short-term. Constraints are also imposed by the availability of factory space and shortage of skilled labor, which will be somewhat alleviated by the proposed industrial estate project. With regard to the shortages of skilled labor, it is encouraging that the government-sponsored garment training school has become fully operational. The increasing incidence of strikes in the garment industry during 1990 suggests that industrial relations might increasingly become a constraint on the expansion of that sector.

Fiji expected to be competitive

The rapid expansion of garment exports that occurred since 1985 arose primarily from the preferential access granted to Fiji manufactures under the SPARTECA arrangements. However, after 1995 the industry will face a watershed when Australia removes all garment quotas, leaving only tariff barriers on imports from non-FICs. Fiji will thus be in direct competition with low-cost Asian exporters. This change could affect the development of the Fiji industry well before this date, depending on how investors perceive its impact. Yet Fiji could expect to remain competitive. According to ILO statistics, wages paid in the Fiji garment industry are less than wages paid in Hong Kong, Singapore, and South Korea and about the same as wages paid in Thailand, but are somewhat more than wages paid in the Philippines. Further, it should be noted that wages make up less than 20 percent of the total production cost of the Fiji garment industry. The ability to make quick adjustments in product lines, due to smaller production runs and proximity to the market, is a major advantage. Fiji has proved to be a quality producer even in the face of the rapid expansion that has occurred. High-quality Fiji garments are now penetrating the U.S. market, which enjoys no special concessions.

Building and construction

The construction sector has shown little growth and the value of work completed remains well below the 1986 level of $66.7 million. The value of construction activity in 1989 was $36.9 million, with the estimate for 1990 being $34.6 million. The major construction project in 1990 was the commencement of groundworks for the expansion of the large Denarau hotel complex in the Nadi area. Some modest investment also has occurred in factory capacity. However, investment in housing remains at a very low level, leading to an acute shortage of middle- to high-level rental accommodations. The fact that high rentals have not attracted investment in housing is an indication that domestic investor confidence has yet to recover from the shock of 1987. The construction industry, however, is now expected to emerge from the slump of the last few years with the implementation of major hotel development projects. Thus, the industry could encounter labor shortages, particularly that of certain skills, due to the recent large emigration of highly skilled workers.

Tourism

Tourism has now fully recovered from the downturn of 1987. Tourist arrivals in 1989 reached 250,600, compared with 208,200 in 1988. For 1990 an estimated 270,000 tourist arrivals are envisaged, which will surpass the level of 257,800 recorded in 1986. This level is well above the 1988 Fiji Tourism Master Plan Report projection for 1990 of 247,000. The growth in tourism is even greater when the average length of stay is taken into account. While visitor arrivals increased by 5 percent between 1986 and 1989, visitor days increased by 22 percent.

Australia is still the dominant tourist market in terms of both size and growth. In 1989 a 29 percent increase in tourist arrivals from Australia resulted in a market share of 39 percent. Part of the sharp increase in Australian tourist arrivals in the latter part of 1990 can be attributed to the prolonged Australian airline strike. However, the same strike likely was a factor in the decline in tourist arrivals from North America, as tourists from this destination favored packages that combined Fiji with Australia and New Zealand. A notable development was the increase in tourist arrivals from Japan from only 3,400 in 1988 to 13,800 (5.5 percent of the market) in 1989, resulting from the introduction of an Air Pacific service to Tokyo. Tourist arrivals from Japan are expected to exceed 20,000 in 1990.

Tourist arrivals are anticipated to reach 290,000 in 1991 and 320,000 by 1992, barring a major downturn in the world economy or any overt political disturbances in Fiji. As with all international tourist destinations Fiji has felt the impact of the Gulf war; arrivals in January 1991 are reported to be lower than those of the same period in the previous year, although the Australian recession also may have had an impact on arrivals. In the medium- to long-term disturbances in the Middle East could have a positive impact, with the South Pacific being perceived as a safe destination.

Acceleration required in rate of hotel construction

If present arrival trends continue, the Tourism Master Plan 1995 projection of 372,000 will be reached well before that time. To service these numbers an estimated 1,500 additional rooms of various types would be required. A marked acceleration in the rate of hotel construction will be required to meet this demand. The timely completion of the Denarau expansion will be a key factor. In this respect recent public reports concerning the financial problems of the developer, EIE, International, are of concern.

Airline seating capacity also poses a constraint, with all routes currently operating at or near capacity. Air Pacific is expected to commence a second service to Japan in 1991. The conventional wisdom is that major Japanese investment in resort hotels will be followed by the entry of Japanese airlines. It remains to be seen if this will be the case. Notably, EIE has a minority shareholding in Air Tahiti and Air Calédonie and is negotiating for a shareholding in Air Pacific. The supply of seats from North America is a major bottleneck. A U.S. carrier has not serviced Fiji since the withdrawal of Continental Airlines in 1987. Hawaiian Airlines was expected to commence a service to Fiji in 1990, however, the subsequent corporate reorganization of the financially troubled airline meant that these plans were not implemented. These seating problems have been compounded by the withdrawal of Canadian Airlines in early 1991; the seats have been taken care of through a seat-buying arrangement with Qantas and Air New Zealand. It is hoped that a U.S. carrier will be attracted by the opportunities offered by servicing an expanding Fiji tourist market and will re-enter the market.

Savings and Investment

Macroeconomic trends

In 1986 gross fixed capital formation represented 14.7 percent of GDP, which was considerably below the average values of the earlier part of the 1980s. After the 1987 political upheavals investment fell to 13.6 percent of GDP; it failed to recuperate in 1988 and fell even further to 11.6 percent of GDP in 1989. In 1990, although current economic activity had returned and expanded on 1986 levels, investment demand remained weak. In nominal terms it is estimated to have risen slightly to 13 percent of GDP. While foreign investment is again commencing in the construction of new hotels and some new factory construction has been started in the emerging industrial sector, domestic investment remains at a very low level. Table 3 indicates recent trends in investment, inventories, and savings.

Information on inventory change is scarce at this time, but indications suggest that considerable variation has resulted since the political upheavals in 1987. In 1987 and 1988 evidence suggests that large destocking took place. In 1989 and 1990, as economic activity returned to normal and traders regained confidence in the economy, at least in the short to medium term, stocks were rebuilt. The very large growth in imports in 1989 of 35 percent, which was 20 percent above the level of economic growth, reflects these trends. Both the trends in investment and inventories reflect past political events and an uncertain political future.

Insufficient data are available on domestic or national savings except from the national accounts. The figures indicate that after the 1987 coups national savings fell significantly from 21 percent of GDP in 1986 to around the present level of 13 percent as real incomes declined. This drop suggests that savings are strongly income elastic in

Table 3. Gross capital formation and savings as a percentage of GDP

	1986	1987	1988	1989	1990*	1991*
Gross capital formation, total	18.2	13.9	13.1	17.2	19.1	17.7
Gross fixed capital formation	14.7	13.6	12.4	11.6	12.9	11.6
Stocks	3.4	0.3	0.8	5.6	6.2	6.1
Domestic savings	23.0	17.2	15.5	18.7	15.2	14.4
National savings	20.7	14.5	12.9	16.2	13.3	12.8

Source: Bureau of Statistics, Current Economic Statistics, July 1990.
* Estimated.

Fiji and that the population diverted potential savings into basic consumption requirements during economic hardship. With the economy now returning to more normal circumstances, domestic savings should resume their previous levels.

Sectoral developments

Investment in the rapidly growing export manufacturing sector utilized existing building space until the end of 1989 when capacity constraints emerged. As a consequence, additional building activity occurred in 1990, but an anticipated $2 million investment in a new factory by a major Australian garment manufacturer failed to materialize due to overseas financial difficulties of the company. To help maintain the momentum in this sector government plans to construct an industrial estate project in 1991.

The tuna canning factory had been able to handle the substantial increase in output by operating an additional shift, but it now faces capacity constraints and will increase its productive capacity by 50 percent by the end of 1991. The forestry sector has had no significant investment since the commissioning of the pine-processing facility in 1987. The increase in gold production was facilitated in 1986 by a $15 million investment in a new shaft, and an additional $5 million has been invested in the completion of the shaft. The Fiji Sugar Corporation has embarked on a $130 million investment program in the mills, of which $35 million was expended in 1990. Although demand for rental accommodations by newly recruited overseas staff (to replace emigrating nationals) is strong, the subsequent financial incentive has not stimulated any renewed interest in house-building activity.

Japan, in particular, expressed considerable renewed private sector interest in investing in tourism. By the end of 1989 this interest was translated into substantial investment, and in 1990 the sizable Denarau expansion project commenced with about $30 million scheduled to be invested in engineering, excavation and works, and tidal waterways. The first 300 rooms are scheduled for completion in 1992. Government has invested $10 million in infrastructure for the Natadola Beach project, but the Suva Park Royal project did not begin in 1990 as expected, and is now in doubt.

For 1990 a significant upturn in foreign investment was forecasted with major investments in the tourist sector, but apart from the Denarau project most of the investment has failed to materialize. A more realistic projection for 1991 would be an outcome similar to that of 1990, with foreign investment awaiting the outcome of the forthcoming elections. If this event passes smoothly, a return to far greater foreign investor confidence is likely. However, the return of domestic investment is more uncertain.

Inflation

Recent trends

Devaluation and rising import prices

The CPI grew by 6, 12, and 6 percent in 1987, 1988, and 1989, respectively, over the average levels of the previous years. During 1990 the average rate of inflation increased and the CPI rose 8 percent over the 1989 average level. During 1987 the Fiji dollar was devalued by 30 percent, causing import costs (reciprocally) to rise by 43 percent. The import component of consumer expenditure is high, approximately 50 percent. Consequently, substantial costs pushed consumer prices up. However, the deflationary impact of the political upheavals, and tight fiscal and monetary policies worked in the opposite direction to restrict an upward movement in prices. As aggregate demand returned to normal in 1989 and 1990 the repressed inflation of the earlier years began to filter through the economic system. Figure 4 indicates recent trends in imported inflation and consumer prices.

Wage restraint

During September 1987 the government imposed a wage freeze for civil servants, reducing nominal wages by 15 percent. This level was maintained until June 1988 when a 6 percent raise was permitted, and in January 1989 the wage cut was restored. In July 1989 a 6 percent wage increase was granted to compensate for inflation. In 1990 a 6 percent pay award was made in January, and in July an additional 5-7 percent award was made. Over the 1987-90 period real public sector wages had fallen by 7 percent.

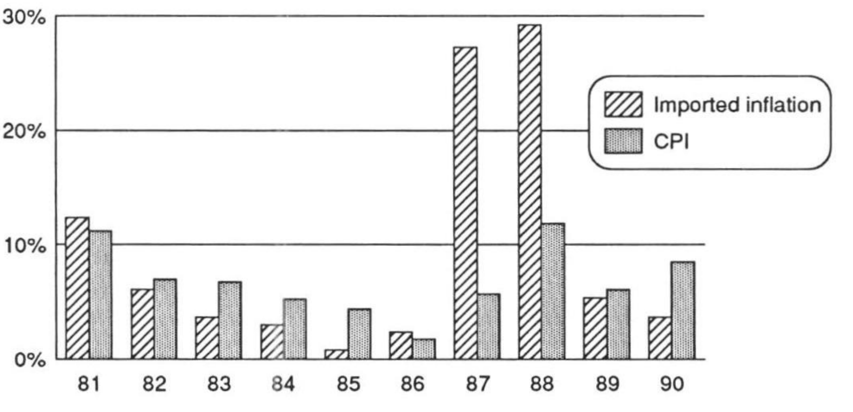

Figure 4. Comparison of the consumer price index (CPI) and estimated imported inflation, 1981-90.

Source: Bureau of Statistics, Current Economic Statistics, July 1990.

Private sector wages increased by 5 percent in June 1987 compared with June 1986, but fell by 2 percent in 1988 reflecting deflationary demand conditions. Changes that took place after that time are not yet known, but real private sector wages probably fell substantially after 1987, and by 1990 nominal wages are only slightly above their 1987 levels.

Deflationary demand circumstances

The reduction in civil servants' pay helped to maintain the size of the public sector deficit, and recourse to inflationary finance occurred only during the latter half of 1987 and the first few months of 1988. With very weak demand for credit from the private sector and rapidly falling levels of inventories real domestic credit fell by 10 percent between 1986 and 1988. The combination of the demand for credit and the stabilization policies mounted by the authorities meant that monetary forces were strongly deflationary and that producers shaved margins to maintain business. However, in 1989 and 1990 as the economy began to pick up private sector credit grew strongly. By the middle of 1990 real credit had grown by 14 percent over the 1986 levels.

After the coups the rapid emigration of high-level workers caused the housing market to plummet and rental values to drop significantly, which further moderated the rise in the CPI. As the economy returned to normal the replacement of local employees by expatriates has had the reverse impact and rental values have escalated substantially, although house rentals of high-income earners are not included in the official figures. The rise in the CPI was further moderated by the official policy of holding public utility prices at their pre-coup levels.

In 1990, in line with deregulatory policy, government allowed public utility prices to move upward and become more in line with economic costs. Housing Authority rental, medical, electrical, post, and telecommunications charges all increased. Regulated bus fares also were allowed to rise. Strong inflation also existed in domestic root crop prices (an important component of the CPI), reflecting the impact of Cyclone Ofa on exports from Western Samoa. Fiji root crop exports found a buoyant market and prices in the domestic market moved upward in response.

In summary, the devaluations of 1987 imparted strong inflationary pressure on the economy, but fiscal and monetary policies coupled with wage restraint moderated the potential rise in 1987 and 1988. In 1989 and 1990 aggregate demand returned and expanded on pre-coup levels, and prices rose to more normal levels. Deregulation of public sector utilities also permitted an upward movement in prices.

Inflationary expectations for 1991

Fiji has in the past (apart from the brief period after the political disturbances in 1987) adopted a noninflationary monetary policy. Credit expansion has been determined by the need for maintaining an adequate level of foreign reserves and a stable medium-term expansion of the money supply. Under these circumstances inflation has been determined by the rate of imported inflation from Fiji's trading partners and by domestic wage rises.

Domestic prices

The link between wages and automatic adjustments for cost of living increases was broken after the political events of 1987. Since that time wage levels have been determined by government edict. As part of the 1991 budget government decided to deregulate the labor market and abolish centralized wage fixing. Wages are now determined by bargaining at the enterprise or establishment level. If deregulation of the labor market is successful and wages reflect their opportunity cost, wage pressure should be moderate. In general, unemployment or underemployment of labor is the rule rather than the exception and the trend in real wages should be downward. However, in the skilled section of the market, with the substantial exodus of highly skilled labor overseas, deregulation would likely be inflationary. In some of the newly rapidly growing sectors of the economy upward pressure on wages also may result, but at present this trend is unlikely. In summary, deregulation should not result in any serious inflation in wages, which could erode Fiji's competitiveness, although wages will rise in certain areas in which the market is in short supply.

Imported prices

With the conclusion of the war in the Gulf, imported inflation is now likely to moderate. Although the cost of fuel in Fiji rose substantially in late 1990 as a result of the Gulf crisis, fuel prices can be expected to rapidly fall back to their mid-1990 levels and perhaps even farther. World inflation is also likely to moderate because a recession is still being experienced in many Western economies. Given these assumptions inflation is projected to be 8.5 percent in 1991.

Fiscal Developments

Stabilization after the 1987 crisis

The economic crisis precipitated by the events of 1987 characterizes recent developments in the government budget and fiscal policy. The imminent collapse of the economy in 1987 rapidly reduced government revenues. Government responded quickly by reducing civil servants' pay by 15 percent in September 1987 and by devaluing the currency by over 30 percent in October. By the end of the year government savings had turned negative for the first time in the 1980s, and the deficit as a percent of GDP had risen to over 5 percent. Recent trends in the government's budget are shown in Tables 4 through 7.

During the preparation of the 1988 budget, with estimates of further collapse in the revenue base by 13 percent, government made plans for a reduction of non-debt recurrent expenditures of 30 percent. However, as 1988 progressed the pessimistic forecasts of government revenue failed to eventuate and the situation eased considerably, which allowed a 6 percent restoration in civil servants' wages and some easing in expenditures. These measures were incor-

Table 4. Government expenditure (F$ million)

	1986	1987	1988	1989	1990*	1991**
Current expenditure	330.9	355.4	343.9	400.0	426.9	438.3
Wages & salaries	186.0	187.5	166.8	202.1	226.0	230.6
Interest	45.1	53.3	65.8	65.4	70.7	69.4
External	13.7	15.9	20.6	18.4	21.2	19.9
Domestic	31.5	37.3	45.2	47.1	49.5	48.4
Subsidies & transfers	51.0	60.0	54.8	59.8	73.2	76.3
Goods & services	48.8	54.6	56.5	72.7	59.0	62.0
Capital expenditure	84.2	60.7	69.5	113.5	103.3	81.1
Fixed assets	37.9	32.7	37.8	53.4	67.8	65.8
Grants & net lending	46.3	28.0	31.7	60.1	35.5	15.0
Grants	16.6	16.0	25.0	38.4	29.1	24.4
Net lending	29.6	12.0	6.7	21.6	6.4	-8.1
Total expenditure	415.0	416.1	413.4	513.5	532.2	519.5
Current expenditure/GDP	22.8%	24.6%	22.4%	22.3%	21.0%	19.7%
Capital expenditure/GDP	5.8%	4.2%	4.5%	6.3%	5.1%	3.5%
Total expenditure/GDP	28.4%	28.8%	26.9%	28.7%	28.1%	25.5%

Source: Ministry of Finance, Budget data.
* Trend.
** Budget.

Table 5. Government revenue (F$ million)

	1986	1987	1988	1989	1990*	1991**
Revenue & grants	345.9	342.2	398.9	464.7	516.2	524.5
Tax revenue	276.0	266.7	292.8	381.4	427.2	428.1
Income & profits	136.1	128.8	140.5	169.7	184.0	188.5
Goods & services	43.8	44.9	49.0	61.9	78.2	64.1
International trade	91.4	89.0	99.6	145.4	159.0	150.5
Other	4.7	4.0	3.7	4.4	6.0	5.0
Nontax revenue	60.5	64.1	83.8	71.3	75.5	78.0
Grants	9.5	11.4	22.2	12.0	13.5	18.4
Capital	7.6	7.1	21.9	11.8	13.3	18.2
Other	1.9	4.3	0.4	0.2	0.2	0.2
Deficit	69.1	73.9	14.5	48.8	16.0	-5.0
Revenue & grants/GDP	23.7%	23.7%	25.9%	25.9%	25.3%	23.5%
Tax revenue/GDP	18.9%	18.4%	19.0%	21.3%	20.9%	19.2%

Source: Ministry of Finance, Budget data.
* Trend.
** Budget.

Table 6. Financing of government deficit (F$ million)

	1986	1987	1988	1989	1990*	1991**
Government saving	5.6	-24.6	32.8	52.8	73.8	67.8
Deficit	60.1	73.9	14.5	48.8	16.0	-6.0
External financing (net)	-3.2	-14.9	-14.0	-28.9	-1.0	-10.6
Borrowing	17.1	7.9	11.3	0.0	20.7	18.0
Repayment	17.2	22.6	25.3	28.9	21.7	28.6
Domestic financing (net)	72.3	88.8	28.5	77.7	17.0	5.6
Banking system	27.2	36.7	n.a.	9.0	9.6	7.0
Provident fund	36.7	44.4	n.a.	0.0	0.0	0.0
Other	6.4	7.6	n.a.	68.7	7.4	-1.4
Government savings/GDP	0.4%	-1.7%	2.1%	2.8%	3.6%	3.0%
Deficit/GDP	4.7%	5.1%	0.9%	2.7%	0.8%	-0.2%

Source: Ministry of Finance, Budget data.
* Revised estimates.
** Budget.

porated in a mini-budget in mid-1988. By the end of the year the situation had improved even more and revenue had grown by over 30 percent above the original forecasts. With the tight control enforced on expenditures during 1988 and the perennial failure to achieve capi-

Table 7. Government debt (F$ million)

	1986	1987	1988	1989	1990*	1991**
Debt outstanding	533.7	658.4	671.0	n.a.	n.a.	764.8
Domestic	386.9	456.0	482.5	n.a.	n.a.	560.9
Overseas	146.8	202.4	188.5	n.a.	n.a.	203.9
Debt/GDP	36.5%	45.6%	43.6%	n.a.	n.a.	34.4%

Source: Ministry of Finance, Budget data.
* Revised estimates.
** Budget.

tal budget expenditure targets, the deficit had fallen to $15 million, compared with $74 million at the end of 1987. Ironically, government savings had reached the highest level and the deficit the lowest level during the decade under initial circumstances that had indicated the exact opposite.

The 1989 budget was shaped under these conditions with the economy returning to normal, but domestic investment was still nonexistent. Government authorities decided not to use fiscal policy to reinvigorate the domestic economy. Under the prevailing circumstances they felt that domestic business activity would not necessarily react positively to greater aggregate demand. They also felt that when business confidence showed signs of returning to normal, sufficient resources should be available in the financial system to meet the ensuing demand.

However, to assist with the development of the private sector, government felt that an expansion of the capital budget in selected areas was appropriate. To achieve this objective, without placing pressure on domestic markets and crowding out the private sector, government set a target of increasing public sector savings to 3 percent of GDP within the medium term. The 1989 budget restored civil servants' wages to their levels before the 1987 pay reductions, but held other non-debt service recurrent expenditures to their 1988 levels (34 percent below 1986). These measures resulted in a net deficit of $49 million or 2.7 percent of GDP, and government savings rose to $53 million or 2.8 percent of GDP.

New directions for economic policy

The mini-budget of August 1989 set in motion a major reorientation of government policy toward deregulation of the economy. First, greater international competitiveness would be promoted by reducing the protection on import substitutes to bring domestic prices in line with world prices. Consequently, licenses on manufactured items were abolished and replaced with a maximum tariff of 50 percent, which also was applied to any item that previously had attracted a higher rate of duty. However, licenses still remained in force for many agricultural products. Second, government indicated its intention to reform the tax system to encourage entrepreneurship by shifting the incidence of taxation toward indirect taxes. Third, government expenditures would be restrained to ensure the availability of resources to the private sector. And finally, the labor market would be deregulated. This statement of government intention became the major platform for future policy directions.

Reduction in income taxes

In line with these new policies the 1990 budget reduced income taxes by 20 percent across the board. The loss in revenue was maintained through increases in indirect and excise taxes, but implied a $13 million giveaway. In view of the policy of containing the net deficit the implication of reduced revenues required expenditure constraint. A marginal increase in recurrent expenditures and a reduction in capital outlays was budgeted. The latter was to be achieved through a reduction in lending to public enterprises in line with deregulation, thereby requiring a greater degree of financial self-reliance.

In the 1990 budget outturn expenditure growth was greater than expected mainly due to the civil service pay awards (6 percent inflation and 5-7 percent general guideline increases) and additional capital expenditure approvals during the year. However, revenue growth proved to be buoyant with the revitalized economy despite the tax giveaway, and the overall budget deficit was $16 million or 0.8 percent of GDP, $12 million below the initial estimates. Financing of the deficit was entirely from domestic sources, with a small net increase of overseas debt of $1.0 million. The lack of private sector demand for financing and the corresponding large excess liquidity in the banking system permitted a policy of early repayment of the more costly public sector debt.

The 1991 budget cements the new economic policy

The 1991 budget cemented the earlier deregulation policies first announced in the 1989 mini-budget. The maximum rate of protective tariff on imports was reduced from 50 to 40 percent. Further removal of agricultural licenses was introduced in the 1991 budget although the aim of complete removal was not achieved. Government stated its intention to further reduce maximum protective import tariffs by 10 percent in the 1992 and 1993 budgets. The 1991 budget indicated its seriousness in deregulating the economy and desire for an export-led, open-oriented development strategy.

A set of further reinforcing deregulatory policies also was included in the budget. Government indicated its intention to look at the wide range of commodities presently under price control, which clearly are contrary to the present policy direction, and to reduce the public sector net deficit and drain on private sector savings with a target of 0 percent of GDP in the medium term. For 1991 a target of 1 percent was indicated. Government also announced its intention to corporatize state-owned public enterprises, making them self-sufficient, and subject to income tax. A major policy initiative was announced in the deregulation of the labor market, abolishment of central wage fixing, and curtailment of trade union powers.

Introduction of a value added tax

To complement the reductions in tariff protection government announced its intention to introduce a value-added tax in 1992. The intention would be to further reduce direct taxes, thereby providing greater incentive to the private sector, and replace them with a broad-based value-added tax. The value-added tax would complement the focus in tariff policy through its lack of discrimination between producers and its support of efficient economic prices.

The 1991 budget was a landmark in the reorientation of economic policy. This step clearly is very important in providing the type of economic environment that is appropriate for private sector development. The policies will take several years to implement, and it is hoped that by that time the political situation will have stabilized sufficiently for the private sector to generate the type of development that is expected.

Monetary Developments

Deregulation and the 1987 credit crunch

The crisis of 1987 and falling government revenues, demand, and business profits led to an immediate growth in domestic credit. Credit growth in the first half of 1987 (before the crisis) averaged 10 percent and rose to 19 percent during the second half. The demand for credit arose equally from the private and public sectors, with public sector demand originating from inflationary central bank credit creation. Beginning in mid-1987 short-term interest rates reflected the shortage of liquidity and rose to unprecedented levels in excess of 20 percent. Figure 5 indicates recent movements in short-term interest rates and the commercial bank liquid assets ratio, while Figure 6 indicates changes in private sector credit growth.

The financial crisis generated by the events of 1987 was followed by quick and decisive action. Monetary and fiscal policies were coordinated, and a prompt adjustment to the new economic circumstances prevented an external crisis or rapid excessive inflation. The Reserve Bank of Fiji instituted a series of monetary restraints, which included removing ceilings on interest rates, raising its minimum lending rate, imposing quantitative credit ceilings, and enforcing very tight exchange control arrangements. By the beginning of 1988 the financial crisis was under control, domestic credit growth had fallen to 10 percent, short-term interest rates had been reduced to 5 percent, and the level of net foreign assets had returned to their 1986 levels. Table 8 indicates recent monetary developments.

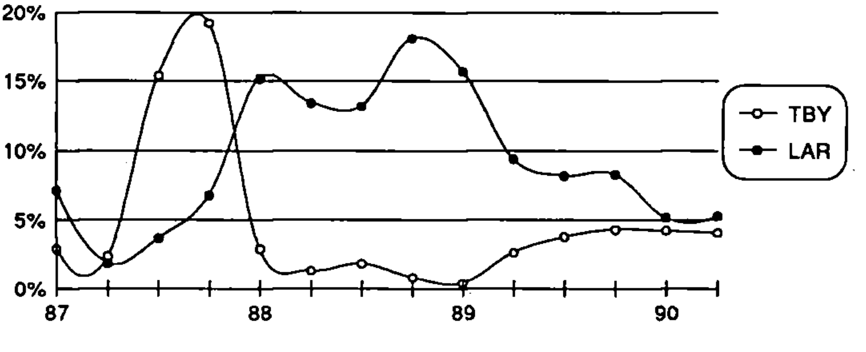

Figure 5. Treasury bill yields (TBY) and commercial bank liquid assets ratio (LAR), 1987-90

Source: Reserve Bank of Fiji, Quarterly Review, June 1990.

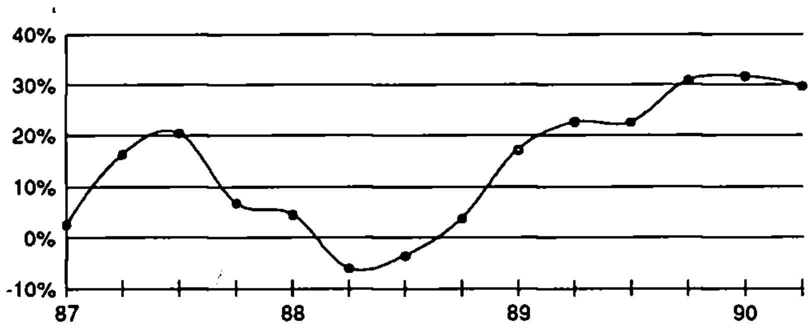

Figure 6. Annual growth of private sector credit, 1987-90 (year on year percent change)

Source: Reserve Bank of Fiji, Quarterly Review, June 1990.

Table 8. Monetary survey (F$ million)

	1986	1987	1988	1989	1990*	1991**
Net foreign assets	190	195	328	332	363	365
Domestic credit	472	541	501	662	830	957
Government	48	81	19	53	60	61
Official entities	56	66	70	68	80	82
Private sector	368	394	412	541	690	814
Other items (net)	75	128	96	185	203	222
Broad money (M3)	586	608	733	809	990	1,100
Annual percent changes						
Net foreign assets	45.0	2.6	68.2	1.2	9.3	0.6
Domestic credit	6.8	14.6	-7.4	32.1	25.4	15.3
Government	51.8	68.8	-76.5	178.9	13.2	1.7
Official entities	9.3	17.9	6.1	-2.9	17.6	2.5
Private sector	5.1	7.1	4.6	31.3	27.5	18.0
Other items (net)	7.1	70.1	-25.0	92.7	9.7	9.4
Broad money (M3)	16.7	3.8	20.6	10.4	22.4	11.1

Source: Reserve Bank of Fiji, Quarterly Review, June 1990.
* Estimated.
** Projected.

The emerging excess liquidity problem

These trends continued in 1988 as business confidence evaporated. Domestic credit had fallen by 7 percent by the end of 1988 although money supply (M3) had risen by 20 percent during the same period. The sharp rise in M3 arose entirely from the rapidly rising level of net foreign assets, which had risen over 60 percent by the end of the year. The situation was dominated by low levels of aggregate demand, rapid reduction of traders' inventories, and the associated demand for imports. As a consequence the Reserve Bank was faced with a very large buildup of commercial bank deposits on the order of $80 million at the end of 1988. Macroeconomically, domestic savings had outstripped investment demand, the external account was in surplus, and resident demand for liquidity was high.

These forces were reflected in interest rate movements. From the very high levels experienced during the second half of 1987, the rates of interest during 1988 and 1989 had fallen to very low levels. Short-term interest rates and wholesale deposit rates fell to less than 1 percent, five-year government bonds had fallen from 12 to 6 percent, and savings rates fell from 6 to 4 percent. However, lending rates did not fall to the same extent and were 12 percent at the end of 1988, compared with 14 percent at the beginning. The widening interest rate spread reflected in part the cost to commercial banks of holding large non-interest bearing deposits with the Reserve Bank.

Employment of new monetary instruments

In 1989 policy shifted from preserving the level of foreign reserves to addressing the growing liquidity problem. As conditions returned to normal the large surplus deposits held by the Reserve Bank of Fiji (RBF) presented the opportunity for a rapid and destabilizing growth in credit. To offset this potential the RBF floated its own notes and sold government securities to the market. By July 1989 the surplus liquidity in the system had been absorbed and by the end of the year the $55 million RBF notes were in circulation. The shift in policy was accompanied by an easing of exchange control regulations and prepayment of foreign debt. The decline in liquidity was intended to lead to a reduction in commercial bank lending rates.

Monetary developments were conditioned by an easing of monetary growth to 10 percent by the end of 1989, which was below the rate of nominal GDP growth. Net foreign assets grew by 1 percent but had reached a new plateau after the rapid expansion in 1988. The main feature dominating monetary developments in 1989 was the return of demand for credit and associated imports by the private sector as inventories were rebuilt, although demand for longer term funds for investment remained absent. By the end of 1989 private sector credit was 31 percent above the level of one year earlier.

The management of liquidity by the RBF, which was the first use of open market operations in Fiji, led to a firming up of interest rates. Short-term money rates rose from 1 to 4 percent by the end of the year, while the 5-year government bond rate rose from 5 to 6 percent. Deposit rates, however, fell marginally, while commercial bank credit rates fell from 12.3 percent at the end of 1988 to 11.5 percent at the end of 1989. The ability to earn a return on previously non-interest bearing funds through the purchase of RBF notes resulted in a reduction of the commercial bank's interest rate spread. Thus, the RBF liquidity management led not only to the sterilization of liquid funds, but also to greater efficiency in Fiji's money markets.

Return in demand for credit but not investment

During 1990 monetary regulations and monetary developments did not change. Money supply growth is estimated to rise by 22 percent in 1990, with a growth of 25 percent in domestic credit and 9 percent in foreign assets. The growth in domestic credit is almost wholly from the additional demands of the private sector resulting from the expanding economy. However, change did not occur in the commercial bank holding of RBF notes during the year, which suggests that private sector demand for credit reflected only the demand for working capital needs to maintain economic growth and not any longer term investment needs.

The lack of demand for investable funds is also shown by the inability of the Fiji National Provident Fund (FNPF) to find outlets for its resources. In earlier years with sizable public sector deficits, the FNPF invested the majority of its funds in public sector paper. With the new policies of deregulation and reduction in government's deficit these outlets have decreased. Coupled with the reduction in private sector demand for investment and the inability to invest offshore, the FNPF currently has a considerable amount of underutilized funds. By the end of November 1990 the FNPF had accumulated more than $40 million in RBF notes.

Short-term money and deposit rates remained largely unchanged on the 1989 levels, although the average weighted deposit rate rose from 6.8 percent to 7.6 percent by September 1990. Commercial bank lending rates also rose from 11.5 percent in 1989 to 12.1 percent during the same period. This trend indicates the gradual improvement in business conditions in Fiji.

Present indications suggest, however, that continuing excess liquidity is likely to prevail throughout 1991. The level of excess liquidity in the commercial banking system seems to have stabilized. However, a growing problem exists in the longer term funds market that is determined by the Fiji National Provident Fund (FNPF). With deregulation, reduced demand for funds by the public sector, and weak private sector demand for investment the FNPF is experiencing a growing surplus of funds. These forces will tend to push interest rates down. With rising inflation and falling interest rates, real interest is likely to turn negative and discourage savings. However, a policy to increase interest rates would dampen what little investor demand presently exists. These difficult policy problems will need to be resolved during 1991.

Developments on current account

In 1987 the value of exports rose by 31 percent (foreign exchange values must be adjusted for the large cumulative devaluations of 43 percent in 1987 before comparison may be made with earlier years). Imports fell by 6 percent due to a lack of investment, sharp reductions in inventories, and a lack of consumer durable demand. However, the substantial private remittance outflows, reduction in official aid, and fall in tourist receipts caused the year to end with a balance of payments current account deficit of $6.8 million. Tables 9 and 10 provide details on the current account of the balance of payments and selected exports.

In 1988 the value of exports rose an additional 29 percent to $529 million, while imports increased by 42 percent. (Thus, over the 2-year period the value of exports had in nominal terms increased by 69 percent, compared with an increase of 42 percent in imports.) In 1988 private remittance outflows subsided under strict foreign exchange restrictions and tourist receipts improved. Official aid receipts returned to previous levels after the low of 1987, and the current ac-

Table 9. Balance of payments, current account (F$ million)

	1986	1987	1988	1989	1990*	1991**
Exports	281.2	389.6	506.9	601.2	681.9	689.5
Imports	417.9	399.9	564.1	755.0	933.6	987.4
Trade balance	-136.7	-10.3	-57.2	-153.8	-251.7	-297.9
Service credits	337.2	279.5	368.4	549.6	607.4	683.1
(Tourism credits)	185.4	146.2	182.6	281.0	324.7	378.2
Service debits	176.9	219.6	250.7	323.5	373.6	412.0
Services (net)	160.3	59.9	117.7	226.1	233.8	271.1
Goods and services (net)	23.6	49.6	60.5	72.3	-17.9	-26.8
Investment income credits	13.8	16.2	21.6	22.6	24.8	25.3
Investment income debits	56.0	61.8	67.7	76.9	70.6	69.6
Investment income (net)	-42.2	-45.6	-46.1	-54.3	-45.8	-44.3
Goods, services & income (net)	-18.6	4.0	14.4	18.0	-63.7	-71.1
Private transfers (net)	-6.0	-23.4	-5.1	-19.3	-39.3	-38.5
Government transfers (net)	16.7	12.6	48.2	51.3	60.7	54.5
Current account balance	-7.9	-6.8	57.5	50.0	-42.3	-55.1

Source: Bureau of Statistics, Current Economic Statistics, July 1990.
* Estimated.
** Projected.

Table 10. Exports by commodity (F$ million)

	1986	1987	1988	1989	1990*	1991**
Sugar						
Value	133.7	186.2	198.3	208.2	253.9	245.1
Volume ('000 tonnes)	324.1	429.4	408.7	399.6	413.8	413.6
Unit value (F$/tonne)	412.5	433.6	485.2	521.0	613.6	592.6
Molasses						
Value	7.9	10.6	11.4	9.9	10.9	9.9
Volume ('000 tonnes)	125.6	126.6	133.6	143.5	142.4	128.0
Unit value (F$/tonne)	62.9	83.7	85.3	69.0	76.5	77.3
Coconut oil						
Value	4.2	3.0	3.4	5.3	6.0	7.0
Volume ('000 tonnes)	15.4	6.6	4.4	9.2	9.7	11.0
Unit value (F$/tonne)	272.7	454.5	772.7	576.1	618.6	636.4
Gold						
Value	38.6	50.6	81.5	76.2	73.0	66.0
Volume ('000 fine oz.)	93.1	96.2	132.7	135.5	126.0	102.0
Unit value (F$/fine oz.)	414.6	526.0	614.2	562.4	579.4	647.1
Timber	7.9	16.6	26.6	32.2	37.0	38.0
Fish	18.4	25.1	48.2	44.5	52.0	56.0
Garments	4.9	8.8	30.1	100.7	123.0	135.0
Green ginger	3.0	2.8	3.2	4.0	2.9	2.8
Other	23.6	30.4	43.3	51.8	85.2	75.7
Re-exports	70.4	74.5	83.2	104.2	74.0	95.0
Total exports	312.6	408.6	529.2	637.0	717.9	730.5

Sources: Bureau of Statistics, Current Economic Statistics, July 1990; Ministry of Finance, Budget Supplement 1991.
* Estimated.
** Projected.

count recorded a $58 million surplus. The current account surplus in 1988 indicated an underlying lack of domestic investor confidence as the economy accumulated savings in excess of investment demand.

In 1989 both exports and tourist receipts showed significant increases over their 1988 levels as the economy returned to capacity production levels. Exports recorded a 20 percent growth while receipts from tourism rose by 54 percent. Imports grew by a substantial 35 percent as traders rebuilt stocks, although investment in fixed capital remained at very low levels. Private remittances increased to $19 million as foreign exchange controls were relaxed, and official aid flows were maintained at $51 million. The current account revealed the same outcome as in 1988, with a substantial surplus of $50 million, which indicates the continuing excess of domestic savings above investment demands.

In 1990 the main components of the current account displayed trends similar to those of 1989, but at lower growth rates. Exports continued their strong performance of 1989 and expanded by 13 percent. Growth in tourism receipts, reflecting the growth in visitor arrivals, expanded by 16 percent. Import growth (excluding the purchase of jet aircraft) of $80 million also moderated and expanded by 14 percent. Private outward transfers continued growing to $39 million with relaxed exchange controls, and development aid expanded to $61 million. The current account recorded a deficit for the first time since 1987 of $42 million, which would have shown a surplus if not for the import of the jet aircraft.

Projections for 1991 suggest that exports will be maintained at their 1990 level. While sugar exports are expected to fall due to a projected decline in price, and a reduction in gold exports is anticipated, exports of garments, fish, and timber are expected to rise. A further slowdown in import growth to 7.5 percent is projected for 1990, primarily because of higher oil prices for fuel products. Tourism earnings are anticipated to be buoyant and yield an additional 16 percent. Overall, the growth in imports is projected to exceed exports and a current account deficit of $55 million has been forecasted.

Capital transactions

Large official loans were incurred in the early 1980s to fund the construction of substantial infrastructure projects; since then new loans have been small. The rate of official net capital inflows since 1986 has been negative, with the exception of 1988, and debt repayment has exceeded the new borrowing rate. Official borrowing disappeared after the political crisis in 1987, and official flows in the balance of payments recorded -$31 million. However, in 1988 the official inflows were positive and recorded $10 million. In 1989 and 1990 official borrowing recorded a substantial negative position with debt repayments outweighing new loans by $52 and $43 million, respectively. This situation arose from a deliberate policy to reduce excessive domestic liquidity by substituting commercial public sector external debt with domestic borrowing. Table 11 provides details on the capital account of the balance of payments.

Private long-term capital flows have been positive in the 1980s, reflecting small levels of equity investment and reinvestment. Analysis of direct private investment is difficult due to the treatment of reinvestment of profits, which is included as an imputed outflow on the current account with a counterbalancing inflow on the capital ac-

Table 11. Balance of payments, capital account (F$ million)

	1986	1987	1988	1989	1990*	1991**
Direct investment	35.9	17.9	58.2	54.7	140.2	87.3
Government debts	0.2	-13.9	13.9	-16.3	-8.0	-33.9
Statutory authority debts	-10.8	-17.1	-4.3	-35.6	-35.1	-18.5
Banks	-1.5	-9.4	4.4	-9.5	0.0	0.0
Others	-0.5	-40.1	21.0	7.8	-12.5	15.0
Capital account balance	23.3	-62.6	93.2	1.1	84.6	49.9
Errors and omissions	21.8	20.3	4.2	-68.9	0.0	0.0
Overall balance	37.2	-49.1	154.9	-17.8	42.3	-5.2
Memorandum items						
Change in official balance	-37.2	49.1	-154.9	17.8	-42.3	5.2
Valuation adjustments	-11.9	44.7	-19.0	12.0	0.0	0.0
Net change in reserves	-49.1	4.4	-135.9	5.8	-42.3	5.2

Source: Bureau of Statistics, Current Economic Statistics, July 1990.
* Estimated.
** Projected.

count. In 1987, precipitated by the political crisis, direct investment fell to $18 million from a level of $36 million in 1986. In 1988 and 1989, as political conditions returned to normal, direct investment reached $58 million and $55 million, respectively. Excluding the purchase of the jet airliner, direct investment rose to $60 million in 1990.

Short-term credit movements are erratic and reflect a degree of speculation, depending upon anticipated currency realignments and political circumstances. In 1987, with the imminent fear of currency devaluation and low business spirits, producers repaid short-term trade credit and the balance of payments recorded a $40 million outflow. In 1988, as conditions returned to some normalcy, credit was again extended and an increase of $21 million was recorded. In 1989 and 1990 trade credit flows reflected more normal circumstances and recorded flows of $8 and -$13 million, respectively.

Movement in foreign assets

At the end of 1986 net foreign assets had risen to $190 million and covered 4.6 months of imports. By the end of 1987, although the balance of payments recorded a cumulative deficit on current and capital accounts of $49 million, the level of net foreign assets rose to $195 million and covered five months of imports. The real purchasing power of the foreign reserves, however, had fallen substantially and the outcome reflected the revaluation gains arising from the large devaluations. In 1988 net foreign assets rose to record levels and by the end of the year had attained a level of $328 million. This amount represented six months of imports. The outcome reflected the large surplus on the current account of $58 million, arising from the excess of domestic savings over investment, and an even larger surplus of $93 million on the capital account.

Overall balance of payments

In 1989 the current account continued to remain in surplus and recorded a surplus of $50 million, reflecting the continued lack of domestic investor confidence. The capital account was in balance and the level of net foreign assets remained more or less unchanged from the 1988 levels, although import coverage fell to 4.5 months, reflecting growing import demand as the economy returned to normal. In 1990 the current account is projected to record a $42 million deficit with a capital account surplus of $85 million. Excluding the distorting effects of the import of the jet airliner, the underlying 1990 outcome is very similar to 1989, with a current account surplus of $42 million and balance on the capital account. Net foreign assets are projected to rise by $31 million.

Projections for 1991 suggest that a surplus of $50 million may be anticipated for the capital account of the balance of payments. Direct investment flows are projected to rise above 1990 levels (without the jet airliner), and statutory body debt repayments are estimated to fall with the previous early repayment of external debt. Overall, a small surplus of $5 million for the balance of payments is projected for 1991.

Foreign debt

The absence of any major recourse by Fiji to borrowing on commercial markets and the low levels of new loans at concessionary rates have caused Fiji's external debt and debt service to remain moderate and sustainable in recent years. In 1989, with the comfortable external position and emerging domestic liquidity problems, government instigated a policy of early repayment of the more expensive public sector external debt. Foreign loans would be traded for domestic debt. This policy not only reduced the cost of finance payments, but also aided in domestic liquidity management and reduced future exchange rate risk. Table 12 provides details on Fiji's external debt service.

Government external debt remained more or less unaltered as debt repayment was matched through new loans. However, the public enterprise sector reduced its overseas liabilities substantially and foreign debt fell from $220 million in 1988 to $185 million in 1989, and to $157 million in 1990. Private sector debt also fell from $103 million in 1988 to $82 million in 1990. Debt service remained relatively easy and represented 16 percent of exports of goods and services during 1986. In 1987 this level rose to 18 percent with the reduction in export levels, but returned to a more normal level of 14 percent in 1988. In 1989 debt service fell to 11 percent with the reduction in external debt and

Table 12. External debt outstanding (F$ million)

	1986	1987	1988	1989	1990*
Total external debt outstanding	458	566	555	502	465
Government	170	214	226	223	226
Statutory bodies	178	215	220	185	157
Reserve bank (IMF)	8	10	6	1	0
Private sector	102	127	103	93	82
Total external debt servicing	98	119	124	131	142
Public sector	64	87	83	100	106
Principal	34	52	48	65	75
Interest	30	35	35	35	31
Reserve bank (IMF)	10	3	4	6	1
Principal	9	2	3	5	1
Interest	1	1	1	1	0
Private sector	24	28	36	25	35
Principal	17	21	26	18	23
Interest	7	7	10	7	12
External debt/GDP ratio	34.6%	43.2%	40.1%	31.4%	25.6%
Debt service/exports ratio	15.5%	17.8%	14.2%	11.4%	11.0%

Source: Reserve Bank of Fiji, Quarterly Review, June 1990.
* Provisional.

rapidly growing export sector. This trend continued in 1990 and debt service is estimated to fall further.

With the continuing policy of early repayment of foreign loans by substituting domestic debt for foreign debt, the external debt situation is likely to continue to improve in the early 1990s and external debt service will fall in line.

Exchange rate developments

The cumulative devaluations of 1987 imparted a substantial improvement in Fiji's competitiveness and made a significant contribution to Fiji's economic recovery and diversification. In particular, Fiji became an attractive tourist destination after the devaluations of 1987. The extent to which the devaluations were important in the emergence of Fiji's other new industries is less clear. The burgeoning garment industry, whose roots were established in 1985-86 owes its emergence primarily to the SPARTECA trade arrangements. Figure 7 indicates the movement in Fiji's real exchange rate since 1986. It measures relative movements in Fiji's CPI compared with her trading partners, weighted by each country's share in trade and adjusted for exchange rate movements.

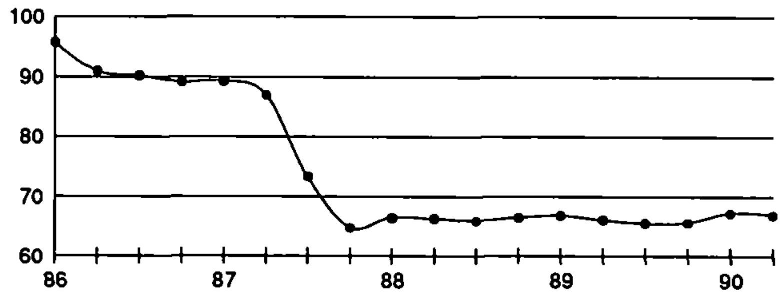

Figure 7. Fiji's real effective exchange rate, 1986-90

Source: Reserve Bank of Fiji, Quarterly Review, June 1990.

Terms of trade

Discussion of Fiji's terms of trade is problematic due to dubious statistical measurements. The official series suggests that import unit values rose by 17 percent after the 1987 devaluations of 43 percent. At that time the currencies of those nations from whom Fiji imports, moved adversely and should have exasperated the inflationary consequences of the currency depreciation. Estimates based on the costs of imports using export unit values for Japan, United States, and the United Kingdom and CPIs for Australia and New Zealand suggest that import prices would have risen by about 50 percent. Estimates based on this information and the official export unit value index, which seems quite plausible, suggest that Fiji's terms of trade have changed little in recent years and have not risen by 20 percent as officially recorded. Figure 8 shows both the official and PIDP's estimates.

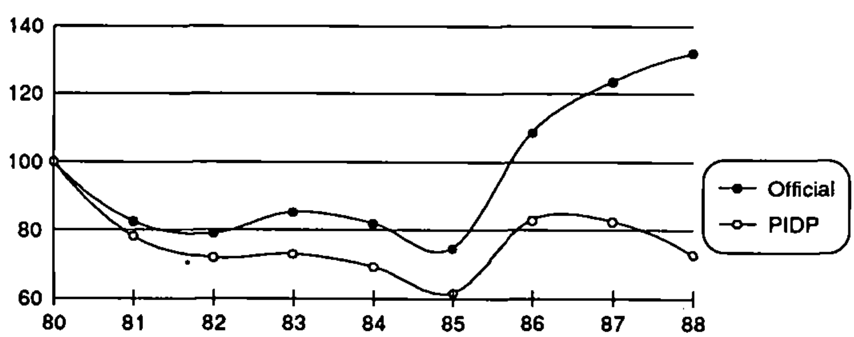

Figure 8. Comparison of official terms of trade series with PIDP estimates (1980=100), 1980-88

Source: Reserve Bank of Fiji, Quarterly Review, June 1990.

Future of the sugar industry

During the last few years the Fiji economy has experienced important economic diversification with past investments in forestry coming to fruition, the extension of the gold mining industry, the expansion in canned fish, and the emergence of an important manufacturing sector. Although these factors are important and have helped to reduce the structural weakness in the economy, sugar remains the backbone of the economy. Sugar still constitutes about 12 percent of GDP, accounts for 40 percent of exports from which import leakages are very low (approximately 12 percent), and provides approximately 20 percent of employment. In the longer term, however, the future of the sugar industry is of some concern. If sugar fails to provide the engine of growth that it has in the past, major alternatives must be found if the economy is to provide a growing level of income for its people in the future. Some reasons why sugar production is unlikely to fulfill this role are discussed below.

Although returns to farmers have kept pace with inflation in recent years, the terms of trade are expected to move against the industry over the next decade. Real prices received under the Lomé Convention's Sugar Protocol have declined over the last decade, a trend that is likely to continue as the European Economic Community (EEC) grapples with its massive sugar surplus. Furthermore, future price peaks are likely to be less pronounced with the structure shift of world demand to price-sensitive developing countries such as China.

Under this price environment, significant increases in cane yields are unlikely, especially given the Fiji Sugar Corporation's extension capability and the perceived insecurity of growers. Uncertainty remains about the status of native land leases that are due to expire around the turn of the century. In response to the dispute over the new cane contract (Master Award), there have been some disturbing utterances advocating that leases should not be renewed. In addition, sufficient suitable land is unavailable that would allow for sizable expansion in the cane perimeter. Milling efficiency also is under pressure from the loss of emigrating skilled workers. The tendency of recent years to delay the start of harvesting due to industrial and political disputes is a major concern. A continuation of this trend, as the experience of a number of Caribbean industries has shown, will lead to a downward spiral of falling cane growing and milling efficiency.

Garment industry diversification

The garment industry expansion has made a major contribution to the economy, particularly with respect to employment, at a crucial time in Fiji's history. The need exists for diversification from the "cut-make-trim" method of production, which has limited value-added and a great deal of competition. Incentives given to the garment sector must not lead to an industrial "monoculture." Every encouragement needs to be given to higher value-added lines of activity such as high fashion and island-type exotic clothing that utilize local design capability. While garments alone do not provide a viable basis for future development they can provide a springboard for more diversified manufacturing development. Garments can offer the prospect of substantial accumulation for reinvestment in other manufacturing sectors and provide exposure to Fiji-based firms of international markets. For this reinvestment to occur, investors need to have greater confidence in Fiji's political future.

After the events of 1987, economic strategy took a major shift from an inward-looking, import-substitution protected course to a more outward export-oriented approach. This strategy shift initially was promoted through the Tax-free Factory Scheme to encourage export-oriented manufactures. The large devaluations of 1987, although intended to deflate the economy and preserve foreign reserves levels, have aided these policies and have made Fiji considerably more competitive. These policies have encouraged production since their introduction and in part explain Fiji's ability to perform well in difficult times.

Deregulation

In the mini-budget of 1989 government announced a major policy shift toward deregulation and abolished licensing in many industries, replacing it with a more streamlined tariff system. New rates of nominal tariffs on the order of 50 percent were installed. As part of the 1990 budget these rates were reduced to 40 percent, and even more licenses were removed. It is the intention of the next two budgets to reduce tariff rates by an additional 10 percent per year. If these policies are implemented Fiji will have successfully reduced the huge rates of effective protection that existed in the early 1980s to more appropriate levels. The further reduction of very high rates of direct taxes that exist in the upper-income brackets and the stated introduction of a value-added tax in 1992 should complete the reorientation of tax and tariff policy. With the proposed set of fiscal policies Fiji will present the type of economic environment necessary to sustain economic development into the 1990s.

While much attention has been given to deregulation Fiji still maintains an extensive system of price controls (mainly markup control), which no longer is appropriate to a more deregulated economy. In most instances these controls (with the exception of house rentals) are ineffective and impose unnecessary bureaucratic barriers to efficient business operation.

Government's announced policies toward deregulating the labor market are welcomed. Wages since the early 1970s have largely been determined through a central fixing system, which has proved to be inefficient. In the early period wages were set according to cost-of-living changes and have led to a particularly rigid economic environment. Before the events of 1987 the system began incorporating terms of trade changes, but an economywide guideline was still administered. After the events of 1987 wages through economic necessity were strictly controlled by central government edict. However, in line with its other deregulatory policies the new focus of policy will be to abolish centralization and let market forces determine wage levels. New legislation is being proposed that will free the labor market and require a secret ballot before strike action can be called. These policies are appropriate.

Regarding monetary policy, interest rates were deregulated in 1987 and allowed to be determined by market forces, although credit rationing is still maintained with specified credit allocations reserved for "priority" sectors. The deregulation of interest rates was a welcomed development. However, interest rates have been slow to react to changing circumstances. The large volume of excess liquidity earning low rates of return partly explains the failure of interest rates to react to market signals, but it also points to a lack of competition in the commercial bank sector. The flotation of Reserve Bank notes, which absorbed domestic liquidity and indicated greater institutional maturity, failed to encourage greater market responsiveness. New policies are needed to improve efficiency in domestic money markets.

Recent economic policy reforms

Recent economic policy reforms have been comprehensive and have been designed to encourage entrepreneurial development, domestic resource mobilization, productive resource use, and increased public sector efficiency as well as to promote private sector activities, especially in export manufacturing. While improvements have been made, the tempo of change in government's bureaucracy needs to be quickened so as not to stifle foreign or local investment. Also, apparent differences of emphasis and even philosophy need to be resolved between the various institutions involved, such as the Ministry of Trade and Industry, the Ministry of Finance, the Reserve Bank, the Development Bank, and the Fiji Trade and Investment Board. Conflicting interpretation of policy by institutions serves to confuse investors. Investors need clearly laid out rules and procedures with a minimum of discretion, particularly in areas such as domestic borrowing by foreign corporations and in foreign exchange transactions.

Conflicting interpretation of policy

Confusing signals concerning deregulation and privatization recently have emanated with the installation of the Fiji Oil Company, which has been granted sole rights to the importation of crude and refined oil products. While the previous distribution of oil products through three international oil companies may have led to oligopolistic pricing, it is difficult to understand how a concentration of distribution into a monopoly could benefit the consumer. Independent studies have suggested that fuel prices are likely to rise, and the consumer will pay the increased costs. Furthermore, certain economies of scale have existed through the business Fiji acquires through re-export to other Pacific island economies. Faced with higher prices these countries are likely to shift their source of supply elsewhere, resulting in even higher prices in Fiji as economies of scale are lost. While the present arrangements contradict moves toward deregulation elsewhere in the economy, confusing signals are being sent to foreign investors as to the roles they may be expected to play in the economy.

It is important for government, supported by the international agencies and aid donors, to make every effort to ensure that the dynamic outward-looking policy reforms are seen as continuing to work. A worst case scenario could be that the response from entrepreneurs is inadequate, market-oriented policy is deemed as unsuccessful, and controls and inward-looking policies are reimposed.

Conclusion

The Fiji economy has undergone severe and rapidly changing circumstances since the events of 1987. The ability to adjust to adverse conditions, by avoiding excessive inflation while maintaining foreign reserves, attests to the sound economic management of the authorities. While short-term economic management has been well designed, long-term development strategy in the early and mid-1980s was not well formulated. Strategy was excessively inward-looking, inefficient, regulated, and bureaucratic. The authorities have recently shifted to a more market- and export-oriented approach through the implementation of deregulatory policies. The long-term success of these changes, however, is preconditioned by the return of investor confidence. The elections scheduled for late 1991 will be an important landmark in this respect, which may provide the needed environment.

Pacific Islands Development Program

The purpose of the Pacific Islands Development Program (PIDP) of the East-West Center is to help meet the special development needs of the Pacific islands region through cooperative research and training. PIDP conducts specific research and training activities based on the issues and problems prioritized by the Pacific Islands Conference of Leaders, which meets every three years. The Standing Committee, composed of eleven island leaders, reviews PIDP's research projects annually to ensure that they respond to the issues and challenges raised at each Pacific Islands Conference. This unique process enhances the East-West Center's capability in serving the Pacific.

East-West Center

The East-West Center is a public, nonprofit educational institution established in Hawaii in 1960 by the United States Congress. The Center's mandate is "to promote better relations and understanding among the nations of Asia, the Pacific, and the United States through cooperative study, training, and research."

Some 2,000 research fellows, graduate students, and professionals in business and government each year work with the Center's international staff on major Asia-Pacific issues relating to population, resources and development, the environment, culture, and communication. Since 1960, more than 25,000 men and women from the region have participated in the Center's cooperative programs.

Principal funding for the Center comes from the U.S. Congress. Support also comes from more than 20 Asian and Pacific governments, as well as private agencies and corporations. The Center has an international board of governors.