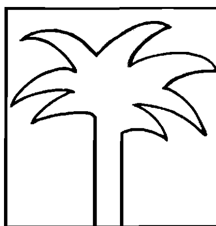

The economy of French Polynesia after the nuclear boom

Bernard Poirine

The economy of French Polynesia has been characterised since 1962 by a booming military and administrative sector. GDP per capita and consumption indicators are on a par with countries like New Zealand. However, the booming military and administrative sector has had 'Dutch disease' effects on the private sector, especially on the traditional exports sector, and on tourism. The high cost of living has resulted in an overvalued currency, greatly hampering tourism. This paper proposes a plan to help French Polynesia build a competitive economy less dependent on public transfers from metropolitan France.

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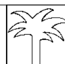
French Polynesia lies on approximately the same longitude as Hawaii, but in the southern hemisphere tropical zone. It is made up of four archipelagos and 125 islands spread over an oceanic area the size of Europe. The closest industrial country is New Zealand, more than 2,000 miles away and France is 10,602 miles away, an 18-hour plane trip. Since the islands are very much dispersed, inter-islands transport, communications, education and health coverage are costly.

But isolation and dispersion is also of great geostrategic interest—because it had such a huge oceanic zone, French Polynesia was an ideal testing ground for the French atomic bomb—as was Bikini and Eniwetok for the United States, and Christmas Island for the United Kingdom.

Today there are approximately 220,000 inhabitants of French Polynesia (from 80,000 in the 1960s), of whom 149,000 reside in Tahiti, most of them in Papeete and its immediate vicinity (100,000). The population is growing rapidly (2 per cent a year, down from 3 per cent in the 1960s and 1970s), and is very young (47 per cent are less than 20).



The political setting

In the 1950s, French Polynesia chose by referendum to become a territory rather than a department or independent. The main advantage of this solution was to avoid paying income tax, while remaining French citizens and getting financial aid from France.

In 1984 French Polynesia was given a *statut d'autonomie* (self-rule)—a local territorial assembly, a local government with ministers and a president, a local flag and hymn. The French Government keeps control of money, defence matters, the judiciary, the police, higher education and research funded by the state, and diplomatic relations (treaties with other nations). Local government is responsible for all other matters, including some, like primary and secondary education, for which the French state pays most of the expenses (teachers' and professors' salaries, for example). An extension of the self-rule statute is currently before the French parliament: the territories of New Caledonia and French Polynesia are to become *Pays d'Outre-Mer* (overseas countries). According to the new statutes (which require an amendment to the French Constitution), the *Pays d'Outre-Mer* will have a dual citizenship. Metropolitan French citizens will be allowed to become local citizens after residing for a number of years (yet to be determined). French citizens who are not local citizens will not be authorised to buy land, and their work contract will be limited in time.

French Polynesia before the nuclear tests

In the 1950s and the beginning of the 1960s, the population was only 80,000 on this huge archipelago (less than half today's figure). This time is often remembered as a golden age, even though most objective indicators point to underdevelopment (for example, high infant mortality, low education, short life expectancy and so on). Fishing, hunting, copra gathering, mother of pearl diving, coffee and vanilla growing, and phosphate mining at Makatea (Tuamotu) were the main economic activities. There were few salaried jobs, except in the phosphate mines.

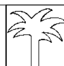
In 1959 the export to import ratio was 95 per cent: the Territory's exports were sufficient to pay for its limited imports. In 1962 this ratio had fallen to 56 per cent because copra, vanilla and mother of pearl prices were down, while phosphate mining was coming to an end in Makatea.

There were very few tourists then, since there was no international airport, and the trip by ship from Europe was very long. As a result, economic growth was sluggish, many Polynesians had to emigrate to New Caledonia to find jobs, and the local government had acute budget problems.

The economic fall-out from nuclear testing since 1962

In 1962 Algeria, where France had carried out its first atomic experiments, became independent. General De Gaulle had visited French Polynesia earlier. De Gaulle told the Tahitian representatives who were requesting financial aid to finance the Territory's budget deficit that, with commencement of nuclear testing in the Tuamotu archipelago, all the economic and budgetary problems of the territory would be over. The territorial assembly donated the (uninhabited) atoll of Mururoa to the French state. An international airport and a four-lane highway to Papeete were quickly built. Papeete harbour was enlarged and modernised, and another (military) airport was built on Hao atoll, near Mururoa.

From 1964 on, the testing activities represented huge spending: in 1966 they amounted to 76 per cent of GNP (Blanchet 1991). The servicemen, as well as the expatriate civil servants in Tahiti were paid twice as much as in France, and there was no income tax. As a result, importers and



retail shops benefited from booming consumer spending.

The military also created many jobs through the building of nuclear testing bases in Hao and Mururoa, barracks and other buildings in Tahiti, plus military naval bases in Hao and Papeete. Real per capita GNP increased by 43 per cent in 1964 and 35 per cent in 1965. It more than doubled between 1960 and 1969 (Blanchet 1991).

In the 1970s, the growth rate slowed, but booming civil administration employment helped boost the economy. The Territory's receipts, based on import duties, were growing fast, and the local bureaucracy ballooned. The total number of civil servants increased seven-fold between 1962 and 1988. The number of wage earners increased by 46 per cent between 1976 and 1984. The world oil crisis from 1975 to 1982 went virtually unnoticed in Tahiti.

In the 1970s the local unions succeeded in negotiating agreements where the local civil servants were paid at the same rate as expatriates (twice as much as in France). The legacy is that a schoolteacher is now paid twice as much as in New Zealand (about US$3,500 a month with 15 years experience), 16 times as much as in Samoa and five times as much as in American Samoa. The public sector wage bill makes up more than half of the total wage bill.

The administrative boom helped to maintain a rapid growth rate well into the 1970s, and at the beginning of the 1980s, French Polynesia became the richest of the French overseas departments and territories, according to per capita GDP.

Since 1962 there has been no net emigration from French Polynesia, but rather net immigration from metropolitan France. This contrasts with a very high emigration rate in most other Polynesian countries (the percentage of emigrants circa 1991–92 is 62 per cent in American Samoa and the Cook Islands, 65 per cent in Tokelau, 76 per cent in Niue). The rate of unemployment has been rather low (3.7 per cent in 1977, less than 10 per cent in 1989, 11.8 per cent in 1994, 13.2 per cent in 1996) when compared to other French overseas departments and territories (18.3 per cent in New Caledonia, 28.8 per cent in Martinique, 29.5 per cent in Guadeloupe, 34.3 per cent in Réunion and 25.6 per cent in French Guyana, circa 1997).

French Polynesia's economy is now rich by most standards: high per capita GDP (US$17,000 in 1996, about the same as Australia's GDP, and higher than New Zealand's GDP), low infant mortality rate (9.9 per cent in 1996), long life expectancy (69 for men, 74 for women in 1996), high rates of ownership of automobiles, television sets, VCRs, good health coverage, extensive social security system (Tables 1 and 2).

The structure of employment is typical of a post-industrial economy: by 1988 only 11 per cent of the active population was in the primary sector (agriculture, fishing, pearl farming). Most people were employed in the tertiary sector: 36 per cent in public administration, 34 per cent in private services (tourism, transport, banks, commerce, imports). Value-added and jobs in the primary sector had dwindled to a very small share of the total in just 30 years while the booming service sector became the main job provider (Table 3). Manufacturing's share of employment was 9.1 per cent and the building industry's share was 8.7 per cent. The 1996 census showed few changes: in 1996 the share of building had gone down to 6.4 per cent, the share of agriculture up to 14.6 per cent, thanks to the booming pearl culture industry (classified in the primary sector). The share of the tertiary sector and industry were unchanged.

But the economy remains dependent on public transfer payments from France—36 per cent of GNP at the end of the 1980s. In 1998 transfers still represent US$5,400

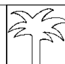


Table 1 **French Polynesia: selected statistics**

	Fcfp	US$
GDP, 1993 (millions)	329,266	3,197
Per capita GDP, 1993	1,566	15,204
Civilian imports, 1993	72,874	708
Exports and tourism services, 1993	32,138	312
(Exports and tourism)/civil imports (per cent)	44	44
Metropolitan public transfers, 1994 (millions)	117,638	1,165
Per capita	549,766	5,443
Per household	2,748,830	27,216
Metropolitan civil transfers, 1994 (millions)	66,343	657
Per capita	312,939	3,098
Per household	1,564,693	15,492
Metropolitan transfers/GDP (per cent)	36	36
Military expenditures/GDP (per cent)	12	12
Consumption expenditures, 1993 (millions)	201,486	1,956
Consumption per capita, 1993	949,510	9,219
Consumption per household, 1993	4,747,549	46,093
Minimum hourly wage, 1994	506	5
Minimum monthly wage, 1994	85,449	846
Average monthly gross income		
Territory civil servant (6000 persons)	267,000	2,644
Communes (4500 persons)	167,000	1,653
French state civil servants (local + expatriate)	417,000	4,129
Banks (1100 persons)	392,000	3,881
Schoolteacher (10 years' experience)	300,000	2,970

Notes: Exchange rate for US$1: Fcfp96 (1992), Fcfp103 (1993), Fcfp101 (1994).
Public sector = 54 per cent of wage bill = 22500 persons
Private sector = 46 per cent of wage bill = 41500 persons
13 per cent of total resident population was born outside French Polynesia
6 per cent of people born in French Polynesia live abroad (half in France and half in New Caledonia or Pacific Rim countries)
Source: Institut Territorial de la Statistique (ITSTAT), 1995.

Table 2 **Ownership of durable goods among all households, 1988** (per cent)

Ownership of durable goods	French Polynesia	France
Washing machine	67	87
At least one car	68	75
TV set	81	94
Stereo systems	35	23
VCR	38	17
Refrigerator	80	98

Source: Institut Territorial de la Statistique.

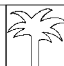


Table 3 **French Polynesia: employment by sector as a percentage of total employment, 1962–88**

	1962	1977	1983	1988
Administration	12.3	33.4	35.7	36.3
Private services	22.4	32.4	31.8	34.2
Industry	19.2	17.5	18.6	17.7
Agriculture	46.1	16.7	13.9	11.8
Total	100	100	100	100

Source: Census data, Institut Territorial de la Statistique.

per capita: 31 per cent of GDP and 13 per cent of the Territorial government budget. In addition, the *loi Pons*, which gives a tax break to metropolitan France investing in the Territory, brought in US$1.25 billion of direct investments from 1995 to 1998.

Most consumer goods, all machines, and almost all raw materials (wood, steel, glass, cement and so on) are imported. The export/import ratio was 26 per cent in 1998. Booming imports linked to public transfers from France and the decline in coffee, vanilla, and phosphate exports explain this growing trade deficit.

Recently black pearls have become by far the largest export item (88 per cent of local exports). In 1998 receipts from tourism (US$400 million) exceed merchandise exports (US$280 million). The export to import ratio for services is 125 per cent. Compared to these export earnings, the wages bill received from the metropolitan government represents US$478 million, and the other net transfers from outside administrations represent US$540 million (including social security benefits and public pensions).

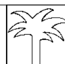
With the surplus on services and public transfers from France, the Territory's balance of payments (recently computed for the first time) shows in 1998 a current account surplus of US$280 million, or 6.6 per cent of GDP, even though the merchandise deficit amounted to US$800 million (IEOM 1999).

The end of the atomic rent and the search for a substitute

The nuclear tests were suspended by President Mitterand in April 1992, resumed by President Chirac in September 1995, and terminated in March 1996. Chirac officially promised to keep military and civil transfers to French Polynesia at the same level for the next ten years. In 1994 a law had been voted on by the French Parliament: *Loi d'orientation pour le développement économique, social et culturel de la Polynésie Française*. In its first article, the law stipulated

> ...the Nation will help the Territory of French Polynesia to undertake a profound economic transformation, in order to achieve a more balanced development and lessen its dependence on public transfers.

In August 1996, the law went into effect with an agreement between the French state and the Territory—the *Convention pour le renforcement de l'autonomie économique de la Polynésie française* (Agreement for the Reinforcement of the Economic Autonomy of French Polynesia). According to this agreement, the State maintains the same



annual level of total public transfers until 2005, compensating the decrease in military expenditure by an equivalent increase in civil expenditure. Half of the increase in civil expenditure will go to infrastructure, a quarter to help economic development and a quarter to social spending and health care.

French Polynesia has therefore entered a new post-atomic rent era. The issue is now how to compensate for the expected decrease in transfers after 2005.

Dependency on the atomic rent: the ARAB economy

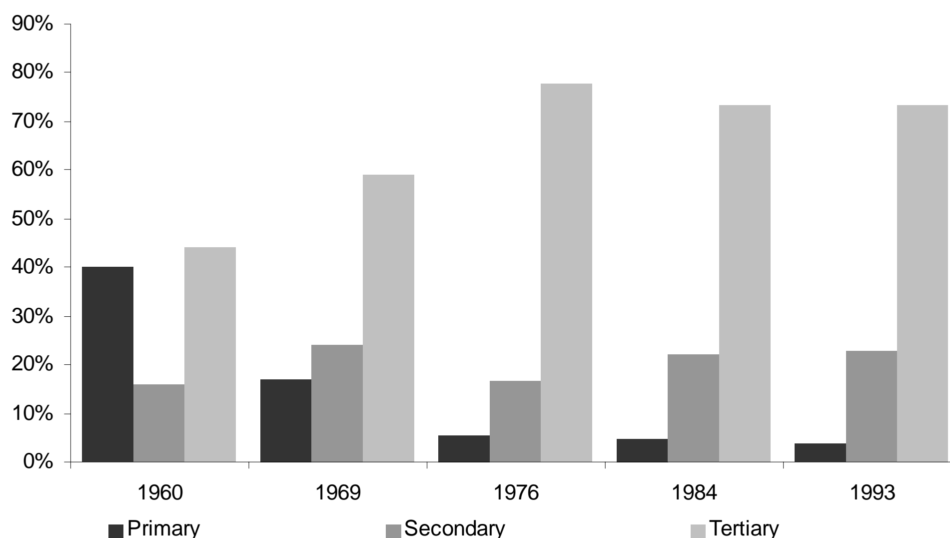
The atomic rent: payment for an invisible export?

French spending in French Polynesia represents US$1,22 billion in 1998, that is, US$5,415 per capita or US$27,075 per household. Total military spending amounted to US$497 million in 1996 (some military imports are paid for in France). Let us suppose that this represents the value to France of the strategic service it obtained from French Polynesia. That means that French Polynesia was exporting to France an 'invisible' non-market service worth US$497 million a year.

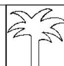
In 1996 French Polynesia's balance of goods and services was in debit US$369 million. In 1996 the 'invisible export' of strategic services offset the 'official' deficit on trade of goods and services, implying that the 'unofficial' balance of goods and services, including 'invisible strategic exports' was more or less balanced. In other words, the deficit on official 'civil' trade of goods and services was more than offset by the surplus on the invisible trade of military services.

But today the strategic value of Tahiti is less obvious because of the termination of the atomic experiments. Therefore in order to maintain the same level of imports French

Figure 1 **French Polynesia: value added, by sector, 1960–93** (per cent)



Source: Territorial accounts, various years, Institut Territorial de la Statistique.



Polynesia has to increase civilian exports to make up for the end of its strategic rent.

The Dutch disease in French Polynesia

The atomic rent has had Dutch-disease effects on the local economy: it drove resources out of the private sector to the administrative and military 'booming' sector. For example, higher wages paid in the civil service drove up wages in the tourism sector, as well as the cost of supplies to hotels and restaurants. This explains also why civilian exports dwindled to almost nothing (with the exception of black pearl exports) and coffee and vanilla plantations disappeared as other sources of income were made available to families through the extension of civil service employment and welfare benefits.[1]

Local entrepreneurs or professionals in the private sector were scarce, because almost all Polynesians holding a higher education degree chose to work for the local administration.

The nuclear rent was not distributed evenly, however. Landowners, landlords, shopowners and local civil servants obtained the lion's share. But in the outer islands at least, mayors attempted to distribute the administrative rent as evenly as possible by appointing almost everybody in the village to at least a part-time, nominal job. In Tahiti, mayors cannot do this, and there is much jealousy and talk of favouritism and nepotism when people with no qualifications are hired because of their political connections to a mayor, a minister or a president.

According to the 1988 census 40 per cent of all jobs were in the public (or private non-profit) sector. According to the 1996 census 38 per cent of wage earners worked in the public sector. But this percentage rose to 65 per cent in the Marquesas islands, 77 per cent in the Australes islands, 44 per cent in the Tuamotu-Gambier islands (ITSTAT 1991, 1999).

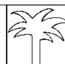
As a result, there has developed a rentier mentality because it has seemed rather easy to earn a good living if one had the right 'connections', or could marry the right person. For instance, a prestigious male occupation in the outer islands was (and still is) 'schoolteacher's husband'. All employees of the territory's local administration (and of the local social security) are entitled to a free round trip to France, or anywhere else not further away than France, every three years, for the whole family, on the ground that French expatriates of the State administration also do.[2]

The Chinese population of French Polynesia (4.7 per cent) has been an exception to the rentier mentality. They were barred from the public service until the 1970s, because most of them were not French citizens (until 1974). As a result, the only way open to them for upward social and financial mobility was through commerce, in which many succeeded.

In the non-traded goods sector, such as services (except tourism), construction, electricity, public works, plus all 'protected industries', wages and prices are driven up because the reservation wage for workers, managers, professionals, and technicians, is whatever could be earned in the public sector—about twice as much as in metropolitan France.

In the traded-goods sector higher prices of inputs and higher wages cannot be passed on to the consumer. For instance, tourism cannot be protected from competition with other destinations. Therefore, profit margins are pinched between rising costs and prices that must not exceed those of competing imports or similar products (such as similar tourist resorts elsewhere). In French Polynesia, tourism has been stagnating for the last 10 years: the number of tourists (163,000 tourists in 1996) is about the same as in 1986.

Therefore, there is a crowding-out effect of public transfers hurting competing



exports other than the booming 'strategic services export' sector.

Another aspect of the Dutch disease is that the real exchange rate tends to increase, hindering the growth of manufacturing for the domestic market or for exports.

This is just what happened in French Polynesia: the Pacific franc has been fixed to the French franc since 1949. However, prices increased much more in French Polynesia than in France in the 1970s and 1980s because of the atomic boom, and also because of rapidly rising import duties to finance the local budget (import duties rose from 10 per cent in the 1960s to 43 per cent of the value of imports in 1996). As a result, the real exchange rate has become too high and the local currency is overvalued. This is why prices appear so outrageous to tourists, while French Polynesians love to go for a week-long shopping spree to Hawaii or Los Angeles, where they find prices lower than at home. A 1990 UN study shows that French Polynesia ranked seventh among 199 countries for the daily cost of living for a visiting business traveller. According to the 'Big Mac index' published by *The Economist* (April 1998), French Polynesia is the home of the second-most expensive Big Mac in the world: in Papeete, the famous hamburger is priced (in dollar terms, using the April 1998 exchange rate) at US$3.39, that is, 33 per cent per cent higher than in the United States, 79 per cent higher than in New Zealand and 94 per cent higher than in Australia. Because French Polynesia is not responsible for balancing its official (visible) trade with the rest of the world, it can maintain an overvalued currency with no adverse financial consequences.[3] But a devaluation of the Pacific franc would have adverse consequences for the Territory's budget (with most of its debt being denominated in French francs) and for the cost of its ever-increasing imports.

MIRAB, MIRAGE, ARAB

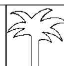
According to Bertram and Watters (1985), most Pacific island economies are rent driven, with the rent coming from migrant workers' remittances and international public aid, the local bureaucracy being financed by this aid. This is the MIRAB model (migration, remittances, aid and bureaucracy), but it has also been called the MIRAGE (migration, remittances, aid, government expenditures) model.

French Polynesia does not perfectly fit the model, since there is no emigration (this ceased in the 1960s when the atomic experiments provided so many well-paid tax-free jobs).

But French Polynesia is definitely a rent-driven economy. The only difference from MIRAGE economies is that the foreign 'modern' sector was brought to the island—the military and administrative sector. Thus, people emigrated internally: from the rural districts and outer islands to Papeete and the nuclear sites of Mururoa and Hao in the Tuamotu archipelago.

Therefore, the rent came not from emigrant workers abroad, but from the atomic tests—atomic rent, aid, and bureaucracy (ARAB) (Poirine 1994, 1996). Just as in MIRAB economies, the trade deficit is offset by public transfer payments, local exports are not competitive, neither are local manufactured goods (unless heavily protected by high tariffs) since most consumer goods can be imported thanks to this 'rent', which is a payment for geostrategic services to the donor country.

The ARAB economy works in the same way as a MIRAB economy: the local civil servants give 'remittances' to the extended family, while working at home in the 'foreign' (administration) sector. People have a choice as to whether they adopt the 'subsidised' traditional lifestyle (like the part-time fisherman, full-time



schoolteacher's husband) or the 'urban' wage-earner lifestyle. It is also common to alternate between these lifestyles.

The issue arises whether it is 'good' to live off a 'rent' (Poirine 1998). Most economists would answer no, because the economy is not balanced, and the economy is too dependent on the rent which may disappear. But Bertram (1986, 1993) answers 'why not?', if the rent is greater and more predictable than receipts from traditional exports such as copra and the like, or even more stable than receipts from tourism, which are unstable and unpredictable. Many island countries or territories do not wish to take the hard capitalist road taken by Mauritius or Fiji, of trying to export manufactured goods to pay for imports of consumer and durable goods. They would rather continue to live a traditional lifestyle, while at the same time benefiting from imported goods, through public and private transfer payments (Poirine 1993a). If we consider that aid is payment for geostrategic services (Poirine 1993b, 1995b) and that remittances are repayments to island parents for the expenses incurred in the education of their children (Poirine 1997), then there is nothing abnormal about receiving rents from foreign governments and emigrant relatives.

An optimal strategy for a small island is to export geostrategic services if it reflects a 'comparative advantage' in the production of such services (Poirine 1993b, 1995b). This means that the Dutch disease (less and less activity in the traditional primary sector and in the non-protected secondary sector, and a growing trade deficit) reflects a new equilibrium where the economy adapts to the rent, as in parts of the United States, France or Australia, where some towns live off a naval or air base. As long as the rent persists, the economy will adapt to it, and farmers and fishermen will abandon traditional activities to become workers for the army, for example.

In the case of French Polynesia, the atomic rent is coming to an end, though, because most of the geostrategic value of the Territory lay in its role in the 'atomic deterrence' strategy of France since De Gaulle.

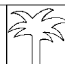
A new development strategy after the end of the atomic rent

Import substitution and export processing zones: a dead end

In the 1980s the local government claimed that import-substitution was an appropriate development strategy. This policy has justified a very high degree of protectionism (as a percentage of the CIF value of imports, import duties rose from 13 per cent in 1960 to 43 per cent in 1996). There are many non-tariff trade restrictions, for example, on cars and dairy products from non-European Union countries, and the delicatessen trade. Protectionism has contributed to the high cost of local production, wages and services. This has harmed tourism and other exports. Moreover, import duties are higher for non-European Union countries, which tends to encourage imports from distant France and Europe, incurring higher transportation costs than imports from the Pacific region, Japan and the United States.

What this policy failed to understand is that an island's growth rate is determined by the growth of external resources (exports, tourism, aid). In French Polynesia, the multiplier of external resources is close to 2, and fairly stable. Any attempt to generate growth without increasing external resources is bound to fail (see Poirine 1995a and 1996).

Since 1997, the government has been introducing the value-added tax (VAT). Over a period of five years, the VAT is going to replace import duties. By the end of 2002, there should be no import duties



on goods coming from the European Union (but a value-added tax on imports will replace it). This policy should increase the tariff discrimination on non-EU imports, since a tariff will still exist for them. This policy also decreases the tariff protection of locally-made products, since the VAT is the same on imported and local products. Local industries have been lobbying to obtain 'local development duties' on specific imports which are also locally manufactured, such as mineral waters, milk, coffee and so on.

Because the minimum wage is higher than in the United States (but lower than in France), French Polynesia cannot count on cheap labour to attract industries as Mauritius or Fiji managed by setting up duty free export-processing zones.

Black pearl exports: unregulated production results in a steady price decline

Black pearls are by far the strongest export item (US$140 million in 1996, 95 per cent of local exports, not counting tourism). French Polynesia has become one of the three most important cultured-pearl exporters in the world with a 25 per cent to 30 per cent share of the world market.

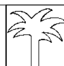
Cultured pearls provide a natural rent as they represent a 'booming sector' (from 1986 to 1996 exports grew 50-fold in grams, 14-fold in value). With the success of this activity, the Tuamotu-Gambier archipelago has been re-peopled, as former emigrants to Tahiti come back to work in pearl farms or to set up their own pearl farm. However, the average price per gram has been steadily declining since 1990, thus lowering the rent element of this activity. Despite the growth in quantities exported, the value of pearl exports has been stagnating at Fcfp14.4 billion from 1996 to 1998, because the average price declines approximately at the same rate as the supply grows. Thus, in 1998, exports in weight have increased by 25 per cent (to 6 tonnes), while the value of exports stagnated at Fcfp14.4 billion. The average price per gram declined from Fcfp3,021 in 1997 to Fcfp2,383 in 1998 (in 1990 the price per gram was Fcfp6,490).

It is necessary to regulate the growth of this industry, by enforcing production quotas, in the best interest of the resource. The success of the Australian South Sea pearl culture is an example to follow. A strictly enforced quota policy has resulted in regulated growth of the quantities exported, each producer being induced to improve quality instead of quantity. As a result, Australian South Sea pearl prices, which were approximately equal to Tahitian black pearl prices at the end of the 1980s, are now much higher. But the industry is highly structured in Australia, with a dozen companies operating farms, while in French Polynesia there are several hundred companies or family operations. These are very difficult to regulate because the atolls where pearl culture takes place are very remote and dispersed over a huge oceanic zone (Poirine and Tisdell 1999).

The receipts from pearl exports now represent 37 per cent of the receipts from tourism. Unless a radical change in policy takes place to regulate quantities and quality, it is doubtful that pearl revenues will grow much more in the future. Moreover, new competitors appear in the Pacific for the Tahitian black pearl (the Cook Islands are beginning to market black pearls) making it doubtful that a slower growth of quantities exported from French Polynesia will succeed in obtaining higher prices on the world market.

Tourism: why Tahiti is not Guam or Hawaii

Can French Polynesia imitate Hawaii and Guam, substituting receipts from tourism for military spending? It is possible in theory, because French Polynesia has fantastic landscapes, many potential tourist sites suitable for resorts, and a rich Polynesian culture. But there are many



obstacles—the high cost of local labour, the overvalued currency, and the high cost of airfares from Japan, Europe and the United States, compared to competing destinations.

Today, very few hotels make a profit in French Polynesia, even though investment in tourism is favoured by a tax law (*loi Pons)* which gives tax relief to French individuals or companies when they invest in the French overseas departments and territories, and another local tax law (*loi Flosse*) giving similar tax relief to local investors. The indirect subsidy for investment given by the *loi Pons* (investing companies and individuals benefiting from a tax deduction equal to 40 per cent of the value of the investment) has been in effect for more than 10 years and has had some effect in stimulating investment in hotels. Between 1993 and 1996, Fcfp3.848 billion worth of investment have benefited from the *loi Pons*. Since 1996 all new hotels have been financed this way. Moreover, the tax deduction also applies to investment in the restoration of existing hotels.

But because the occupancy rate is too low, except for a few well known and very expensive hotels in Tahiti and Bora Bora, and because profit margins are squeezed, many of those hotels paid for under the *loi Pons* have either folded or have been resold at bargain prices to other companies.

A recent example is the five-hotel chain Tahiti Resort Hotels, a company in bankruptcy. The five hotels (located in Tahiti, Moorea, Huahine, Bora Bora, Tahaa) were recently sold for approximately the price of the land to a new owner—Nouvelles Frontières, owner of the Corsair airline company. The hotels were originally built in 1986 by a French company, Climat de France, financed through the *loi Pons*. This company then sold them at a bargain price to Tahiti Resort Hotel, who then re-sold them—the hotels were not profitable, the occupancy rate being too low. True, service was dismal (the author tried it). Hotels have a very hard time finding qualified and motivated staff, because of the competition of public sector jobs. Tourism is not considered a rewarding or promising career by young graduates. Graduates in tourism (there is a secondary school specialised in tourism and hotel management—the *Lycée Hôtelier* in Pirae, Tahiti) are reported to seek jobs first in the tourism administration *(service du tourisme, GIE tourisme, ministère du tourisme)*.

Another well-known Tahiti hotel, the Hotel Taharaa, formerly the Tahiti Hyatt Regency Hotel, has been sold to a local company owned by the family of President Gaston Flosse. It has been closed for ‘restoration’ for more than two years, the staff has been laid off, and there are no plans to reopen it shortly and restoration has not been taking place.

Table 4 and Figure 2 compare French Polynesia, Hawaii and Guam, three Pacific islands where military spending has been declining and tourism receipts are becoming a substitute for military rent.

It is obvious that Hawaii and Guam have been more successful at boosting tourism as military spending was phased out. The higher GDP per capita in Hawaii and Guam is mostly due to their higher tourism receipts per capita. Both Guam and French Polynesia receive high public transfers per capita from the state, due to their military bases and welfare state programs, but Guam receives 10 times more tourists per capita, even though tourists stay longer in French Polynesia (7 days instead of 4 days on average in Guam). The reasons behind Guam’s success are

- cheap airfares to Japan and Korea
- duty-free shopping (no import duties)
- security
- many golf courses (18).

French Polynesia should follow the strategy of Guam if it wants to be ready for

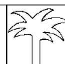
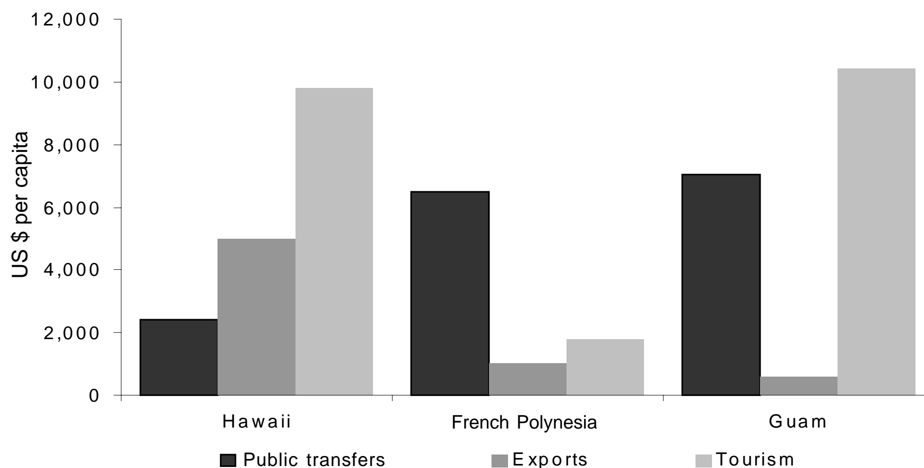


Figure 2 **External resources per capita, 1995** (US$ per capita)



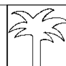
Source: Institut Territorial de la Statistique.

the end of the 'Chirac rent' in 2006. It should try to increase the share of tourism in its external resources, in order to compensate for the falling share of public transfers. French Polynesia has dozens of islands to offer in an archipelago the size of Europe. Guam is a lone island just 50 km long, and 6–14 km wide, with 30 per cent fewer inhabitants than French Polynesia. There is no reason why French Polynesia should not be able to accommodate as many tourists per capita as Guam (7.4 in 1994). This would mean about 10 times more tourists than presently: 1,576,000 tourists instead of 166,000 in 1994. But tourism growth is hindered by

- expensive airfares from Europe, the United States, Japan and Korea
- the high cost of shopping for tourists because of high import duties and protectionism
- high operating costs (energy, food, supplies, labour costs) and high building costs
- only one golf course (on Tahiti, far from all hotels)
- an overvalued currency.

A plan for the post-nuclear era

In order to maintain the existing level of GDP per capita after the 2006 deadline, French Polynesia needs to replace falling public transfers from France by an increase in tourism receipts. Figure 2 and Table 4 show that since 1976 the Territory's GDP has always been about twice that of external resources (exports, tourism and public transfers). Transfers now make up 70 per cent of external resources, tourism 20 per cent (Table 4). Let us assume public transfers fall by half starting in 2006. If tourism is to make up this loss, the share of tourism should increase to 55 per cent of the present level of external resources (compared to 57–58 per cent in Guam and Hawaii). This means that receipts from



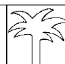
tourism should increase to approximately US$1.1 billion by 2006, an almost three-fold increase (189 per cent), requiring approximately 515,000 visitors in 2006 (an increase of 337,000 visitors over 11 years), or 2.05 tourists per capita.[4] (Compared to 5.59 tourists per capita in Hawaii and 9.12 in Guam). Very rapid increases in tourism receipts are not unheard of, when the right conditions prevail (good price/quality ratio, spectacular sites, good service, hospitality, security and cleanliness, good promotion). In Guam the projected visitor increase is from 1995 to 2001 is from 1.198 million to 2.25 million, an 87 per cent increase, or a 1.052 million visitors increase (Guam Visitors Bureau). Recalling that the population of Guam is 25 per cent less than that of French Polynesia, that it is an island 30 miles long and 4 to 8 miles wide, while French Polynesia is an archipelago of 125 islands spread over an oceanic area the size of Europe, it is realistic to expect 337,000 more visitors in French Polynesia in ten years (1995–2005).

However, despite attractive tax incentives given to investors since 1986, outstanding sites and landscapes, a well-known image as a tourist destination in the United States and Europe, falling airfare prices in the last decade and costly promotion campaigns, tourism has been stagnating. There were 161,236 visitors in 1986, 163,774 in 1996, and 180,444 in 1997

Table 4 **French Polynesia, Hawaii and Guam: comparative statistics, 1995**

	Hawaii		French Polynesia		Guam	
	1995	per capita	1995	per capita	1995	per capita
Population	1,179,198	n.a.	213,000	n.a.	149,250	n.a.
GDP (US$ billion)	32.72	27,748	3.99	18,732	3.00	20,101
Tourist arrivals	6,589,000	5.59	178,222	0.84	1,361,000	9.12
Net public transfers from federal state or French state (US$ billion)	2.84	2,408	1.38	6,479	1.05	7,022
Exports (US$ billion)	5.88	4,986	0.22	1,033	0.09	596
Tourism (US$ billion)	11.59	9,829	0.38	1,770	1.55	10,414
Total transfers+ exports+tourism (US$ billion)	20.31	17,224	1.98	9,282	2.69	18,032
GDP/total external revenues	1.61	n.a.	2.02	n.a.	1.11	n.a.
Net public transfers (per cent of total)	14.0	n.a.	69.8	n.a.	38.9	n.a.
Exports (per cent of total)	29.0	n.a.	11.1	n.a.	3.3	n.a.
Tourism (per cent of total)	57.1	n.a.	19.1	n.a.	57.8	n.a.

Sources: Bank of Hawaii, *Country Reports*, various issues; Institut Territorial de la Statistique; *Guam Economic Review*, 18(4); *1994 Guam Annual Economic Review*; Guam Visitors Bureau, 1996. *Visitor Exit Survey*, November.



(ITSTAT 1999), meaning that French Polynesia's share of the rapidly expanding Asia Pacific tourism market has been steadily shrinking. If we count only visitors staying at hotels (and many French visitors stay with their expatriate relatives), there were 141,054 in 1986, and 127,666 in 1994 (ITSTAT 1995).[5] Occupancy rates have been consistently low (54 per cent in 1997). Surveys show that tourists complain about the high costs of beverages, food and other items, and that very few of them come back after a first visit.

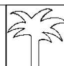
The reason for all this is simple: the cost of living is too high, because of the high tariffs (43 per cent on average) needed to finance the cost of a very expensive local public sector. It is as if the tourists, by paying high import duties, were required to make up for the absence of income tax on residents and to finance the high buying power of local civil servants. As a result, the currency is overvalued, few hotels can make a profit and most of them lose money, because occupancy rates are low, since the quality/price ratio is not competitive compared to alternative tourist destinations in the Pacific.

In order to reduce the cost of living, tariffs would need to be abolished. This would mean also lowering the cost of the local bureaucracy.

The only way out of this deadlock is a devaluation of the Pacific franc combined with the simultaneous abolition of import duties and decrease of the international cost of the local public sector, leaving metropolitan public transfers unchanged in French franc (or Euro) until 2006. Such a plan would stimulate the growth of tourism so that, by 2006, tourism receipts would have increased approximately three-fold.

A plan to go forward involves the following strategies.

- A 30 per cent devaluation of the Pacific franc would increase the price of imports by 43 per cent—the average duty paid on the c.i.f. value of imports (in 1996). Therefore, if all import duties were abolished at the same time as the devaluation took place, the average net impact on import prices would be nil: on average, the cost of living for the locals would not change. Some prices would increase (for goods which are taxed less than 43 per cent), and some prices would go down (goods which are taxed more than 43 per cent). French Polynesia would then become a duty-free zone, with an instant 30 per cent fall in the local cost of living for visitors.
- The French State could compensate the Territory for the abolition of import duties by paying state civil servants in French Polynesia 30 per cent less in French francs. This would leave the State's civil servants' salaries unchanged in Pacific franc, and therefore their buying power would not change since prices would stay unchanged on average. The State would also save (in French francs) 30 per cent on all the goods bought in the Territory for civil or military purpose (since the end of atomic testing, imports by the state administration have decreased and represent a very small share of the State's expenditure in the Territory). The value of imported goods bought by the State would not change much in Pacific francs. Therefore the State's expenditures in Pacific francs would be approximately unchanged, but its counterpart in French franc would decrease by 30 per cent.
- Total French Government expenditure in French Polynesia amounts to 125 billion Pacific francs (Fcfp) in 1995 (Fcfp121 billion in 1998), or 6,875 billion French francs (FF) at the current exchange rate of FF1=Fcfp0.05. After a 30 per cent devaluation, the new exchange rate would become FF1=Fcfp0.0385. The same amount spent by the French Government would become Fcfp178 billion. Since



we assume that wages and pensions of State civil servants and military personnel would stay the same in Pacific franc (meaning that civil servants would earn, in French francs, 29 per cent more than in France, instead of 84 per cent more at present) and since wages, pensions, and social security benefits, which make up most of the State expenditure, would stay unchanged in Pacific francs, the French government would save Fcfp53 billion a year, for the same outlay in French franc.[6] This difference could be transferred to the Territory, in addition to the Fcfp125 billion given before. Compare this to the Fcfp39 billion a year in lost revenue from import duties (in 1995), and it is clear that this plan would leave the State's budget unaffected, increase the Territory's budget (by Fcfp14 billion a year), and leave the purchasing power of State civil servants in the Territory unchanged. With this added revenue the Territory could pay back public debt, finance the early-retirement of many excess civil servants, lower corporate taxes, subsidise the promotion of tourism and the airline companies in order to lower airfares to French Polynesia. Some of the added revenues might also be spent on subsidising the price of imported 'necessities' such as sugar, rice, condensed milk, canned butter and instant coffee, which are at present exempted from import duties, in order to prevent a 43 per cent price rise of these goods following the devaluation (poor families could be subsidised through a system of 'food stamps' used to buy those items, similar to the US food stamp program applied in Guam and Hawaii).

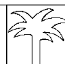
Such a plan would increase profitability for tourism and other export activities (such as black pearl culture).

The only category of people that would stand to lose from the implementation of this plan would be the French expatriate civil servants on short-term assignments (usually 2 to 3 years).

There are, however, some likely difficulties in implementing such a plan. The Pacific franc is common to all three French Territories of the Pacific, and what is beneficial for French Polynesia might not necessary be good for the nickel-rich territory of New Caledonia. Moreover, the French franc is soon going to be replaced by the Euro, the common European currency. Will the Pacific franc still exist when the French franc no longer exists? According to French officials, it will, and its parity with the Euro should result from its fixed parity with the French franc. But will this parity be 'frozen'?

The recent implementation of a value-added tax in French Polynesia is another difficulty since this tax is meant to replace import duties over a five-year period starting in 1997 and ending in 2002. Our plan is to devalue without any inflationary effects, due to the deflationary effect of instantly abolishing import duties. Since import duties are gradually reduced and replaced by the VAT, each year that passes now makes it less and less likely that devaluation without inflation can take place as proposed. The high level of import duties in 1996 (43 per cent) represented an historic opportunity for devaluation (added competitiveness) without bad secondary effects (inflation and social unrest). This chance is now passing by. When and if the devaluation takes place in the future, it will have to be done the hard way (that is, without a compensating decrease in import duties).

But the main obstacle to this plan is political. There is no compelling reason to take such a drastic and politically costly measure as long as the public transfers from France keep coming to the Territory (or 'overseas country'). Everybody in French Polynesia stands to benefit (at least from



their own microeconomic point of view) from the overvaluation of the Pacific franc (through high taxes protecting local industries, cheap imports and travel expenditures and high public sector salaries), except tourists and hotel operators. Moreover, as already pointed out, there is a current account surplus of more than 6 per cent of GDP, with the trade deficit being more than offset by the surplus on services and unrequited transfers.

Notes

[1] A Polynesian civil servant shares their income with their extended family.

[2] Expatriate civil servants cannot stay more than six years however, except judges and university professors.

[3] French Polynesia's balance of payments (being a part of France's balance of payments) was not computed by the Institut d'Emission d'Outre Mer, the state agency in charge of the local currency, until May 1999, when it was published it for the first time. There is a current account surplus equal to 6.6 per cent of GDP, the commercial deficit being more than compensated by the surplus on services (tourism) and unrequited transfers.

[4] This was computed using the projected population for January 2007—256,693 according to the Institut Territorial de la Statistique (ITSTAT 1999).

[5] The statistic for tourists staying at hotels does not appear after 1994.

[6] It could be argued that some of the State expenditure in French Polynesia pays for imports and therefore would cost the same in French Francs and more in Pacific francs after the devaluation, meaning no saving for the State on this part. However, most of what was imported by the State was for the military: Fcfp15 billion in 1995, Fcfp10,4 billion in 1996, and this is one item that is likely to decrease rapidly with the end of atomic testing. The great bulk of civil expenditures goes to wages, pensions, family allowances, social security benefits, and transfers to the Territory's budget, the imported part of the State's expenditure being probably less than 10 per cent. Moreover, remember we assume the abolition of import duties would approximately compensate the higher cost of imports. This is also true of goods imported by the French State. For instance, in 1993 military imports amounted to Fcfp14 billion, on which the French State paid the Territory an extra Fcfp5.3 billion of import duties each year, that is, on average, 38 per cent of the value of the goods imported. The devaluation would increase the value of military imports by 43 per cent, but the 38 per cent duty would disappear: the increase in cost would then be, for an imported good worth Fcfp100, from Fcfp138 before devaluation, to Fcfp143 after devaluation and abolition of import duties, that is, a mere 3.6 per cent increase.

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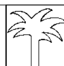

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