



CURRENT ECONOMIC TRENDS IN THE SOUTH PACIFIC

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Introduction

Two quite different developments have altered the short- to medium-term prospects for the South Pacific economies in opposite directions.

On the positive side, the continued, though moderate, growth in the industrial economies outside the region has led to a general price rise in internationally traded goods, including exports from the Pacific region. The reliance of the region's economies on the export of a few commodities has meant that the region has been severely affected by depressed commodity prices in recent years. Any price improvement will therefore help to ease present economic difficulties. A substantial portion of the extra export revenues that will be generated from higher prices should be allowed to flow back to producers to be reinvested, rather than be heavily taxed to support the large public sectors in these countries. The economic decline of 1984 to early 1987 saw governments in the region exercise greater fiscal restraint (especially as regards staffing levels) and to introduce greater efficiency into their operations. The benefits of these policy initiatives should not be lost in public sector growth based on another round of temporary, cyclical price increases.

On the negative side, the recent political developments in Fiji could call into question basic assumptions regarding the stability of political structures and institutions in the region. It has long been acknowledged that tensions existed in several Pacific island countries, but only in New Caledonia and, to a lesser extent, in Vanuatu, has there been major civil unrest related to aspirations for political independence. In contrast, Fiji was often quoted as a country where harmony existed between the major racial groups, and where a multi-racial population was seen as a positive factor in economic development. With recent events, it may be necessary for more recognition to be given to social tensions in Pacific societies, especially as development quickens, and to test the capacity of political structures to contain or resolve these tensions.

Commodity prices

(a) General

Previous issues of the *Bulletin* have noted the long-term decline in commodity prices as compared to manufactured goods, which has serious implications for commodity exporting countries such as those in the Pacific. With sluggish world economic growth

in the 1980s, the average price of traded goods has been remarkably stable, while those of commodity groups have fallen dramatically (see Chart 1).

Price movements for commodities have also tended to be more volatile with two major cyclical swings apparent over the period. These swings reflect major shifts in the supply and demand for particular commodities, the most pronounced being the collapse of petroleum prices in 1986. Other factors contributing to commodity price movements included the dumping of surplus food by both the United States and the European Communities, the large increase in the supply of vegetable oils, and the fall in the world supply of coffee as a result of poor harvests in Brazil.

(b) Gold

It would be an exaggeration to say that there is a classic gold rush to the Pacific islands, though there is a growing interest by overseas investors, including a number of Australia-

lian companies, which are actively participating in various exploration and production ventures. This partly explains the rapid rise in the average price of gold shares on the Australian stock exchanges.

Relatively new prospecting techniques have opened up the geological area known as the 'rim of fire' circling the Pacific from British Columbia in Canada through Fiji, the Solomon Islands and Papua New Guinea. Its distinctive feature is the occurrence of epithermal deposits of gold which are not as immediately apparent as alluvial gold, but are now accessible using core mining techniques. Papua New Guinea already has two major gold and copper operations (Bougainville and Ok Tedi) while several others are in the early stages of prospecting or development (notably, Porgera and Misima). Prospecting licences have been granted for most of the area in the Solomons volcanic islands. Fiji already exports gold from one mine and further exploration and development activity is under way.

Chart 1
International trade price indexes
(1980 SDR values = 100)

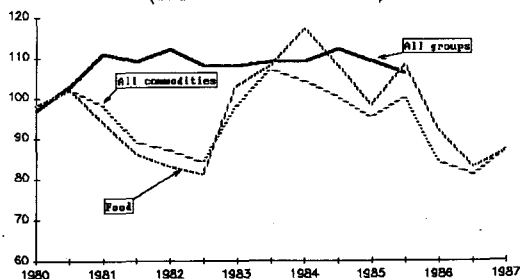


Chart 2
Mineral price indexes
(1980 SDR values = 100)

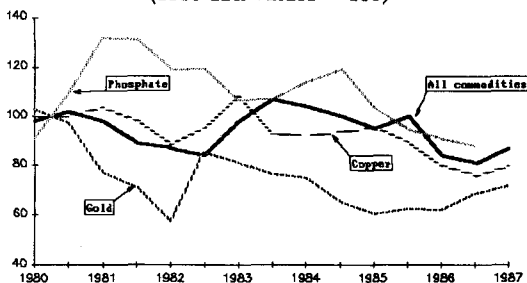


Chart 3
International sugar prices
(1980 SDR values = 100)

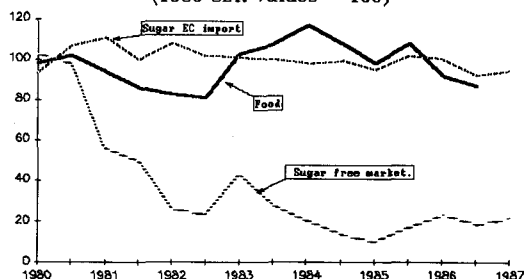
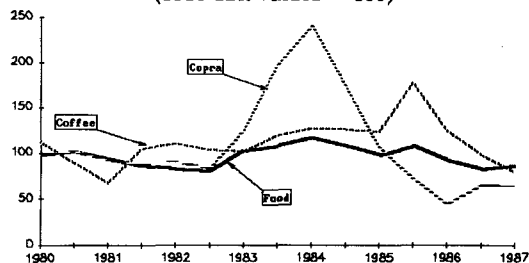


Chart 4
International copra and coffee prices
(1980 SDR values = 100)



Some estimates indicate that as long as the gold price is above US\$350 an ounce, mining would be profitable in many parts of the Pacific. The price is now close to US\$450, and while below the peak levels of the early 1980s it is well above the 1984 trough, largely reflecting the uncertainty surrounding South Africa's political future (see Chart 2).

A marked rise in gold and other mineral production would contribute to a rise in incomes in the islands. However, unless appropriate policy steps are taken it would also raise the foreign exchange value of national currencies and inhibit more traditional exports. The rapid development of gold could thus provide opportunities for improved welfare, but also raise problems for macroeconomic management.

(c) Fish

The Multilateral Fisheries Access Treaty signed by the South Pacific Forum Fisheries Agency and the United States in April 1987, signified acceptance by the United States of the territorial rights of the island nations in their 200 mile exclusive economic zones (EEZs). Under this treaty the United States is expected to inject US\$60 million to the South Pacific Forum countries over the next five years, that is, US\$12 million annually, comprising a US\$9 million cash grant, US\$1 million tied aid, and US\$2 million in fees from the American tuna industry. Most of the money will be paid to countries in whose seas the tuna is caught, but 15 per cent of the total amount is expected to be shared among all the Forum countries. The licence fee per boat will be US\$50,000 and this will increase if there are more than thirty-five boats.

The financial benefits from the agreement will not take effect until after the agreement has been ratified by the US Congress. Fishing by US vessels in the EEZs of Forum member

countries remains illegal until that time. Kiribati recently arrested and confiscated a US vessel for fishing in its waters. The unfortunate incident (the vessel's owners pleaded guilty in the court case) may cause some tensions within Congress when the agreement comes up for ratification.

Export earnings from fisheries have improved during 1987 with slight rises in tuna fish prices in both the Japanese and US markets. Fiji and the Solomon Islands are continuing with plans to expand domestic processing facilities.

(d) Copper

The increase in manufacturing output that is now occurring in the industrial countries is being reflected in a small rise in the price of copper of approximately 5 per cent in SDR terms in 1987 (see Chart 2). With increasing production from Ok Tedi, Papua New Guinea should benefit markedly if the positive price trend continues or prices at least remain stable.

(e) Sugar

In late 1986, prices on the non-negotiated international sugar market declined following a relaxation of European Community restrictions on exports and a reduction in 1986/87 US sugar quotas (see Chart 3). At the end of the year, news of droughts in Brazil, China, Cuba and Thailand stimulated a rise in prices which has since continued. Prices on the international market, however, are small fractions of their 1980-81 levels.

Fiji is largely protected from the variations in this market by its access to the UK (that is EC) market, where prices are substantially above the prices in the non-negotiated market. It has been able to secure an increase in its import quota to the United States. Papua New Guinea now has limited access to the US market where prices tend to be four times those in the international market.

(f) Coffee

Coffee prices have been highly volatile since 1985 when they almost doubled during the year (see Chart 4). Changing weather patterns in 1984/85 greatly affected production from Brazil, the world's major producer. Other producers subsequently sought to increase their market share and the structure of the export quota system became unstable. Attempts to re-establish the agreement on export quotas among members of the International Coffee Organization have so far failed. With large stocks and weak demand, prices have declined. Prices expressed in terms of SDRs reached a peak at the end of 1985, and have tended to decline since then. By mid-1987 they were approximately half their end 1985 level.

(g) Coconut products and palm oil

Declines in Philippine exports have produced a modest improvement in prices since mid-1986. World demand for copra and coconut oil exceeded production leading to a decline in stock levels. In the first quarter of 1987, the price of copra had moved up to almost 50 per cent above its 1986 low point (see Chart 4), but the situation has since stabilized. Coconut oil has also regained its price premium over other vegetable oils. However, prices remain well below their 1984 peak.

Higher returns will help to ease the trade balance of all Pacific economies, especially Kiribati, Tonga and Vanuatu, where copra and coconut oil are primary export commodities. The Solomon Islands is still recovering from the effects of Cyclone Namu, which affected a significant portion of its coconut tree stocks.

The immediate beneficiaries will be the commodity marketing boards in the various countries. Their financial reserves have been severely depleted by the price support schemes they provide to farmers. These operations have been maintained with the assis-

tance of STABEX funds provided by the European Community, which recently granted quite large advance payments to several eligible countries in the region. In the longer run, production levels should also improve if higher prices are passed along to producers.

(h) Cocoa

During 1986, cocoa prices departed from their usual path of following coffee prices and declined, largely because of a one-third increase in the Ghana crop.

(i) Tea

World tea production has declined in response to the low prices prevailing since 1985, but not to levels sufficient to raise prices back to previous levels (some estimates suggested that the inflation corrected level of prices in 1986 was the lowest in history). The main reason for the depressed market is the large accumulation of stocks following high output levels in the early 1980s.

Aid

The Pacific countries receive more foreign aid per capita than any other region in the world. For some of the smaller nations, foreign assistance is at present essential to economic viability. Apart from aid provided by foreign governments to dependent territories, Australia, the United Kingdom and New Zealand are the largest contributors of assistance. An increasing aid role is being taken by the European Communities' and Japan's bilateral programs and contributions to programs operated by regional organizations.

The United States provides aid to the Pacific (excluding its trust territories) largely on a regional basis. Its Pacific Regional Program has three major components: promotion of the work of voluntary and

community based organizations; promotion of private initiatives and indigenous business activities; and support of the fisheries sector as exemplified by the Multilateral Fisheries Access Treaty. Fiji has been the only recipient of official bilateral aid from the United States.

More recently, a new financing scheme - the US Agency for International Development (USAID)/Westpac facility - was introduced by the United States as part of its more general aim of promoting the private sector in the region. This scheme consists of an offer by USAID to guarantee 30 per cent of Westpac's credit risk in making loans to small businesses in the South Pacific up to a total of US\$6 million. USAID's exposure would be limited to 30 per cent of the loan, that is, up to US\$1.8 million. The balance of the risk would be borne by Westpac. The whole of the funds would be advanced by Westpac from its normal deposit base, on normal commercial banking terms and conditions, except that Westpac

would presumably look for up to 30 per cent less collateral than usual from the borrower.

Borrowers under this scheme must be 100 per cent privately owned and controlled, and at least 50 per cent owned by Pacific islanders. No part of the loan may be the subject of any government guarantee. The funds must not be used to produce or process sugar, palm oil or citrus, to deal in pesticides or luxury goods, promote abortion or law enforcement, or buy non-American motor vehicles in excess of 50 per cent of the loan. Nothing can be purchased from a list of eighteen communist countries, including the People's Republic of China.

Individual countries

(a) Fiji

The political change in Fiji was the most dramatic event in the Pacific in the six months up to June 1987. As yet, its economic implica-

Table 1 Net disbursements of official development assistance from all sources, US\$ million

	TOTAL 1980	TOTAL 1985	Australia 1985	New Zealand 1985	United Kingdom 1985	EC 1985	Japan 1985	France 1985	United States 1985	Other 1985
Cook Islands	10.7	9.7	0.79	6.99	-	-	0.34	-	-	1.58
Fiji	36.1	31.9	10.03	3.39	1.81	3.60	8.15	-	1.00	3.92
Kiribati	19.2	12.0	2.56	0.87	4.57	0.48	2.80	-	-	0.72
Nauru		0.1	0.05	-	-	-	-	-	-	0.05
New Caledonia	198.0	145.4	0.04	-	-	0.19	-	145.10	-	0.07
Niue	3.7	3.5	0.06	3.45	-	-	0.01	-	-	0.02
Pacific Is. (Trust Tr)	109.3	159.3	0.18	-	-	-	3.74	-	154.00	1.38
Papua New Guinea	325.9	258.9	226.85	2.86	0.09	4.15	3.95	1.14	1.00	18.86
Polynesia, French	159.5	172.0	0.12	-	-	1.23	0.12	170.21	-	0.32
Solomon Islands	44.5	20.8	5.60	0.59	5.28	1.52	0.81	-	1.00	6.00
Tokelau	1.9	1.8	-	1.58	-	-	-	-	-	0.22
Tonga	16.4	13.6	4.85	2.65	0.17	0.77	1.33	0.35	-	3.48
Tuvalu	4.9	3.3	0.91	0.41	1.73	0.03	0.07	-	-	0.15
Vanuatu	44.0	21.8	4.39	1.04	6.55	1.11	0.75	5.88	-	2.08
Wallis & Futuna	8.3	0.2	-	-	-	0.20	-	-0.02	-	-
Western Samoa	25.7	19.4	5.34	3.77	0.06	1.69	1.82	0.05	1.00	5.67
Oceania unallocated	16.4	26.2	6.83	8.49	0.83	-	0.20	2.40	7.00	0.45
Total	1024.4	899.9	268.60	36.09	21.09	14.97	24.09	325.11	165.00	44.95

Source: OECD, *Geographic distribution of financial flows to developing countries, 1982-85*, OECD, Paris, 1987, pp. 21 for aggregate figures in 1980 and 1985. Figures for bilateral donors are sourced from the OECD's Development Assistance Committee.

tions are unclear. However, it is likely to adversely affect most of Fiji's major foreign exchange earning sectors. Continued political uncertainty will discourage tourists from visiting Fiji and the consequent decline in this major source of foreign exchange will not only create balance of payments difficulties, but also lower domestic incomes.

Foreign investment will suffer. The Fijian authorities had used their record of domestic harmony as an argument to encourage overseas investment. It is likely to take several years of stability to regain the confidence of foreign investors.

Prospects for Fiji's sugar industry are also uncertain. Even before the coup, the 1987 sugar crop had been forecast to be lower than the record 1986 crop (470,000 tons as compared with 500,000 tons). Higher prices were predicted to compensate for some of the forecasted drop in output: however, a drop in production would result in a serious balance of payments problem.

The Fiji authorities maintain that a balance of payments crisis is not imminent as Fiji has international reserves equal to five months import payments. Undoubtedly, export receipts will continue to flow in the short term. However, any marked decline in export receipts could put the balance of payments in a precarious position, especially if the situation is exacerbated by further outflows of private capital. Even a month's delay in the transfer of export receipts to Suva and one month's acceleration of import payments would cause a serious drain on reserves.

Even before the election there was a considerable uncertainty in the community with regard to future prospects. The banks were unusually liquid with the decline of both private and public investment, and many borrowers were repaying loans faster

than others wished to borrow. It already seemed unlikely that the 5 per cent growth rate target for 1986 set down in the Ninth Development Plan would be achieved.

If the political situation is stabilized quickly, there should be little long-term harm done to the economy. Any decline in sugar output could be offset in a short (say one year) period. Tourists will return. Even foreign investors will eventually renew their interest. If present prospecting finds exploitable gold, Fiji will also benefit from the gold boom.

(b) Vanuatu

Cyclone Uma, which swept through the southern islands of Vanuatu, was the other dramatic event of the first half of 1987, causing forty-eight deaths and an estimated A\$35 million of damage to agriculture and infrastructure. An aid donors' meeting was held in early June to arrange for assistance towards a major rehabilitation program estimated at A\$20 million. To date, commitments have been received for approximately 65 per cent of the financing requirement, with the largest donors being Australia, the United Kingdom and Japan.

Vanuatu's economic growth prospects appeared to be diminishing prior to the cyclone. Tourist numbers had been steadily falling, discouraged by the strong exchange rate policy (despite the devaluations of 1985 and 1986) and the reduction in air services. The cyclone added to these problems by damaging hotel and other tourist facilities. Falling commodity prices were reflected in lower export earnings from copra, fish and beef.

However, tourist numbers have been increasing recently and further growth is anticipated. Tourists have redirected their holiday destinations away from Fiji following the political problems there. Additional aircraft have been leased and purchased to in-

crease passenger capacity on major routes, and by late 1987 much of the accommodation closed because of cyclone damage will be reopened. The reconstruction of infrastructure may also lead to improvements in the country's capital assets, while the signing of fishing agreements with both the United States and the USSR will add to foreign exchange earnings. However, the immediate economic prospects are dependent on further growth in the tourism industry and the International Finance Centre's activities.

(c) Papua New Guinea

Uncertainty generated by the forthcoming election dominated the investment climate of Papua New Guinea in the first six months of 1987. The banks were highly liquid and had difficulty in finding adequate borrowers. Preoccupation with electoral problems prevented politicians from implementing many of the reforms that are necessary if Papua New Guinea is to reverse its negative per capita growth rate. It has also deterred the public service from taking strong action.

With Ok Tedi starting copper production and the present and predicted continued high levels of gold prices and current levels of copper prices, Papua New Guinea is benefiting immediately from the gold boom and increasing world industrial production. The increased interest in gold exploration will bring small immediate returns in the forms of licence fees and prospecting expenditures, with expectations of large returns in the future.

The outlook for the coffee industry is rather clouded. The coffee rust problem remains a major threat to the dominant smallholder sector of the industry. There is also a need to rehabilitate the industry as many of the trees have become senile. (See 'The Papua New Guinea Coffee Rehabilitation Program' in this issue.) The rehabilitation program is aimed not only

at attacking rust but also at improving the quality and condition of the trees. Credit may be a major constraint. Many small holders have not made provision for depreciation and obsolescence. They will need credit to replant, fence, and otherwise improve their holdings. As credit has not been used in the past, neither they nor the banks are accustomed to borrowing for coffee production. Only some 3 per cent of total bank credit was extended for coffee production and most of this went to the plantation sector.

(d) Solomon Islands

The Solomon Islands is still recovering from the effects of Cyclone Namu. Rehabilitation of physical assets is still underway and reconstruction continues to be emphasized in development planning.

On a per capita basis, the Solomon Islands could well be the greatest beneficiary in the region from the current influx of foreign investment associated with minerals exploration and development. Exploration licences have been granted for most areas outside Honiara and in 1987 and 1988 licence fees could be approximately equal to total cash aid receipts. Even if nothing comes from this exploration these expenditures will make a significant contribution to the Solomon Islands income.

The Solomon Islands is the largest producer of fish in the Pacific area, and the conclusion of the US fishing agreement will add further revenues to this sector. The recovery of vegetable oil prices will benefit palm oil and copra producers and ease the financial position of the Commodities Export Marketing Authority, which operates a price support scheme funded largely from the EC's STABEX scheme. However, it will take some months before these benefits are reflected in balance of payments and national account figures.

There was sluggish domestic investment demand in early 1987, although several large investment projects (in which the government also has a major equity interest) are being initiated. Private investment associated with these projects will also increase, but there is a need to boost the role of the private sector to assist in the diversification of the country's economic base.

The Central Bank's exchange rate policy remains flexible to facilitate the flow on of international price and interest rate changes. The Solomon Island dollar continued to depreciate in early 1987 against the United States dollar, the Australian dollar and the Japanese yen. The growing budget deficit (SI\$8 million in 1984, SI\$30 million in 1986) with the consequent increased international borrowing (SI\$4 million in 1984, SI\$17 million in 1986) is a cloud on the horizon. No immediate improvement is expected; the government has announced an estimated SI\$38 million deficit for 1987. The government believes that price increases must fall to 5 per cent before monetary policy, including higher interest rates, can be relaxed.

The Solomon Islands' 1987 development budget is the largest on record (estimated at SI\$76 million plus SI\$7 million allocated for cyclone rehabilitation), in an effort to overcome shortfalls in achievements in 1986.

(e) Western Samoa

The improvement in vegetable oil prices and the reappearance of the premium for coconut oil over most other oils will bring benefits to Western Samoa. Problems still remain within the coconut industry. Despite the price improvement Western Samoa's coconut oil mill is still not a viable economic proposition and, further, continued delays in reforming the operations of the Coconut Mar-

keting Board will continue to discourage expanded production.

The Government of Western Samoa has initiated a review into the possible privatization of a number of its state-owned commercial enterprises. The government is being assisted in this review by the Asian Development Bank, which has been the major financial contributor to the investment requirements of these enterprises. A number of important recommendations have been made which should lead to the transfer of government commercial activities to private sector control.

The year 1986 was a mixed one for the economy. Exports were down by some Tala 10 million to Tala 22 million, largely due to falling coconut oil prices. In the 1987 budget statement, the Minister of Finance announced that, as a further decline in export prices was expected, additional fees on government services would subsequently be introduced to compensate. Imports fell in the last quarter of 1986 following reduced development expenditure, lower import prices and a tighter credit policy. The balance of payments showed an historically high overall surplus in the last quarter of 1986 resulting in gross international reserves of Tala 53.7 million in 1987. However, the structural position of the balance of payments remains weak.

Current and development expenditures for 1987 are expected to be less than the 1986 budget levels. However, it is still expected that a National Development Loan of Tala 2.5 million will be required to finance a shortfall in the government's expenditure program.

The Western Samoan tala has stabilized in recent months against the New Zealand dollar and the Australian dollar - the major import supply currencies. Up to March 1987 some improvement was made against

the United States dollar. Overall net foreign assets recorded a satisfactory increase, of Tala 23.8 million, to Tala 33.7 million at the end of 1986.

New guidelines for commercial bank credit were introduced for 1987. The 'ceiling system' has been replaced with a system based on a variation of the banks' loans to deposits ratio, but with fresh credit being linked to the growth in genuine longer-term savings.

A comprehensive review of tax and customs law is also under way. Temporary downward adjustments to income tax collection have been made and further adjustments will be made when the review is complete.

(f) New Caledonia

Large increases in USSR nickel exports in 1986 and expectations that these exports would continue for several years depressed nickel prices which are now well below their early 1986 levels. The depressed nickel prices, together with increasing political tensions, have discouraged new investment in the island and may even have encouraged some capital outflow.

New Caledonia remains one of the wealthiest of the Pacific islands. However, until the political situation is resolved hopes of economic improvement remain slim.

(g) Tonga

The national income of Tonga has continued to grow at the highest rate in the Pacific region owing, in part, to increased exports of goods produced by private entrepreneurs.

The Fifth Development Plan directs attention to regional development through integrated island development plans. This might appear strange for a country of 100,000 people. However, with many widely separated islands, there are considerable economies in concentrating infrastructural development geographically. For

example, earth moving equipment can be more efficiently employed building roads, jetties and airfields on one island at a time. Priority sectors for public sector spending within these regional plans include telecommunications and transport infrastructure.

The restructuring of Tonga's tax system is proceeding. The flat 10 per cent income tax has been implemented and the government has apparently overcome most of the difficulties faced in implementing its retail sales tax and the current receipts from this tax are approximately equal to forecasts. Unfortunately, the opinion expressed in the last *Pacific Economic Bulletin*, that most of the technical and economic problems facing the dessicated coconut factory had been overcome, has proved to be overly optimistic.

(h) Kiribati

The Revenue Equalization Fund is continuing to grow, with approximate reserves of A\$168 million at the end of the third quarter of 1986. Kiribati was officially declared a 'least developed country' in early 1987. This change in status is expected to provide easier access to additional grant and soft loan funds from United Nations agencies.

The expired USSR-Kiribati fishing agreement has not been renewed. However, Kiribati with its very large EEZ (3.5 million km²) and significant stocks of tuna will benefit from the USA-Pacific Forum Multilateral Fisheries Access Agreement.

(i) Tuvalu

Tuvalu, also with a large 900 km² EEZ compared to its land area of 26 km², will benefit from the US fisheries agreement. Discussions were held with the USSR over fishing rights, but Tuvalu ultimately chose to participate in the US agreement instead.

Australia, New Zealand and the United Kingdom have now signed the Tuvalu Multilateral Trust Fund of A\$27 million which should place the

country's public finances on a predictable base. Australia's commitment to the Fund is A\$8 million.

The desirability of tourism: a clarification

Some commentators have suggested that the reference to Dwyer's study on tourism expenditure in Western Samoa included in the article on 'The desirability of tourism' in the last issue of the *Bulletin* cast doubt on the validity of Dwyer's statistics.

This comment is the opposite of the truth. Dwyer's data were regarded as valid. They were noted to compare his findings with a number of observations that have been made on the import leakage effects of tourist expenditures.