

Reviving growth in the Fiji islands: are we swimming or sinking?

Biman Chand Prasad and Paresh Kumar Narayan

The Fiji government's 2008 'budget for hope' rests on some fundamental assumptions: political stability, the recovery of key sectors of the economy from the effects of the 2006 coup, as well as the recovery of the tourism industry, an industry which in the past has been resilient to coups. With 34 per cent of the population already living below the poverty line, low economic growth could push significantly more people into poverty. If the increases in global food and fuel prices persist, creating even more difficulties for the poor, the prospect of social instability could heighten. In the absence of the expected recovery of these key sectors and the loss of skilled workers, achieving economic and social recovery will require political consensus to resolve the political impasse that has gripped the country. The Interim Government also needs to revisit its fiscal austerity package.

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In launching Fiji's 2007 Budget, the Interim Finance Minister talked about the economy swimming or sinking. One year on, the question of whether the Fijian economy is swimming or sinking lingers. Despite a weakening of all key macroeconomic indicators and the below-par performance of key export sectors, we take a conservative stance and conclude that the economy is swimming, but in the wrong direction—not towards the shore but into deeper water.

The 2008 Budget was called a 'budget for hope' and the Interim Finance Minister described it as follows.

Budget 2008 is moulded on the Interim Government's vision for a

modern, prosperous and progressive multiracial society with equal opportunities and a level playing field for all. This means providing the opportunities to improve living standards, providing greater access to education for our children, and efficient health care facilities for our poor, creating more investment opportunities and, thereby jobs, and empowering our people with opportunities and skills to better their lives and those of their families (*Fiji Live*, 1 March 2008).

The 'budget for hope' rests on some fundamental assumptions about the situation

Economic survey

in Fiji. First, it assumes that political stability will be achieved and that the interim regime will pave the way for general elections in 2009, as promised. Second, it assumes that the key sectors of the economy, such as sugar, tourism, construction and retail trade, will recover from the debilitating effects of the 2006 coup. It was expected this recovery would be achieved by early 2008. These assumptions have proved inaccurate, casting doubt on the country's ability to achieve economic growth. The tourism industry, which in the past has been resilient to coups (Narayan 2004a, 2005, 2007), has failed to recover. This is evident from the fact that the Reserve Bank of Fiji (RBF) has revised its initial projection of a 2.2 per cent growth for 2008 to 1.7 per cent. In addition, the contraction of the economy in 2007 has been revised to negative 4.4 per cent—almost double the initial projection.

Most military coups are justified on the grounds that they are replacing corrupt regimes, they will clean up corruption and pursue consistent, transparent and appropriate economic policies to stimulate economic growth and fight poverty. It is often accepted that non-democratic regimes are able to push through unpopular yet appropriate economic policies to achieve economic reforms that can produce sustainable levels of growth. Duncan (2007) listed several priorities for the Interim Government to pursue in what he called an 'economic clean-up'. These included removing customs duty increases announced in the Qarase government's 2007 Budget, establishing a more effective leasehold system for customary land, establishing an efficient court system and privatising the telecommunications system and other inefficient government business enterprises.

Fiji has technically had four coups: two in 1987, one in 2000 and one in 2006. The leaders of each coup stated a particular

objective: in 1987 and 2000, the motivation was to protect indigenous Fijian rights and it was claimed that the coup presented the only way to move forward. As a result, in 1990, Fiji was given a new constitution, which was by all measures a racist constitution that helped create a divided nation. This adversely affected economic growth and development (Narayan and Prasad 2007). As a result, Fiji lost much highly skilled human capital (Narayan and Smyth 2003, 2005, 2006). The lack of economic progress and social distress paved the way for a new, non-racist constitution in 1997. With the advent of the 1997 Constitution, there was a relatively positive economic environment and a good foundation was laid for future growth. There was significant economic growth in the period 1997–99; however, the high growth rate of 9 per cent in 1999 was due largely to the rebound from the 1998 drought.

This progress was disrupted by another coup, in 2000, instigated using the same motivation as the previous coups: protecting the rights and economic position of indigenous Fijians. At the time, many individual Fijian chiefs, the Great Council of Chiefs and the military accepted this objective. After the 2000 coup, the economy declined further and began lagging behind many of its Pacific island neighbours, which Fiji had dominated (economically and socially) since independence.

The Interim Government installed after the 2000 coup and the Soqosoqo Duavata ni Lewenivanua (SDL) government that came to power in the 2001 election continued to pursue the objectives of the coup by adopting economic policies that put significant emphasis on indigenous Fijian economic participation. The '50/50 by 2020' policy and various other expenditure and affirmative action policies were clearly designed to please nationalist elements in the society. After the 2006 election, however, a genuinely

Economic survey

multi-racial cabinet was appointed, and it should have been allowed to run its course. Even if there was initial doubt about the new government, the national mood after the formation of the multi-party cabinet suggested that people at the grassroots level were generally happy. This signal from the people gives hope for the future.

It is our view that the majority of the people want a political settlement that is accommodative and will deliver economic prosperity. There is no doubt that the 2006 coup has been very damaging to the economy and to race relations. This, one could conclude, is being fuelled by some elements in the various groups in opposition to the coup as well as by elements within the Interim Government. For example, some ministers harp on about the failures of the SDL government rather than concentrating on moving the country forward. No coup, whatever the motive, can be good for the country and the 2006 coup is no exception. Now that the coup has taken place, however, and the Interim Government is in charge, the main question is how we can move forward from here.

First year of the Interim Government's policies and achievements: the macroeconomy

The revised 2007 and 2008 budgets were touted as the budgets that would save Fiji from the economic collapse that had been looming for the past five years, and would create financial stability. This economic assessment was based on the country's weak export performance, dwindling foreign reserves and an economy driven by consumption expenditure. These issues have been discussed widely in the literature, so we will not discuss them in much detail here.¹ The biggest challenge for the Interim Government has been to arrest the economic

decline that began in the aftermath of the December 2006 coup.

GDP growth

Generally, Fiji's real GDP growth rates have been very volatile since independence, within a range of -6.6 per cent in 1987 to 12.6 per cent in 1989 (Figure 1). During the 1970s, real GDP grew at an impressive average rate of 5.6 per cent per annum, while it grew at a meagre 1.9 per cent per annum in the 1980s. During the 1990s, the performance of real GDP improved, with the growth rate averaging about 2.7 per cent. This growth rate was, however, well below the national goal of 5 per cent per annum. Unfortunately, during the period 2000-06, the performance of real GDP deteriorated further, averaging only about 2 per cent per annum.

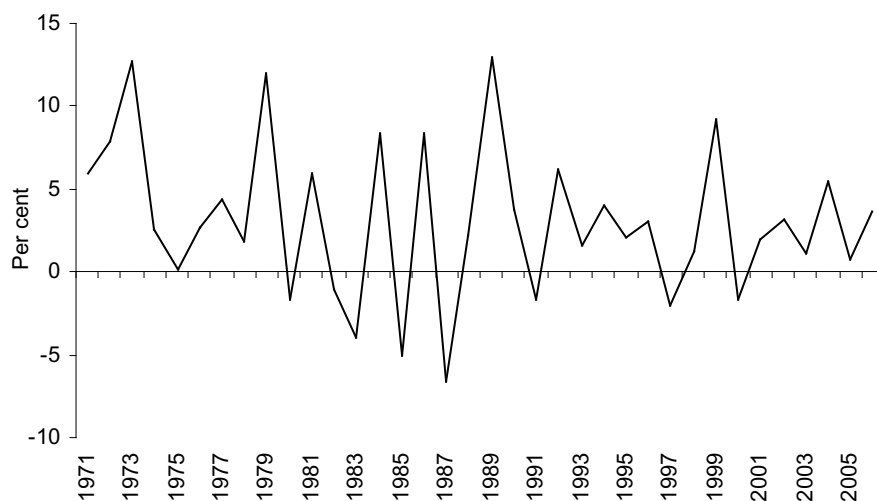
The initial aggregate GDP forecast by the government and the Reserve Bank was that the economy would contract by 2.5 per cent in 2007, compared with growth of 3.6 per cent in 2005 (RBF 2008). The 2007 growth estimate has since been revised several times, with the latest revision in April 2008 estimating negative 4.4 per cent. Assuming a population growth rate of 1 per cent, per capita GDP in 2007 will therefore have fallen by more than 4 per cent.

The 2008 Budget's GDP forecasts were 2.2 per cent for 2008, 1.1 per cent for 2009 and 1.6 per cent for 2010. The 2008 GDP forecast has subsequently been revised down to 1.7 per cent (RBF 2008). These forecasts are, however, based on the assumption that political stability will not be an issue and that the timetable for a general election in 2009 will be adhered to. The expectation that an election will be held in 2009 will contribute to the recovery of the tourism industry and could assist in achieving positive growth rates in 2008, 2009 and 2010.

Generally, the contribution of the primary sector to real GDP growth has been

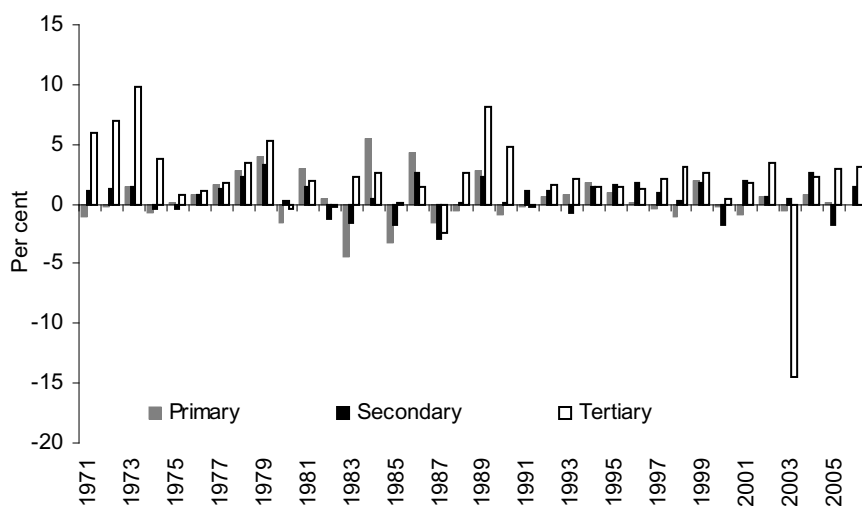
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Figure 1 Fiji: real GDP growth rates, 1971–2007 (per cent)



Source: Fiji Islands Bureau of Statistics, various years. *Fiji Key Statistics*, Government of the Republic of Fiji, Suva.

Figure 2 Fiji: sectoral contribution to real GDP growth, 1971–2007 (per cent)



Source: Fiji Islands Bureau of Statistics, various years. *Fiji Key Statistics*, Government of the Republic of Fiji, Suva.

Economic survey

declining (Figure 2), while the contributions of the secondary and manufacturing sectors have been increasing. This trend is due largely to the high rate of rural-to-urban migration since independence. One of the main reasons for this migration has been the expiration of agricultural land leases and declining agricultural production. The genesis of the decline in the contribution of the agricultural sector can be traced back to 1987 when the then Interim Government pursued a radical shift in economic policy, which emphasised stimulating urban manufacturing, to be led by garment manufacturing. Support for the development of rural infrastructure and agriculture was reduced substantially, contributing to a significant decline in agricultural-sector output.

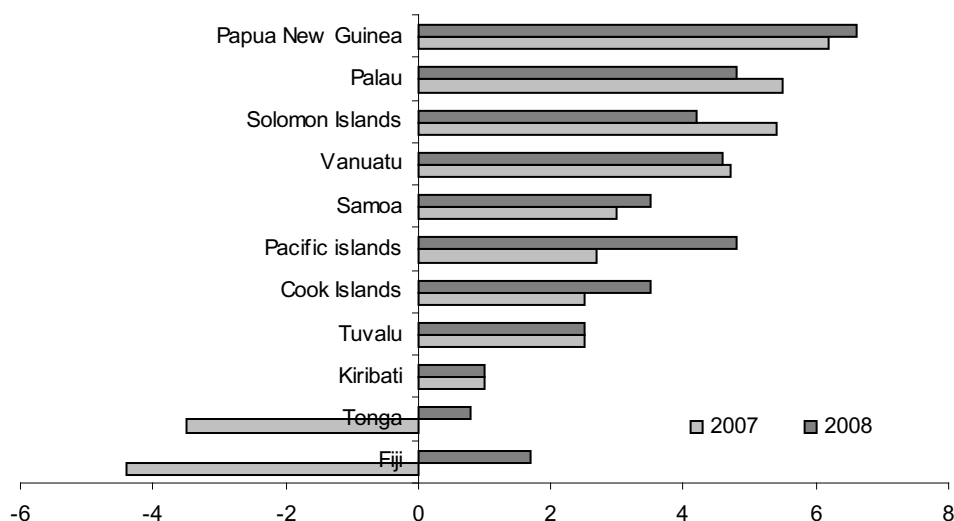
Fiscal policy

The Interim Government's preference for a 2 per cent budget deficit is, in our view, a case of 'feel-good economics', which is counterproductive when all macroeconomic

indicators have worsened. It is widely understood that when an economy is in decline, cutting back government expenditure will not rein in the decline; rather, it will have the opposite effect. In the short term, the best strategy would have been an economic stimulus package. Reducing the budget deficit would have been a more realistic longer-term objective; but clearly persisting with a 2 per cent deficit lacks economic logic and does nothing to promote economic growth.² The result of this poor choice in fiscal policy has been the deteriorating state of infrastructure and the worsening provision of social services, which have had a negative impact on investor and consumer confidence.

The focus of the Interim Government on revenue-raising measures is appropriate and must be applauded; however, the amount of revenue collected is largely a function of economic growth and any revenue-collection strategy that impedes economic growth will be counterproductive. Government

Figure 3 Economic growth in Pacific island countries, 2007 and 2008



Source: UNESCAP Survey 2008 and RBF forecasts April 2008.

Economic survey

action creating instability in the minds of investors, such as the case involving Fiji Water, is short-sighted and lacks strategy and vision. Tax collection must be a process in which taxpayers are not harassed and in which they feel comfortable paying taxes. Any haphazard implementation and identification of individuals and companies can create a situation of panic and can be counterproductive.

Monetary policy

Fiji's key macroeconomic variables have performed poorly in the past couple of years. Inflation has increased from about 3 per cent to more than 8 per cent; total national debt now stands at about 55 per cent of GDP; foreign reserves have declined from a point where they covered six months of imports to where they cover only about three months of imports; and private investment has declined from about 7 per cent of GDP to less than 5 per cent.

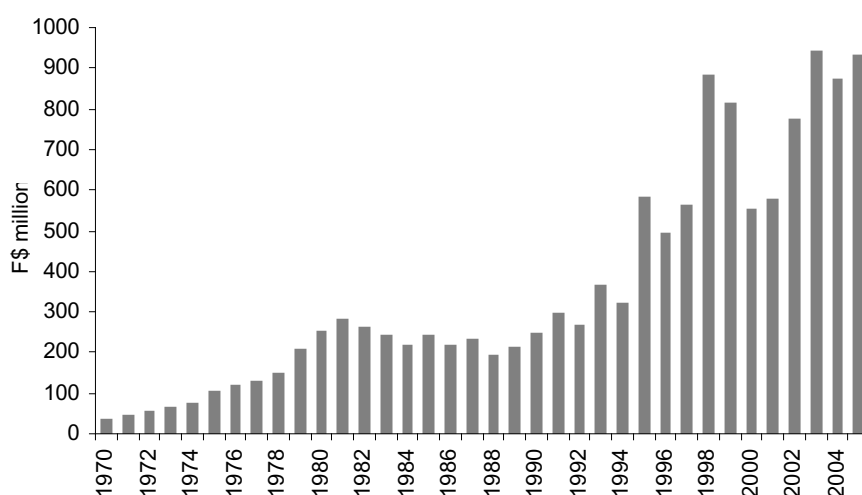
The RBF's response to this poor macroeconomic performance has been to raise interest rates. It raised the official interest rate in October 2005 and, in less than six months, on 24 February 2006, it raised the rate from 2.25 per cent to 3.25 per cent. Higher interest rates are a disincentive for investment. There is also the growing loss of confidence in the economy due to speculation about devaluation, which also negatively affects investor confidence (Narayan and Narayan 2007).

Investment

With a few exceptions (such as in 2000), the value of total investment has generally shown an upward trend, ranging from F\$34.8 million in 1970 to F\$940.5 million in 2003 (Figure 4). Total investment includes investment by the private sector and by the government and statutory bodies.

Similar to real GDP growth rates, investment as a share of GDP has been very

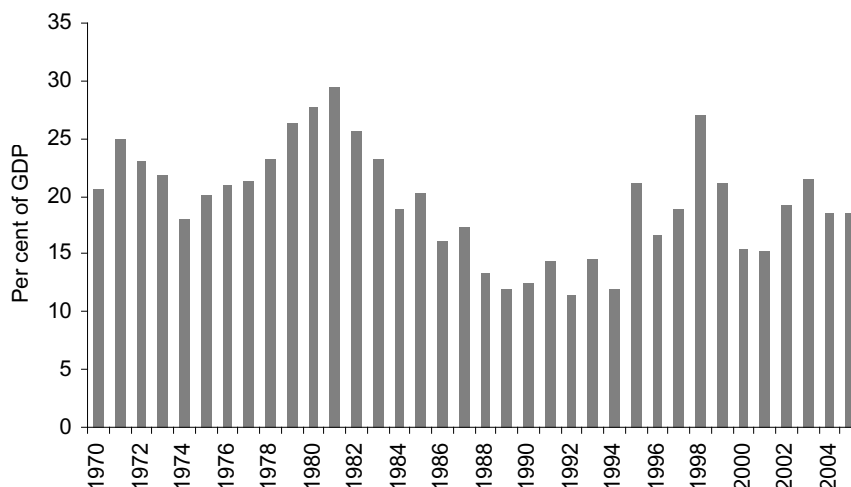
Figure 4 Fiji: total value of investment, 1970–2006 (F\$ million)



Source: Fiji Islands Bureau of Statistics, various years. *Fiji Key Statistics*, Government of the Republic of Fiji, Suva.

Economic survey

Figure 5 Fiji: investment as a percentage of GDP, 1970–2006



Source: Fiji Islands Bureau of Statistics, various years. *Fiji Key Statistics*, Government of the Republic of Fiji, Suva.

unstable since 1970. On average, during the 1970s, investment as a share of GDP stood at about 22 per cent. In the 1980s and 1990s, however, the average share fell to 20 and 17 per cent, respectively. It picked up slightly during the period 2000–06, with an average share of about 18 per cent. Private-sector investment remains weak and this is likely to be the case for the next three years. There is potential for increased investment in tourism and in commercial non-sugar crop sectors. The 2006 coup and the continuing political instability have been significant set-backs in the drive to increase private investment. Private-sector investment needs to be increased significantly if Fiji is to achieve high, sustained levels of economic growth.

While the political environment might be less than conducive to foreign investment, the Interim Government has made some important changes to the foreign investment regulations. The changes include removal

of barriers to investment in certain sectors such as bakery and backpacker operations (Fiji, Ministry of Information 2008).

Inflation and the exchange rate

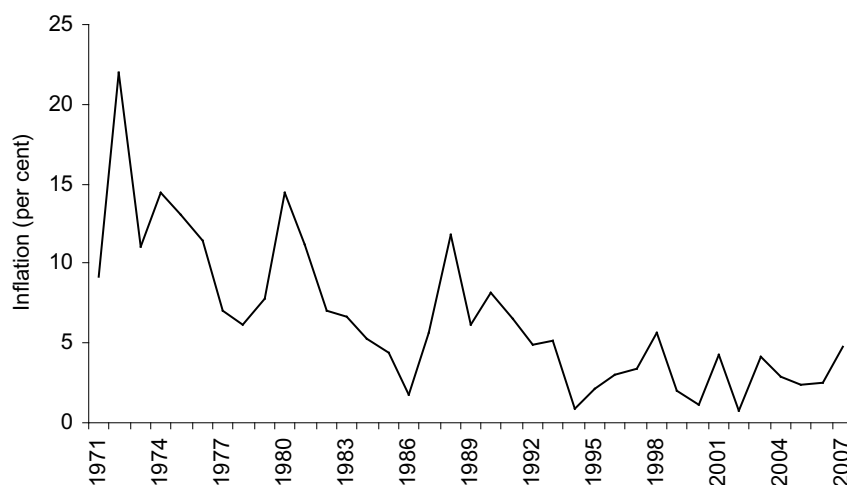
Since the massive hikes in the inflation rate in 1973 and 1981 (as a result of global oil price shocks), the rate of change in consumer prices has showed a general downward trend (Figure 6). Some of the major reasons for this trend are

- Fiji's fixed exchange rate regime has served as a very good nominal anchor for prices
- wage demands have been modest
- there has been good inflation management in Fiji's major trading partner countries
- and there have been good supply conditions for local produce.

The official inflation rate provided by the Fiji Islands Bureau of Statistics might not reflect

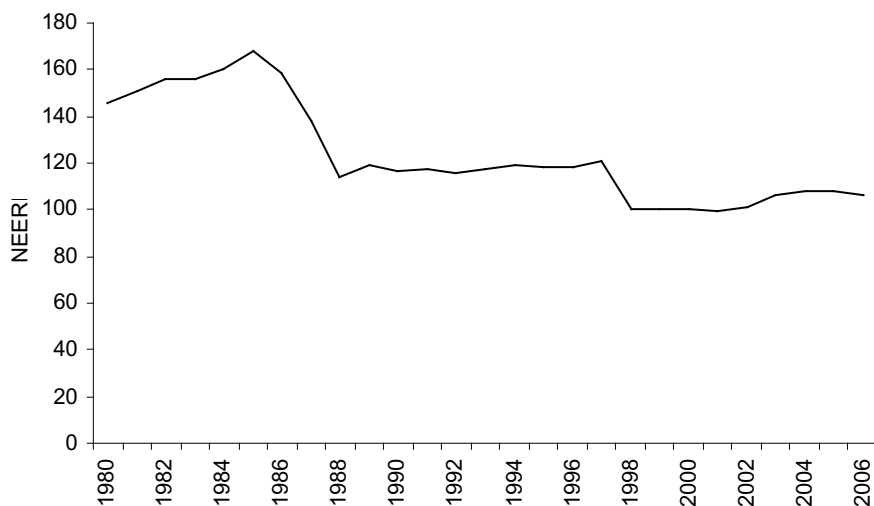
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Figure 6 Inflation rate for Fiji, 1971–2007 (per cent)



Source: Fiji Islands Bureau of Statistics, various years. *Fiji Key Statistics*, Government of the Republic of Fiji, Suva.

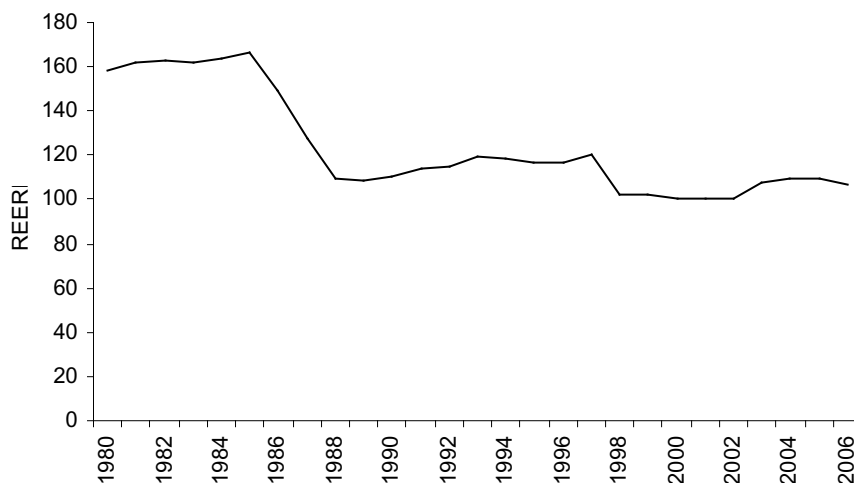
Figure 7 Fiji: nominal exchange rate index, 1980–2006



Source: Fiji Islands Bureau of Statistics, various years. *Fiji Key Statistics*, Government of the Republic of Fiji, Suva.

Economic survey

Figure 8 Fiji: real effective exchange rate index, 1980–2006



Source: Fiji Islands Bureau of Statistics, various years. *Fiji Key Statistics*, Government of the Republic of Fiji, Suva.

the real inflation rate because the basket of goods used to calculate the consumer price index (CPI) has not been changed for the past 14 years. The Bureau of Statistics should consider revising the basket so that it provides a better assessment of changes in the CPI.

Broadly speaking, the nominal effective exchange rate (NEER) index has been trending downwards since 1980, indicating a broad depreciation of the domestic currency against the basket of currencies to which the Fiji dollar is pegged (Figure 7).

The real effective exchange rate (REER) index trended downwards from 1980 to 2006 (Figure 8), signalling an increase in Fiji's international competitiveness. Compared with some of its competitors, however, Fiji's real exchange rate might have become less competitive.

Sectoral growth prospects

The sugar industry. Sugar exports as a percentage of GDP have been declining since 1995 (Figure 9). This trend is the result of the

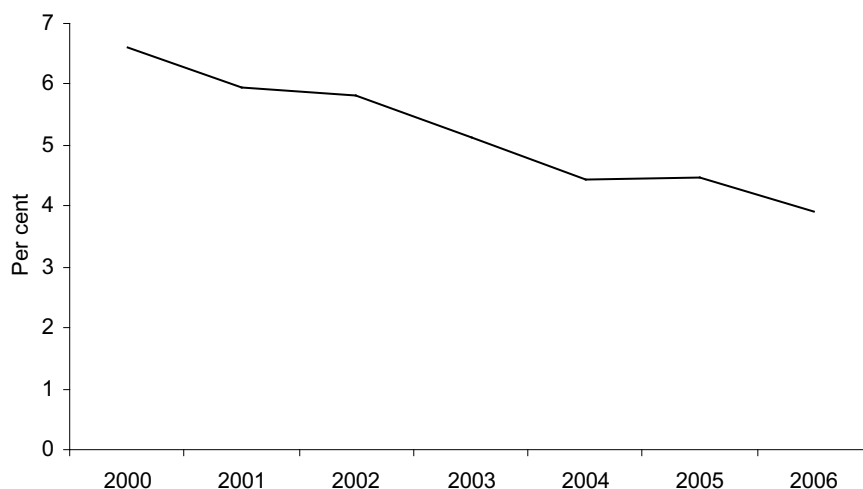
expiration of land leases and the widespread non-renewal of leases to the mainly Indo-Fijian tenants by the Native Lands Trust Board (NLTB). In addition, expectations of declines in the price paid for sugar exports to the European Union, as a result of reforms of the preferential treatment of exports from developing countries, led many sugarcane farmers to leave the industry.

The recent announcement by the European Union of a quota for Fijian sugar might bring some hope to those still in the industry; however, farm-level inefficiency, land lease problems and the younger generation's lack of interest in sugarcane farming are factors making it unlikely that production can be increased.

The biggest concern for the sugar sector is the lack of attention from policymakers to the real farm-level situation. There are four issues that confront the industry at present. The first is the impending price decline due to the reforms undertaken by the European Union in its trade regime. There

Economic survey

Figure 9 Fiji: sugar exports as a percentage of GDP, 1995–2006 (per cent)



Source: Fiji Islands Bureau of Statistics, various years. *Fiji Key Statistics*, Government of the Republic of Fiji, Suva.

is nothing Fiji can do about this but plan for the decline in price. Are we prepared for it? All indications are that the cost of producing sugar will continue to increase. This is evident in rising fuel prices, rising fertiliser prices and rising labour costs. The second issue of concern is the inefficiency of the Fijian sugar mills. This issue could be addressed but alone would not resolve the decline in the sugar industry. The third issue is the impasse over the land lease system, unfortunately a major sticking point for the whole agricultural sector. How this issue is resolved will to a large extent determine the future of the sugar industry and the broader agricultural sector.

The fourth issue is the lack of interest in sugarcane farming. The majority of young people are not interested in sugarcane farming. Once the current generation in the industry passes on, there will be little interest in farming sugarcane. Even if the land issue is resolved, there will be few tenants to take up leases. In this context, it

is surprising that the Interim Government has a plan for an additional mill in Seaqaqa. The future for sugar lies in a smaller and leaner industry, which could be built on the development of efficient mills, sorting out the land issue, interesting new farmers in the industry and providing incentives to those who are already on the farm to remain.

The problems of the sugar industry should have been clear to the political leaders and industry players for some time. The expansion of the sugar industry in the 1970s was based not only on the guaranteed price and Fiji's obligations to supply the allocated quota but on sales in other markets. In the 1970s and to a large extent in the 1980s, the sugar industry was the leading sector in the economy. The deregulation policies pursued by subsequent governments led to the withdrawal of support and lack of strategies to develop the agricultural sector. The sugar industry also suffered from the lack of attention paid to the agricultural sector as a whole and the impact of land tenure

Economic survey

uncertainty on productivity.³ In addition, the leaders of the sugar industry failed to direct the attention of the government to the inefficiencies in the industry and the impending erosion of preferential prices. While subsequent governments indicated plans to restructure the industry, none had the political will to implement the plans. The need for restructuring was summarised by the Asian Development Bank (ADB 2003:1) as follows.

The combination of deteriorating world sugar market prices, declining efficiencies in all sections of Fiji's sugar sector, and the adverse effects of the Master Award which result in an inequitable distribution of Fiji's sugar proceeds that does not permit reinvestment in the sugar sector's infrastructure, has resulted in a situation that dictates an immediate restructure of the Fiji sugar sector. Without immediate restructuring, either the Fiji Sugar Corporation (FSC) will have to cease production due to its technical insolvency and declining credit rating or the government of the Fiji Islands will have to provide an immediate cash injection to [the] FSC of up to F\$33 million to ensure continuing operation of the four mills for 2003–2004. Future annual cash injections can be expected to rise as the deteriorating sugar sector infrastructure maintenance and replacement costs escalate (ADB 2003:1).

The ADB's observation was a timely reminder of the need for serious intervention. Essentially, that intervention should have included

- improving the cost effectiveness of sugar milling
- ensuring the supply of appropriate labour
- rationalising sugarcane farm size and cane-growing areas

- examining the possibilities of raising incomes by producing other products such as ethanol and the more immediate task of producing energy from bagasse
- reducing institutional costs
- sugar research development to produce improved varieties of sugarcane, biotechnology research and by-product and bio-mass utilisation to raise sugarcane yields
- resolving the land issue.

In its 2007–11 Strategic Development Plan, the SDL government put forward its policy objective as being 'to restructure the sugar industry into a commercially viable, profitable and sustainable industry' (Fiji 2006:109), and included some of the interventions identified earlier. Strategies and key performance indicators recommended in the plan are shown in Table 1.

These objectives and interventions remain relevant even under the present Interim Government. The imperatives for reform are the same. If we look at the key performance indicators, we find that time might have all but run out to achieve reforms with minimum pain for the thousands of people directly dependent on the industry. For example, the target of raising the yield per hectare by 25 per cent by 2011 is optimistic, given that there has been no solution to the uncertainty about land leases. Targets set for the FSC assume that there were no disturbances to the plan such as those we have now in the form of the military coup. In well-researched analysis, Lal and Rita (2005) point out that on account of the current level of costs in the industry and costs at the farm level, the sugar industry faces a serious crisis. They conclude with the following.

Time is running out [for] the Fiji sugar industry. In the short term, there will be many casualties of trade liberalisation. Many cane farmers will lose their source of livelihood, and many of

Economic survey

Table 1 2007–11 Strategic Development Plan: strategies and key indicators

Strategies	Key performance indicators
Implementation of sugar industry reform plan	Yield per hectare increased from 61 mega-tonnes per hectare (Mt/ha) in 2006 to 80 mt/ha by 2011
Encourage dialogue and consultation to ensure land availability for the industry	TCTS ratio improved from 11 TCTS in 2006 to 8 TCTS by 2011
Promote milling efficiency and cane quality payment system	Extraction rate of sucrose increased from an average of 72 per cent in 2006 to 85 per cent by 2011
Improve efficiency and productivity of cane production in farms through improved extension and research services	Reduce milling costs from F\$280/Mt raw sugar in 2006 to F\$140/Mt raw sugar by 2011
Review the cane transportation system with the objective of making it cost effective and practical	Sale of up to 137 gigawatt hours of electricity to the national grid by 2011
Increase the range of crops produced (including aquaculture) in the sugar belt through the support of the Alternative Livelihood Project	FSC return on investment not less than 10 per cent and a debt-to-equity ratio of not more than 60:40
Design and implement sugar product diversification such as ethanol production	Returns per farm labour day to remain at least at present levels
Implement measures to address the social impact of the industry restructure	Monitor school enrolment in sugar belts

Note: TCTS is tons of sugarcane crushed to produce a ton of sugar.

Source: Government of Fiji, 2006. *2007–11 Strategic Development Plan*, Government of Fiji Islands, Suva:109–10.

those who remain financially viable will fall below the poverty line. Their only salvation will be in finding other sources of income. Urban drift will be inevitable, placing additional pressure on already stretched infrastructure. Unless economic and technical efficiency are improved, farmers will experience a decline in their net incomes by one-half to two-thirds. Landowners will see a significant decline in their rental income. The reduction in the incomes of growers, cutters, and landowners will have flow-on effects in the cane belt and the economy as a whole. Urban centres in the cane belt, which are mostly reliant on sugar revenue, could become ghost towns. Unemployment in rural and

urban areas could be expected to increase, as may the social problems associated with unemployment (Lal and Rita 2005:35).

The conclusions drawn by Lal and Rita are similar to those drawn by several other studies, including those by global non-governmental organisations such as Oxfam (2005). Figures from the 2007 provisional census report and the results from the 2002–03 Household Income and Expenditure Survey show that the urban population has increased, together with poverty and unemployment, and landowners' incomes have declined; this has given rise to associated social ills such as crime.⁴ The situation has been further worsened by the political instability since 2000.⁵

Economic survey

From a macroeconomic perspective, if Fiji was to be successful in implementing the reforms and following through on the sugar adaptation strategy—even though we might already be lagging behind—there is a possibility that an efficient sugar industry could be part of a restructured Fijian economy. The danger is, however, that if the actions defined in the planned restructuring and adaptation strategy are not undertaken coherently, we could end up with a lot of problems. Achievement of each target is important for others to be successful, as all are intertwined. A failure of one part of the plan could impede other action.

There are highly sensitive social and political issues that need to be addressed, apart from the implementation, if the sugar reform plans are to produce results. Because of their historical and ethnic structure, issues such as expiring land leases for mainly Indo-Fijian tenants and the unwillingness of ethnic Fijian landowners to lease land, or the controversy about land rents and rent arrears, will present special challenges. In addition, the social problems and compensation for those who want to move out of the industry or who are forced out as a result of new demands for lower costs at all levels will require substantial adjustment funds (ADB 2003). Those needing to adjust include mill employees, cane cutters and inefficient low-production farmers. These are all sensitive issues and a transparent strategy to deal with them will be vital for a harmonious transition of the industry.

Non-sugar crop sectors. The focus of the Interim Government should also be on non-sugar crops as there is potential for growth in this sector, especially if it is geared towards exports. Better marketing facilities and improvements in quality through improved quarantine measures could increase exports. In addition, there is an urgent need to upgrade rural infrastructure. Commercial agriculture presents special potential for Fiji

but this might require foreign investment. Vanua Levu could become a special focus for commercial agriculture and the Interim Government needs to consider some drastic measures to rejuvenate the economy of the island. Indeed, the Interim Government should consider declaring a tax holiday for long-term investment in commercial agriculture on Vanua Levu. The island is home to 30 per cent of Fiji's population yet it does not feature much in national development strategies.

Tourism. Visitor arrival numbers have generally been increasing since 1995 (Figure 9), with the exception of 2000. This increase has been due largely to the promotional campaigns undertaken in traditional markets by the Fiji Visitors' Bureau.

The tourism industry led Fiji's rapid economic recovery after the 2000 coup. Unfortunately, this does not appear to have been the case since the 2006 coup. In one of its projections, the Fiji Visitors' Bureau expected visitor arrivals for 2008 to increase to 570,000 from 545,000 in 2007. Such an increase does not, however, mean that tourism earnings are also increasing. According to the Fiji Islands Hotel and Tourism Association president, Dixon Seeto, the number of tourists conceals the profile of the kind of business attracted—that is, the length of stay and associated yield. According to the Hotel Association and the Tourism Action Group (TAG), the majority of hotels have been operating on discounted rates of 40–50 per cent since the 2006 coup (personal communication with the chairman of TAG). This means that the tourism industry is not likely to generate the growth expected by the Interim Government.

Garments. After the coups of 1987, the garment sector grew significantly as a result of extensive tax concessions and the devaluation of the Fijian dollar. The influx of foreign and local investors into this industry led to the value of production

Economic survey

of garments rising from F\$2.5 million to an estimated peak of about F\$188 million in 2001. By 2001, clothing and textiles accounted for about 60 per cent of all production in the manufacturing sector and close to 6 per cent of GDP. Clothing and textile exports reached a peak of F\$353 million in 2000 (Figure 11); this represented about 31 per cent of the value of all merchandise exports, placing them in the top three categories of Fiji's exports.

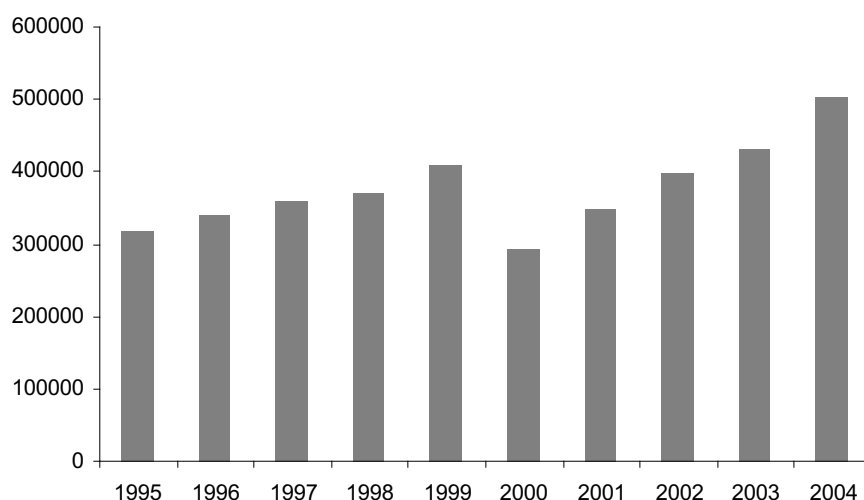
A favourable development occurred a few years after the first garment manufacturers established operations in Fiji. Their growth led to the emergence of support and 'backward linkage' industries such as weaving and knitting, as well as textile and button manufacturing. These new activities helped reduce production costs, shortened lead times and, in a small way, contributed to a more diversified industry.

Since 1998, however, garment exports as a share of GDP have generally declined.

This decline has been caused largely by the erosion of preferential access for garments to industrialised countries such as Australia and the United States. The end of the 13-year tax holiday given to certain garment manufacturers in 2000 and the political crisis in the same year did not help. The garment industry's contribution to GDP has continued to decline (Figure 12).

Construction industry. The construction industry in Fiji has been seriously affected by past coups and the situation is no different in the wake of the 2006 coup. Production in the construction sector as a percentage of GDP fell in the period 1999–2002, reaching a marginal 0.5 per cent in 2002. This decline was largely a result of the adverse effects of the 2000 political crisis. Since 2002, however, production has, by and large, picked up. In 2006, construction as a percentage of GDP was about 6.4 per cent (Figure 13).

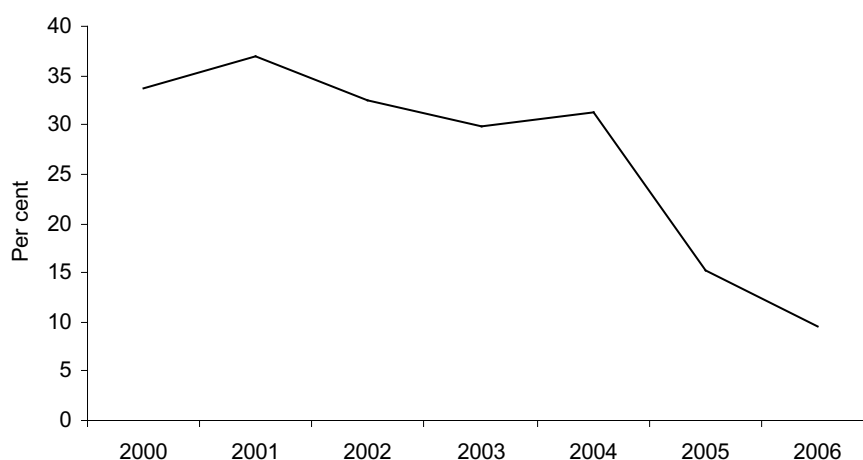
Figure 10 Fiji: visitor arrivals, 1995–2007



Source: Fiji Islands Bureau of Statistics, various years. *Fiji Key Statistics*, Government of the Republic of Fiji, Suva.

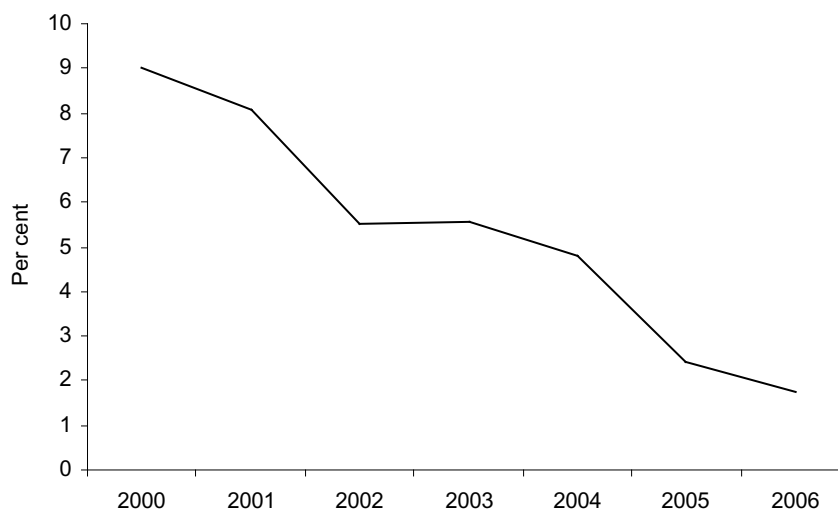
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Figure 11 Ratio of clothing and textiles industry in the manufacturing sector in Fiji, 1995–2007 (per cent)



Source: Fiji Islands Bureau of Statistics, various years. *Fiji Key Statistics*, Government of the Republic of Fiji, Suva.

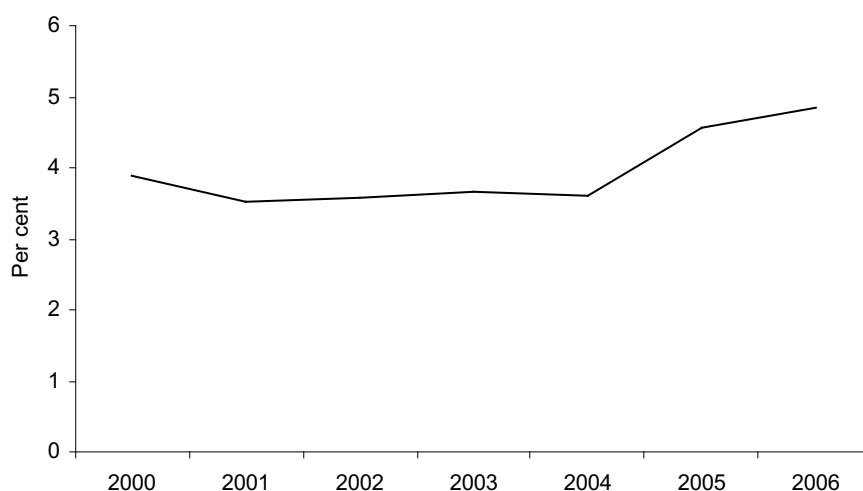
Figure 12 Fiji: garment exports as a percentage of GDP, 1995–2006



Source: Fiji Islands Bureau of Statistics, various years. *Fiji Key Statistics*, Government of the Republic of Fiji, Suva.

Economic survey

Figure 13 Fiji: construction as a percentage of GDP, 1999–2006 (per cent)



Source: Fiji Islands Bureau of Statistics, various years. *Fiji Key Statistics*, Government of the Republic of Fiji, Suva.

The charter process and the role of the National Council for Building a Better Fiji

The intentions behind the *People's Charter for Change* are very noble; however, these are being confused with the policy actions of the Interim Government, and policies seem to be at odds with the current national discourse on political and economic conditions in the country. Discourse is focused mainly on the conduct of the next general election and the state of the economy. The recent increase in food prices and the persistent rises in poverty are also serious national issues. The Interim Government has not been able to build a national consensus to ensure that the charter is completed and accepted in an inclusive manner. The failure to have all parties, including the former ruling SDL party, involved in the process is a major drawback and could derail the whole process.

Apart from the process of adopting the charter, the policy directions being considered by the National Council for Building a Better Fiji (NCBBF) are not new; the issues have been raised before and have not been resolved. In the consultation document for the preparation of the report on the state of the nation and the economy, several issues are presented as problems, including weaknesses in parliamentary democracy, particularly as a result of constitutional provisions and intransigent political attitudes; citizenship, national identity, human rights and civil society; weak institutions and rules of the game; the overly dominant role of government in Fiji; inappropriate and/or inconsistent policies; the dependency syndrome, especially within the indigenous Fijian community; untrained leadership at all levels; and poor management. There are three national task teams, covering good governance; growing the economy; and social and cultural identity and nation building. All

Economic survey

these problems and weaknesses were, however, identified previously in national development strategies.

The NCBBF should concentrate on the strategies already developed and help in their implementation—in particular, the institutional changes that are needed to remove the distortions in the economy. The institutions needing change include the judicial system and its operations, rules surrounding the operations of markets such as commercial laws, banking rules, consumer protection laws, and so on. While the Interim Government has moved to deregulate the telecommunications industry—perhaps producing good results in the long-term by reducing the cost of business—it has not been able to resolve many other issues relating to the problems of or constraints on growing the economy. These include land lease renewals—even though the government has made some attempt to reform the NLTB and create a mechanism for better land utilisation through the formation of the Committee on Better Utilisation of Land (CBUL). It has also not been able to restore the confidence of foreign investors and in some ways it has impeded the growth of investment. The funds allocated to the NCBBF could be better used if targeted to the restructuring of the economy and implementing some of the plans that exist already. This could deliver better results for the country in the long term. If it includes all opposing parties, the NCBBF can be a driver of change and could engage in some ‘creative destruction’ to remove the historical and institutional impediments that are holding Fiji back from becoming a prosperous country. It seems, however, that the NCBBF is losing steam and could end up producing only reports and little implementation.

Major policy actions

Resolving land lease problems

The political impasse over land leases has been a major challenge in Fiji for the past 20 years. Since the 1987 coups, the debate about land leases has taken on greater political significance, as it has become a tool for dominance by political parties. Indigenous Fijian-based political parties and the military in 1987 and 2000 used the pretext of protecting indigenous Fijian land to build political capital. Indo-Fijian-based parties have also used land as a mechanism for creating political capital. Political leaders have ignored many serious proposals for resolving the issue of agricultural leases. Before the 2006 coup, the leader of the Fijian Labour Party and the leader of the SDL party failed to discuss the land issue and ignored proposals for dealing with it. For example, the proposal for a ‘master lease’ concept for agricultural leases, put forward in 1997, has been ignored (Prasad 2006).

Interestingly, the Interim Government has set aside F\$8 million to pay rental subsidies for all agricultural leases from July 2008. The Agricultural Landlord and Tenant Act (ALTA) provides for a rental charge of 6 per cent of the unimproved capital value of land. According to the NLTB, however, the average rental charged is only 5 per cent of the unimproved capital value. The rental subsidy to be paid by the government is an additional 5 per cent and this will take the rental charge to 10 per cent of the unimproved capital value. The funds could have been better utilised to develop the concept of a master lease, whereby the NLTB leases agricultural land to the government and has all its rent paid by the State while the State subleases the land to tenants. In this way, the government would save some of its subsidy as well as allowing

Economic survey

the NLTB to concentrate on other types of leases and develop better programs for development of non-agricultural land.

Building and improving infrastructure

The state of infrastructure in Fiji has deteriorated since the military coups of 1987. Fiji has a 20-year infrastructure expenditure deficit and it will require significant effort to return the current dilapidated infrastructure to an acceptable standard. Much of the drag on infrastructure expenditure has been caused by the lack of a national plan for a capital expenditure program in the budgeting process and a consistently low budget for capital expenditure in budgets since 1987. If we had set a target for 30 per cent of total expenditure to go to capital works since 1987, we would have had an annual average capital expenditure deficit of about 10 per cent. The total capital expenditure for 2007 was F\$1,171.8 million. If we take 10 per cent of the 2007 total expenditure, the total shortfall for 20 years is F\$3.42 billion. This is the magnitude of the problem with respect to infrastructure and it could take several years before we make up this shortfall.

Managing natural resource production

The management of natural resources could be improved to maximise their benefits to the community. For example, there is a need for improvement in the management and production of mahogany, which is a significant national resource. At present, felled mahogany is exported as logs when it could add considerably to the economy's growth if it could be processed locally. Subsequent governments have failed to adopt appropriate policies to promote local processing of mahogany so that landowners and the government could derive greater benefits. The appropriate policy would be to adopt a competitive bidding process to award the contracts for exploitation of the mahogany forests to those investors who have

the capacity to create value-added mahogany products. The Interim Government indicated in its 2008 Budget Address that it was going to promote downstream processing of mahogany to add value.

Regional development

There is a high level of growth inequality between Fiji's two main islands, Viti Levu and Vanua Levu. To a large extent, the bulk of economic activity, including sugar and tourism, is concentrated on Viti Levu. In an economy short of investment funds and incurring budgetary imbalances for a sustained period, the bulk of public investment has been channelled to Viti Levu to support infrastructure demand. This has meant that, due to the under-performing economy, Vanua Levu has been largely neglected. The result has been migration from Vanua Levu to Viti Levu. The bulk of the migrants have come to Suva in search of job opportunities.

The rapid increase in Viti Levu's urban population has put excessive pressure on urban management. Local governments have failed to keep pace with the growing demand for social and basic public services. The outcome has been a decline in living standards in Suva: road conditions are poor; water and electricity supplies are often disrupted; and, due to the high levels of unemployment, the incidence of violent robberies has increased alarmingly. The government should therefore invest heavily in the development and improvement of infrastructure to accelerate regional development to solve the growing problems in urban and peri-urban areas of Viti Levu, mainly in and around Suva. The Interim Government has sought a loan from the Chinese government for this purpose and has also indicated its wish for public-private partnerships to promote the development of infrastructure to overcome its budgetary constraints.

Economic survey

Income tax reform

All macroeconomic indicators in Fiji have performed poorly, leading to RBF projections of negative economic growth in 2008. In light of this projection, it is difficult to comprehend how policymakers can adopt a policy of a 2 per cent budget deficit. Policymakers should have considered alternative sources of income to fund areas (such as infrastructure, regional development and social services) that are in urgent need of reinvestment. One such source of income is income tax. There is a need to reform income tax, particularly in the higher-income brackets. At a time when government budgets are in persistent deficit and debt levels are rising, the marginal income tax rate for high-income earners could be increased or the income level at which the highest marginal tax rate is effective could be reduced. A thorough investigation of this proposal needs to be undertaken to ascertain which strategy maximises the government's revenue from income tax.

The recent decision by the Interim Government to raise the income tax threshold from F\$9,000 to F\$15,000 is a good move on two counts. First, it will provide relief to some families facing rising fuel and food prices. Second, the F\$20 million loss in tax revenue resulting from this action will provide an injection into the economy that could boost retail and small businesses. The decision by the government to reduce duties on some imported food items will also provide relief to the poor. The reduction in duties is in line with the broad economic agenda that Fiji should pursue—to free up trade by reducing or eliminating duties on imports.

Concluding comments

Fiji's economy took a nosedive a few years before the 2006 coup; the coup further weakened the economy. The Interim Finance Minister, in the 2007 revised budget and 2008 budget speeches, emphasised reforms to revive the economy. In particular, a review of tax policies was undertaken.

The record of the Interim Government in achieving these policy reforms has been mixed, to say the least. It has not been able to reform and contain public expenditure in any significant manner. Any savings from the reduction of civil service wages and salaries have been offset by expenditure on the charter process and expenditure on the military. The reduction in government expenditure through cuts in spending on social infrastructure has had an impact on the rural poor and the urban working class.

The Interim Government stated that it would increase government revenue and deliver better services to the people—this has not happened. The quality of social services in Fiji has declined substantially in the past 10 years, and remains in a very poor state. There have been questions raised about the role of the Fiji Independent Commission Against Corruption (FICAC) and whether it has been able to do anything to reduce corruption. The anti-corruption campaigns do, however, provide the military government with legitimacy among the general population as it tries to reveal some of the corrupt practices of the past government.

The charter process that the Interim Government has put in place is an exercise with a very uncertain future. While the intentions behind it might be good and appropriate for forging a way ahead for Fiji, the acceptability and credibility of the process among the majority of Fijians is ambiguous. The charter's brief to look at every aspect of the country's problems is too ambitious and lacks clarity in its aims

Economic survey

and objectives. The focus should be shifted towards an economic program and long-term policies for economic growth. Political proposals, such as reform of the electoral system and changes to the constitution, should be dealt with simultaneously in a process involving the leaders of the major political parties.

All the Interim Government's projections for economic recovery have been off track. First, the forecast contraction of the economy was off track by almost 100 per cent—that is, the original 2007 forecast of a negative 2.5 per cent GDP growth was revised to a contraction of 4.4 per cent. The forecast growth for 2008 of 2.2 per cent has already been revised downwards to 1.7 per cent. With the prospects of growth in sugar and other exports bleak, even the forecast growth of 1.7 per cent for 2008 seems optimistic. If the tourism industry does not recover significantly in the next six months, we should expect negative GDP growth for 2008.

Poor economic growth rates have serious implications for the livelihoods of the poor. With 34 per cent of the population already living below the poverty line, depressed economic growth in the next three years could push significantly more people into poverty. If the increases in global food and fuel prices persist, creating even more difficulties for the poor, the prospect of social instability could heighten.

The Interim Government must therefore pay particular attention to the plight of the poor while formulating economic policies and strategies for recovery. It should not pursue a narrow and parochial agenda of fiscal austerity and further reduce the prospect of growth in the economy. More pragmatic fiscal and monetary policies would support recovery and boost confidence in the economy.

It seems that achieving economic and social recovery will require political

consensus to resolve the political impasse that has gripped the country. Perhaps Australia and New Zealand can help in speeding up this process of recovery. For example, the sanctions imposed should be reviewed, especially those in relation to travel bans on people who take up appointments from the military. A process of engagement and dialogue must be pursued to save the country from further economic decline.

Are we swimming or sinking? Given the absence of the expected recovery, the weak performance of key sectors of the economy and the loss of skilled human capital, Fiji might still be swimming, as claimed by the Interim Finance Minister. Unfortunately, it seems that it is swimming in the wrong direction: not towards the shore but towards deeper water. The next 12 months will be critical.

Notes

- ¹ See, among others, Narayan (2004a, 2004b); Narayan et al. (2006, 2007, 2008); Narayan and Narayan (2003, 2005, 2007, 2008a, 2008b); Narayan and Singh (2007a, 2007b); Narayan and Prasad (2003, 2006, 2008); Prasad et al. (2007a, 2007b).
- ² For a recent analysis of Fiji's budget deficits, see Narayan et al. (2006).
- ³ See, for example, Prasad and Tisdell (1996, 2006) for detailed discussion of the impact of land tenure on the sugar industry.
- ⁴ The 2007 census shows that the urban population increased by 61,591 people between 1996 and 2006. In addition, it shows that the Indo-Fijian population in rural areas declined by 36,708 during this time (Fiji Islands Bureau of Statistics 2007).
- ⁵ See Narsey (2007) for a report on unemployment and Narsey (2006) for an analysis of the 2002–03 Household Income and Expenditure Survey.

Economic survey

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Acknowledgments

The authors would like to thank Professor Ron Duncan for his helpful comments and Yenteshwar Ram for research assistance.