Current economic trends in selected South Pacific countries

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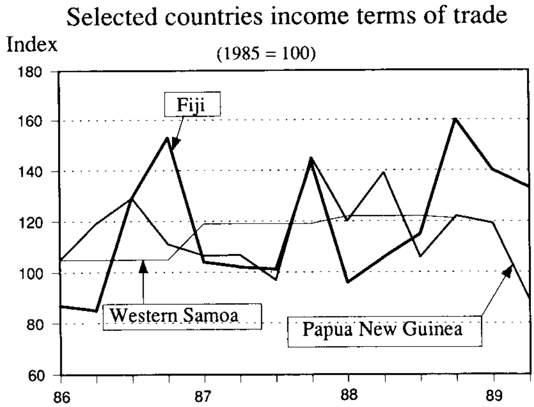
It is difficult to assess the course of development in all the South Pacific countries. As indicated in an earlier issue of this Bulletin, 'the statistical basis for such analyses is most inadequate'[1]. However, it seems that the economic stagflation that was apparent through the 1980s continued in 1989, with the exception of Fiji where a radical change in economic policy was concurrent with a rapid acceleration in economic growth. Even here, the growth in output was largely based on an unusual growth in sugar export receipts, that may not be repeated, and there is great uncertainty regarding the prospects for 1990 and later. The stagnation in Papua New Guinea can be partly explained by the severe setback traced to the closure of the Bougainville copper mine for most of the year. This was the most dramatic event in the region during the year, and one that may have long-term influences throughout the area. There apparently was some progress in Western Samoa in 1989 offsetting the slight decline of 1988 so that living standards were probably unchanged over the two years. Conditions are apparently unchanged in Vanuatu and Tonga.

International conditions cannot be blamed for the slow progress of the Pacific. Their foreign exchange receipts have, on the whole, been rising in recent years when expressed in terms of the imports that they wish to buy (Chart 1).[2] The copra dependent economies have experienced marked declines in their export receipts in the latter half of 1989, but most of them are cushioned from the effects of world price declines by the inflow of remittances. If foreign demands are in fact exerting an upward pressure on Pacific island incomes, the cause of their slow growth must be found in domestic policies and customs.

It may be suggested that domestic production stimulating policies based on import substitution have been a major cause of the stagnation in national production. By turning

Chart 1



1 M. Fleeton and G. Dorrance, *PEB*, 3(2), December 1988.
2 See Technical Note at the end of this review for a discussion of the income terms of trade.

away from the benefits of comparative advantage and effectively discouraging efficient exports, island welfare has been depressed. Xenophobia, mislabelled 'self-reliance', is not a rational basis for economic progress.

In assessing developments in some of the islands (particularly Western Samoa and Tonga), it is reasonable to regard their receipts of overseas remittances as a normal source of national income. These islands export people rather than commodities: to some degree, they export services (education, etc.) rather than goods. However, in many cases, they are exporting 'the best and the brightest' of their young people. To some extent, this means that they are losing potential entrepreneurs - perhaps the most catalytic of the factors of production. Consequently, the benefits accruing from this export of services may be offset by a decline in domestic flexibility and output. On the other hand, many emigrants return and bring back, not only capital, but entrepreneurial experience. Without much more detailed study than has yet been done, it is impossible to evaluate this trade-off.

The violence that erupted in North Solomons at the end of 1988 and the subsequent closure of the Bougainville copper/gold mine in May was the pre-eminent event in **Papua New Guinea** during 1989.

The government's *Development Plan 1989-1993* is based on a major expansion of mining as well as very encouraging prospects for oil production. Bougainville provided the starting point for this program. It was providing a large share of the government's revenue (taxation on the company's profits, customs duties on its imports, payroll taxes on its wage and salary payments, and other small items such as royalties). Ok Tedi is also in production, but currently making losses so that for some time its important contributions to government income are customs duties and payroll taxes. Misima has only just started production and Porgera is still being developed. Even if Misima is profitable, the depreciation provisions applying to mineral investment mean that it will be some time before it is subject to mineral taxation. It has been announced that the work already started on Mount Kare will proceed. Other mining projects such as Lihir and Hidden Valley are still in exploratory stages. It seems likely that oil development, including the pipeline will proceed.

The full impact of the Bougainville closure is only now becoming effective. 1989 mineral revenue taxes are based on 1988 profits. Customs duties tend to be paid approximately four months after the imports are ordered. In fact, for the first half of 1989 government revenues were more than 15 per cent higher than had been forecast in the budget. However, as time progresses, it is almost inevitable that the situation will become more serious. The National Centre for Development Studies' model of the Papua New Guinea economy indicates that gross domestic product (GDP) growth is likely to become negative. The trade surpluses of recent years will be converted into deficits as mineral exports decline by more than the fall in mineral company imports plus the decline in import expenditures associated with falling incomes.

So far, the immediate effects of the crisis have not been severe. Higher customs receipts and other revenues have offset the decline in Bougainville duty and payroll tax payments. The decline in mineral taxes will only occur next year and will do so even if Bougainville reopens. The 7 November budget statement reported that it had been possible to limit any decline in national output so that the country experienced stagflation rather than recession. The budget is based on the assumptions that the mine will reopen soon and that the events of 1989 will not have a depressive effect on future investment. Therefore, a renewal of Bougainville's imports, and imports by other developers, will lead to an expansion of customs revenue to offset the decline in mineral taxes. Increased duties on log and fish exports are expected to produce a net increase in revenues, even if they may have a worsening effect on the balance of payments and economic development. Several indirect taxes and taxes on financial transactions will also add to receipts. Finally, a hoped-for renewal of economic growth will contribute to government revenues. Consequently, it is planned to increase government expenditure by 5 per cent. This, together with some reductions in other outlays, are the basis for a proposed expansion in developmental expenditures on agriculture and other domestic activities, that are intended to reduce the economy's dependence on foreign investment.

The long-term effects of Bougainville are imponderable. The operating costs of a mine are very low (some estimates place them at K150 per ounce of gold). Exploration and development outlays are the important costs that must be recovered from mineral production. Once these outlays are made, they become irrelevant for decisions regarding current production. Therefore, developments such as Misima (now in production), Porgera and, to a lesser extent, Mt Kare will most likely proceed. For other projects, such as Lihir and Hidden Valley the outlook is more uncertain. For the as yet undiscovered potential sites, that are believed to be numerous, the prospects are even more uncertain. The mining companies are all subsidiaries of much larger international corporations. They have world-wide opportunities. If Papua New Guinea appears too risky, these companies will move their operations elsewhere.

The government has declared that it looks to foreign investment to develop the economy and states that it wishes to encourage this stimulus. To this end, the National Investment Development Authority (NIDA) has been reorganized with the intention of reducing the bureaucratic delays in approving foreign investment. However, the fundamental barriers - insistence on national majority control of investment, strict limitations on the employment of expatriates, difficulties in obtaining land leases, restrictions on domestic borrowing by foreigners, etc. remain. Elimination of bureaucratic procrastination will make these barriers less formidable. However, until they are removed, a large flow of investment to augment the mineral development and diversify the economy cannot be expected. The reform of NIDA was intended to convert it into an investment-encouraging, as well as approving agency. As yet, it has done much less than its Fijian counterpart to implement this role.

The depressing effect of any decline in mineral development makes it more important that Papua New Guinea's international competitiveness be improved. To this end, the government requested the Minimum Wage Board to postpone the scheduled determination of new minimum wages. In August, the tribunal, in effect, determined that wages should be increased by three per cent every six months in place of the previous rate of increase of five per cent every year. The government accepted the tribunal's decision.

The year 1989 has been one of greatly increased incomes in **Fiji.** The sugar crop is close to record levels, and, with high prices, the value of sugar exports is expected to be larger than in any previous year. Tourist arrivals are returning to almost their pre-coup levels and average spending is estimated to have risen, so that 1989 will be a record tourist year. Consequently, the balances of payments on goods and services and on overall accounts will almost certainly be greater than they were in 1988 (F$31 and F$158 million). The emigration of many skilled workers and managers has imposed a limit on domestic output and it will be some time before this shortage of capable workers and managers can be overcome. While incomes are at record levels, there continues to be great uncertainty regarding the future, and investment has not yet recovered. For example, in March, credits to the private sector from the commercial banks, Development Bank and the National Provident Fund had not returned to their end of 1986 levels in constant price terms (nominal value of credits divided by the price index). Hence the Reserve Bank had to admit 'that the recovery of the economy may not be firmly based'.[3]

The Fiji dollar was devalued twice in 1987, for a total of 35.7 per cent, to protect foreign reserves. However, this has had an important stimulating effect on the economy. The Reserve Bank estimated that by the end of March, 'The impacts of the 1987 devaluations had mainly worked themselves through the economy'[4] leading to a general price increase of only a little more than 18 per cent. Even if this assessment is optimistic, it still appears that the devaluations have provided a noticeable stimulating effect.

The government has embarked on a vigorous program to stimulate the economy. In the mini-budget of 8 August, the Minister of Finance declared that the aim was 'to achieve a soundly based, export oriented economy'. One of the key elements of this new policy is 'deregulation of the economy to bring domestic

3 Reserve Bank of Fiji, *Annual Report 1988*, Suva, p.6.

4 ibid., p.9.

prices more closely into line with world prices'. It is reported that one symbol of this deregulation is a decision not to compile a Development plan to replace DP9. In the implementation of the policy, the Minister announced the elimination of practically all import prohibitions on non-agricultural imports (they had already been largely eliminated). Most of these quantitative restrictions were replaced by a 50 per cent tariff, but these tariffs are to be reduced to 'appropriate levels' over a five-year period. Almost all duties in excess of 50 per cent were lowered to 50 per cent with the provision that they also will be reduced to appropriate levels. A number of other duties (particularly on hotel equipment and tyres for machinery and buses) were lowered, most to a range of 7.5 to 20 per cent. To restrain inflation and maintain competitiveness, a limit of 6 per cent was imposed on wage and salary increases after July.

The continued accumulation of saving in the form of financial assets, the overall balance of payments surplus resulting in the accumulation of foreign reserves in 1988, and the reluctance of private investors to borrow, resulted in a large accumulation of liquidity by the banks. The Reserve Bank considered that this provided a potential threat to its major responsibility of maintaining an adequate level of international reserves (this is expected to be the equivalent of six months imports by the end of 1989). Consequently, at the end of March and the beginning of April, it sold F$30 million of Reserve Bank notes to the banks to reduce their deposits at the Reserve Bank (in excess of their required reserves). Excess reserves exceeded F$75 million before the sale of the notes.

Policies regarding foreign investment have been significantly revised, starting in 1988. The Trade and Investment Board has been converted from an approving to a stimulating agency. It is seeking new investments by sending missions to inform foreign investors that: most projects will be approved; there are no requirements for minimum Fiji share ownership; non-resident companies can borrow their working capital requirements and, on occasion, other amounts, from Fiji banks; and profit remittances of up to two years earnings as well as the proceeds of sales of any financial assets to Fijians and the historic cost of physical assets sold may be freely converted into foreign exchange. In addition, the Board will arrange for the issue of required work permits (there are only limited restrictions on their issue) and facilitate the obtaining of property leases. It aims to be a 'one stop' foreign investment encouragement agency.

The tourist industry is operating at capacity. If any more aircraft were scheduled to arrive, they would impose a serious strain on resources. The prevailing uncertainty regarding the future and the scarcity of skilled tradesmen, is discouraging investment. One large hotel is under construction and two other developments (one is a large Japanese project) are being considered. There are considerable opportunities for expansion. For example, of over 300,000 visitor arrivals in 1988, only 3000 came from Japan.

There are also opportunities for expansion of sugar output. The Fiji Sugar Corporation is undertaking both a modernization and increase in cane growing capacity program. If this succeeds in increasing sugar exports by 10 per cent (a not unreasonable target), it would increase sugar receipts by more than F$15 million per year, of which almost F$14 million would be value added in Fiji.[5]

The tax free factory[6] scheme has aroused considerable interest. Under it, any newly established or existing factory, whether resident or foreign owned, that agrees to sell not more than 5 per cent of its output on the domestic markets: may import all its requirements of both capital equipment and materials to be processed duty free and benefit from tariff concessions on purchases from Fijian suppliers; be exempt from corporate profits tax for 13 years; and receive other concessions. By the end of August, 160 approvals had been granted for the classification of factories as tax free. Of these, 71 (43 of them garment factories) were operating. It is forecast that the factories now in operation will export almost F$100 million when they are in full operation (equal to al-

5 See 'The Fiji Sugar Industry'in this issue.

6 It was originally intended to create taxfree zones. It was decided that it would be most satisfactory to grant tax free status to any firm meeting the requirements, irrespective of where it was located.

most one-quarter of Fiji's domestic exports in 1988). Of this, less than one-third would represent domestic value added. Only part of these sales would be additional exports, as many of these firms are already exporting. If all the firms that have been classified as tax free, but that have not yet started production, were to produce their forecast output, they would export an additional F$175 million. Hence, it is just possible that, if the program is a complete success, there will be a net addition to Fiji's export income of some F$50 million (compared to the current net contribution of approximately F$125 million by the sugar industry).

Conditions in 1989 provide a basis for satisfactory progress in Fiji. The government has embarked on an innovative program to foster development. Yet, there is considerable uncertainty regarding the future. The National Centre for Development Studies' 1988 analysis of the Fiji economy concluded that: 'The outlook...depend(s) critically upon how rapidly current political uncertainty is resolved'.[7] This assessment is probably still valid.

1989 began well for **Solomon Islands,** with export sector performance ahead of that achieved in the two previous years. Despite lower international commodity prices, earnings by major exports (copra, timber, fish and palm oil) were up, with earnings for the half year totalling SI$82.9 million compared with SI$52.9 million and SI$67.5 million in the half years to January 1987 and 1988 respectively. Part of this improved performance must be attributable to continuing recovery from the devastating effects of Cyclone Namu in 1986.

On the other hand, the volume of imports jumped by some 20 per cent in value to SI$128.4 million for the six months to June 1989. The country's barter terms of trade worsened resulting in a current account deficit of SI$44.7 million for the half year. This fall was offset by an estimated contribution to the capital account of SI$35.7 million made up of official and private borrowings and aid flows. There was an estimated decline in the balance of payments of SI$9 million with official reserves amounting to SI$75.8 million at the end of June 1989.

The country is beginning to reap the benefits of private investment, in particular the new fish canning factory established by Solomon - Taiyo Limited at Noro. Other important initiatives are the reafforestation and timber project on Kolombangara[8], a joint Investment Corporation of Solomon Islands / Commonwealth Development Corporation venture and a coconut oil mill on Russel Island to be developed by Lever Plantation interests.

The effects of a change of government early in the year are beginning to be felt. For the first time since Independence in 1978, a single party (the Peoples Alliance Party (PAP)) has formed a government, thereby acquiring the ability to enact legislation and embark on policies without having to trade off objectives with supporting groups to stay in power. As a policy basis, the PAP has adopted a Programme of Action drawn from its 1989 Election Manifesto. Major economic and constitutional reforms are foreshadowed. On the economic front the government has stated that its philosophy 'will have the underpinning of a free enterprise economic system'. The role of the private sector will be encouraged and incentives for increased local and foreign investment will be provided. Initiatives cited in the Programme of Action include restructuring the Central Bank of SolomonIslands, streamlining the Development Bank of Solomon Islands, and establishing a Peoples' Bank.

A fairly rigid timetable for progress in wide ranging reforms has been laid down with phase I, Policy Review and Analysis, due for completion by the end of July.

New policies could have important implications for the future stability of the economy of Solomon Islands and it is hoped that in its implementation stage the Programme of Action will continue to recognise the importance of consistent and stable macroeconomic policies. In a review of the current economic trends, the need for stability in government policy was stressed. It is hoped that in its first major economic statement, the 1990 budget, the government will spell out progress with implementing the Programme of Action in precise terms and what this means in terms of fiscal and monetary policy.

7 R. Cole and H. Hughes, *The Fiji Economy,* May 1987, Canberra, National Centre for Development Studies, 1988, p.87.

8 See Davis and Abbott, *PEB,* 4(1), June 1989.

Recent economic conditions in **Western Samoa** have been favourable. It is believed that real GDP grew by only 1.9 per cent in 1988. Projections for 1989 estimate 3.6 per cent real GDP growth. Despite relatively weak world prices for key agricultural products, the current account recorded a surplus in 1989 for the first time. The trade deficit has been more than compensated by bustling tourism and other service sectors and large inflows of private remittances. By the first half of the year international reserves were equal to more than seven months of imports. However, long-term growth prospects face several obstacles. Little action has yet been taken to move towards privatizing government operated institutions, such as the government's copra and other agricultural estates (Western Samoa Trust Estates Corporation). In fact, resolution of WSTEC's debt position remains a serious problem. Other growth obstacles include the deterioration of roads and bottlenecks in tourism capacity. Without successful action in these areas, the country will continue to lose its skilled manpower to other countries.

There are positive signs of recovery in **Vanuatu.** It is believed that 2 per cent real growth occurred in 1988. A similar projection is made for 1989, although the economy may grow even more strongly. Agricultural production generally has not performed well this year (except perhaps in beef and timber). However, the service sector has done well. Tourism has recovered from the bad publicity Vanuatu received in Australia towards the end of 1988. The pilots' strike in Australia and stability in New Caledonia have contributed positively to the tourism sector's rebound in Vanuatu. The activities of the financial centre have added to growth, through company and shipping registrations as well as the local expenditure and net foreign exchange earnings of financial centre companies. The contributions of these service sectors to long-term growth and development are generally underestimated. However, recent population growth figures suggest that real per capita income has been declining at least since 1984. Reliance on official grant aid probably will continue for the foreseeable future.

Data collection and analysis remain an important obstacle to understanding the **Tonga** economy. Nevertheless, it is believed that drought and closure of the desiccated coconut factory caused real GDP to decline by two per cent in 1987/88. Recovery from the adverse weather this year (1988/89) implies real growth in the range of three per cent. Living standards are supported by large private remittances, which have remained relatively constant. Remittances 'in kind' have been increasing. Current account deficits occurred during the last two years and are the cause of the balance of payments deficits. If these deficits are not related to healthy investments, but rather to consumption, persistent deficits will lead to a debt problem. The tying of the pa'anga to the Australian dollar has made the economy less competitive. However, the dollar devaluation in 1989 restored Tonga's competitive position. The new Reserve Bank of the Kingdom of Tonga began operations in July 1989. It is widely believed it will tie the pa'anga to a trade-weighted basket of currencies, as is the policy in several other Pacific countries.

In 1985 the government of **Kiribati** held the first aid donors meeting to be organized by a South Pacific country to coordinate support for national development. So called 'round table meetings' are now a regular feature of aid management and coordination in the region. In October, Kiribati again invited donors to meet and discuss a particular regional problem, the development of the Northern Line Islands.

The conference was held on Kirimati (Christmas Island) the world's largest atoll and was concerned with the development of Teraina (Washington Island), Tabuaern (Fanning Island) and Kirimati. Isolation and a low resource base are the major problems faced by the Kiribati Government in the development process. These features are in turn exacerbated by a high birth rate and high population levels on the main islands. A decision to develop the Northern Line Islands is based on the fact that while these islands represent 60 per cent of the Republic's land area, they are inhabited by only four per cent of the population. The only commercial activities carried out in the islands are copra production, some tourism on Tabuaeran and salt production on Kirimati. Development plans envisage the population being lifted to some 9500 over the next five to ten years based on increased tourism, light industry and agriculture. The population expansion will rely on the voluntary relocation of people from other islands of the Republic.

This ambitious program which might ultimately make up for some of the loss of revenue following the cessation of phosphate mining on Banaba will depend on financial support both from government, private investors and aid donors.

Private investment will be encouraged to focus on the development of tourist facilities, fishing and an expansion of solar salt production. There are also prospects for Kirimati developing as a satellite launching station. The government will develop the infrastructure necessary for resettlement, improve existing communications facilities and upgrade existing infrastructure, in particular, roads, wharfs and airports. Social infrastructure such as schools, hospital services and law and order facilities also need government attention. The government will look to aid donors to support a large part of its development expenditure.

Recognizing the importance of private sector support for development, the government exercises a liberal approach to investment from abroad. Incentives are offered by way of taxation concessions and capital and profits may be repatriated without restriction.

In a communiqué at the conclusion of the conference, donors noted the positive aspects of developing the Northern Line Islands while at the same time hearing of the constraints under which both resettlement and development would take place. In particular, the negative aspects were noted for consideration. These included limited skilled personnel, the fragile environment of the islands and the high cost of all forms of communication and infrastructure development. Nevertheless those participating in the conference responded in a positive fashion to the Kiribati Government's initiative and future developments will be awaited with interest.

The recently elected government of **Tuvalu** Prime Minister Bikenibeu Paeniu has indicated a desire to be less reliant on aid in the development process. This is a highly commendable attitude on the part of a government with probably one of the most limited resource bases of any country in the world. Yet it has one asset which can help implement this ambition, the Tuvalu Trust Fund, described in the previous issue of the PEB.

The benefits of the Fund were borne out in the 1988 budget which resulted in a deficit of A$752,132. Of this deficit, A$493,000 was available from the automatic distribution facility of the Fund to cushion the position. A further deficit is anticipated in 1989 as a result of reductions in a number of revenue items, particularly in fees from fisheries licences. This is mainly the result of a fall in the quantity of tuna caught by United States vessels. A severe revision of expenditure proposals is expected to reduce spending from a planned A$5.47 million to A$4.47 million with a resultant deficit of A$376,470 after allowing for a contribution from the Trust Fund of A$380,103.

Despite the very tight budgetary position, the government has continued to take a positive approach to national needs, particularly in the development sector with support from donor agencies. Communications with the outside world will be enhanced with the installation of a satellite earth station, expected to be operational by May 1990. Fisheries development has continued with the arrival of a number of small fishing vessels provided by the Japanese Government, soon to be joined by an extension training and research vessel from the same source.

The Business Development and Advisory Unit (BUDAB) has continued to encourage small-scale commercial activities such as trochus shell and giant clam farming and beekeeping. Handicrafts from Tuvalu are of a high standard and find a ready market internationally.

Technical note: The income terms of trade [9]

Chart 1 records changes in the income terms of trade for Papua New Guinea, Fiji and Western Samoa (the only Pacific countries for which adequate data are available). The income terms of trade are the values of a country's receipts divided by an index of the costs of its imports. That is, they record changes in the amount of imports that a country may purchase with the proceeds of its export receipts. In the case of Papua New Guinea, the value of commodity exports is deflated by the cost of imports, that is, the chart records changes in the purchasing power of commodity exports. For Fiji, where tourist receipts are extremely important sources of foreign exchange, changes in the purchasing power of commodity exports plus tourist receipts are recorded. For Western Samoa, where emigrant remittances are larger than commodity exports or tourist receipts, the sum of commodity exports plus tourist receipts plus emigrant remittances is deflated by an import price index.

There is no up-to-date import price index for the South Pacific island countries, or for any one of them individually. The index of the average value of imports by non-oil exporting developing countries, compiled by the International Monetary Fund, has been used as the most relevant index. An average value index is compiled by revaluing a country's imports to base year prices and dividing the nominal value of imports by this revalued total. It reflects changes in the composition of countries imports and thus reflects changes in tastes or technical requirements and reactions to changes in relative prices. In this, it differs from a fixed weight price index.

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9 G. Dorrance 'The income terms of trade', Review of Economic Studies, XXI(1), 1948.