Current economic trends in selected South Pacific countries

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THE cognoscenti have long held that the Pacific islands are subject to wide fluctuations in growth as a result of their vulnerability to climatic disasters and adverse developments in the international economy. This view has become widely accepted in recent times.

For many observers and policymakers, the absence of comprehensive statistical data has constrained the analysis of economic trends in the Pacific islands.[1] The cost of data collection and the lack of skilled statisticians are but two factors impeding progress in this area. However, Vanuatu and the Solomon Islands are making headway. In Vanuatu, the Asian Development Bank and United Nations Development Program project, now nearing completion, has developed a comprehensive data base for the National Accounts from 1983–87. These statistics should form the basis for ongoing collection and analysis of the National Accounts. In the Solomon Islands, a data collection project will make it possible to analyse the relationships amongst sectors of the economy and with the rest of the world. It is hoped that it might also provide a basis for modelling aspects of the economy and hence create a better framework within which to analyse policy options.

Analysis of the island economies revealed some bright spots in 1989. Tourism and sugar, mainstays for Fiji, picked up and contributed to a 12 per cent growth in its gross domestic product (GDP). The garment industry is now a major contributor to export receipts. In Vanuatu, the tourist industry experienced a revival following an effective advertising campaign. The introduction of a new air service will build on that success. Estimates for Western Samoa saw a return to positive growth in 1989 while pre-Cyclone Ofa forecasts pointed to a modest continuation of economic progress in 1990. Capital works projects, such as the upgrading of Bauerfield airport in Vanuatu and the upgrading of port facilities in Tonga are providing the necessary infrastructure for strengthening trade and commercial links with neighbouring islands and the Asian region.

Nevertheless, the uncertainties inherent in the nature of the Pacific islands economies have become more overt in the first quarter of 1990. In February Cyclone Ofa ripped through Tuvalu, Niue and Western Samoa. The destruction demonstrates how climatic disasters can nullify hard-won gains.

The deceleration in the growth of world economic activity, already apparent in 1989, continued in the first quarter of 1990 and appears likely to continue through 1991. The outlook is mixed for agricultural prices, on which the islands depend heavily. World sugar prices are at a nine-year high. The low level of stocks suggests that prices can rise further, while increasing consumption is contributing to the tight market. Demand is being more effective because of the easing of United States' sugar import quotas and the re-opening of credit facilities to China. However, prices for other major agricultural commodities, particularly coffee and cocoa, have fallen sharply.[2]

The total value of exports by South Pacific countries has been increasing in the 1980s. The increase in their volume has been even greater, as commodity prices are now lower than they were at the beginning of the decade. Japan has replaced the European Community (EC) as the major destination of island exports largely because of the increase in copper exports from Papua New Guinea and fish and

1 Fleeton and Dorrance, PEB, 3(2) December 1988:1–2.
2 See 'Pacific island commodity prices', this edition of PEB.

timber from sources such as the Solomon Islands. While the EC has ceased to be the major export destination, it is still in second place. On the other hand, exports to the United States, particularly from Papua New Guinea and Fiji, have declined. Except for Fiji's sugar exports to China, Malaysia, Western and American Samoa and other Asian countries, exports to other developing countries are small, and to the other Pacific countries negligible. Aside from petroleum from Singapore (that has recently been diverted to Australian users) and goods from Hong Kong, imports from developing countries are also very small.

Trade protectionist measures, now a key feature of trade policy in the United States, were recently extended to include a call for 'voluntary restraints' on Fiji's exports of nightwear garments. The economic slowdown in Australia and New Zealand will have effects in Tonga and Western Samoa. Both countries rely on remittances to sustain their balance of payments and domestic consumption levels.

All the Pacific islands governments are employing trade strategies as key policy tools. Maintaining market access in an environment of rising trade protectionist sentiments will become more important. Even though the Pacific countries have neither the resources nor the influence to counteract these changes, it is important for them to enter into the lobbying process through international organizations. For example, they have a direct interest in the success of the Uruguay round of General Agreement on Tariffs and Trade (GATT) negotiations.

There are eight Pacific island members of the Lomé Convention—Fiji, Kiribati, Papua New Guinea, the Solomon Islands, Tonga, Tuvalu, Vanuatu and Western Samoa. Under Lomé IV, member countries receive exemptions from customs duties for exports to the EC provided that very restrictive rules regarding the origin of products are observed. Lomé IV also embraces areas of financial and technical assistance.

Issues for discussion on the agenda for the March meeting of the African Caribbean and Pacific Countries (ACP)–EC Council of Ministers included the allocation of US$14 billion of aid to all Lomé IV participants over the period 1990–95 and the proposed reduction of 2 per cent in the price that the EC pays for ACP sugar. Although some aspects of the Lomé IV outcome did not satisfy member countries, aid from the EC to the Pacific islands will amount to some European currency units (ECUs) 250 million. This will be largely devoted to civil aviation programs, port developments and regional shipping. Money will also be directed towards energy and telecommunications projects.

It is becoming more widely recognized that increasing exports will facilitate monetary and fiscal policy formulation, such as the maintenance of an adequate level of foreign reserves and controlling inflation while sustaining adequate domestic demand. For instance, declining exports arising from disturbances on Bougainville forced the Papua New Guinea government to introduce a comprehensive economic package which included a 10 per cent devaluation, severe controls on credit to all economic activities as well as requiring a marked reduction in government expenditure. Similarly, the worsening balance of payments in the Solomon Islands prompted a debate regarding the possible devaluation of the Solomon Islands dollar.

Policymakers in the Pacific islands are also working to implement structural reforms aimed at enhancing potential output. In line with much currently accepted wisdom, deregulation and privatization are being pursued as important elements of reform. Fiji, for example, has embarked on an ambitious agenda of corporatizing a number of public sector agencies as a first stage towards their privatization.

The road to island paradise may not be paved with gold, but the governments of the Pacific islands are coming to terms with the realities of managing production and administration in their special economic environment. In a climate of global economic uncertainty, it now becomes more critical for governments to continue to implement these sometimes unpopular, but necessary, measures if they are to meet their development objectives.

Papua New Guinea—coping with the unexpected

The troubled economy of Papua New Guinea received a further setback due to a combination of poor prices for agricultural commodities and loss of revenue from the Panguna mine on Bougainville. As a result there was a sharp decline in export revenues, and gross national product (GNP) is estimated to have declined by 6 per cent in 1989 and is expected to fall by 7 per cent in 1990.

The decision to place the Panguna mine on a 'care and maintenance' basis, after months of uncertainty since its closure in May 1989, created a fiscal and more general economic crisis. Prior to its closure, the mine accounted for almost 40 per cent of the nation's exports and 20 per cent of government revenues.

Approximately half the households in Papua New Guinea rely on coffee growing as their major source of cash income, even though many of them depend primarily on subsistence production. Coffee prices have been close to record lows in late 1989 and early 1990 and show few, if any, signs of improvement.[3]

The misfortunes of the coffee industry will have an extensive impact on the broader economy, and a collapse of the industry would cause widespread economic, social and political hardship. Coffee represents some 9 per cent of total export earnings and some 45 per cent of agricultural exports. Cocoa accounted for some 18 per cent of agricultural exports and about 4 per cent of total exports in 1988. Since half of this crop is grown on Bougainville, this production will also be lost.

The coffee and cocoa stabilization funds were originally set up to smooth out fluctuations in world markets. Both funds were depleted in 1989. A relief package was agreed upon that provides for three more years of price support while allowing the industry to restructure. The Coffee Industry Board has cut the bounty payments from Kina 0.60 per kilo to Kina 0.35 per kilo in 1989. On the other hand, 90 per cent of coffee grown in Papua New Guinea is of the arabica type, for which demand is growing more rapidly than for the common robusta types. Nevertheless, with forecast production greater than consumption until 1990–91, the outlook for coffee prices is for a continued decline. The outlook for cocoa is also gloomy. High levels of stocks and excess production will have a depressing effect on prices.

The closure of the Panguna mine, combined with a serious decline in world prices for the country's major commodities, has seen a fall in government revenue, a serious shortfall in export income, and a drop in international financial reserves. This difficult environment has led to a sharp revision of demand management policies.

In early January, the banks and other financial institutions were instructed to maintain their total credit to the non-mining sector (with some exceptions) unchanged. Subsequently they were allowed to increase it by 4 per cent over 1990. This credit clamp will increase the severity of the progressive tightening of monetary policy during 1990. Previously, the credit ceilings had been guidelines which the banks as a group, were expected to observe. In January, they were converted to targets which individual banks were required to meet. Any bank exceeding its credit limit will be subject to severe penalties (including the reactivation of the Lender of Last Resort Facility with high discount rates). The establishment of individual bank targets was inevitable if zero or very low rates of credit growth were to be achieved. This introduces an element of inflexibility into the banking system which is probably a prerequisite for the implementation of the economic program. These restrictions have produced a liquidity shortage as commercial banks maintain the limits set by the Central Bank, while many firms are pressing for larger loans to meet their costs which have been increased by the devaluation.

Pressure on rates had already emerged because of the shortage of liquidity in the banking system. Deposit rates in some cases were over 18 per cent for large deposits. This contrasts with Indicator Lending Rates for the six commercial banks which ranged from 11.75 to 13.75 per cent. The consequent excess of deposit rates over lending rates makes the situation unsustainable.

The kina was devalued by 10 per cent on 9 January 1990 primarily to halt the loss of reserves by restraining imports and to compensate producers of export crops for the decline in prices. The devaluation also acted as a signal to foreign investors that the problems facing Papua New Guinea are being taken seriously. The major impact of devaluation, as seen locally, was the immediate rise in the price of imported goods including many basic foodstuffs.

The program commits the government to a reduction of Kina 100 million in public expenditure to offset the declines in revenue and partly to reduce overall demand. The specific proposals to produce these economies are still tentative. It is reported that the Public Service Commission and the Administrative Services Department will be abolished and that there will be retrenchment in other departments. Altogether, there may be a reduction of some 4 per cent in the public service. The increase provided in the Budget for the Public Investment Program will be reduced. The Department of Finance and Planning is to be separated into its component

3 See 'Pacific island commodity prices', this edition of PEB.

parts (a reform not likely to produce economies). Evidently, no steps have been taken to introduce economies in the provincial governments.

Wage restraint is a vital component of the adjustment package and leading trade unions have agreed to reductions in real wages. It is hoped that their agreement will open the way for more widespread restraint but there are signs of a rocky path ahead.

This set of measures is essential for recovery of the economy from its present crisis. However, price increases arising from the devaluation, combined with limited wage increases and higher unemployment, could exacerbate the already serious social tensions. They might even stimulate a further deterioration of law and order. This gives added urgency to measures required to establish internal security.

On the positive side, the demand management policies have helped to clear the way for an international assistance package. At a meeting of the Consultative Group for Papua New Guinea in Singapore on 17–18 May 1990, the World Bank, the International Monetary Fund (IMF), a number of international agencies, Australia, New Zealand, Germany, Japan, the United States and the EC agreed to provide approximately US$710 million during 1990. Of this, approximately US$210 million would be Australian budgetary support, and US$110 million in other grants. US$225 million would be devoted to project-related assistance to the Public Investment Program, the Forestry Action Plan, and the Special Intervention Program which is designed to alleviate the adverse effects on income and employment of the recent developments and the need for adjustment. US$245 million would be immediate direct balance of payments assistance, US$90 million coming from the IMF. The Consultative Group agreed to meet again in May 1991.

The continuing negotiations on Bougainville offer some hope for a resolution of the conflict. However, adherence to the demand management package will be essential.

Fiji—paradise regained

In Fiji, the progress achieved in 1989 suggests that the economic destabilization arising from political events in 1987 has been reversed. A comprehensive economic strategy, combined with favourable external conditions, has been responsible for this reversal.

As from 1988, economic strategy has comprised fiscal restraint, taxation reform and a wages policy aimed at maintaining international competitiveness. Deregulation and privatization to encourage exports were other key features of government policy. The National Economic Summit held in 1989 reaffirmed this policy stance.

GDP grew by 12 per cent in 1989, compared to a decline of 3 per cent in 1987 and a growth of 0.4 per cent in 1988.

Fiji's two major industries, sugar and tourism, performed very well in 1989. Sugar production increased by 28 per cent on 1988 figures to 465,000 tonnes. As noted previously, the outlook for sugar remains healthy for 1990–91.

Tourists have been returning to Fiji. The tourist boom is being experienced right across the industry in all size- and price-bracket hotels and tourist services, but particularly in large multi-hotel, condominium and marina complexes. The competitive cost of holidays in Fiji relative to other tourist destinations and the Australian airline pilots' dispute were two major influences on increased tourist numbers. Some 250,000 people visited Fiji in 1989, an increase of 20 per cent over the 1988 figure of 208,000. The outlook for 1990 is also promising, with some 270,000 visitors expected. Australia and New Zealand are still the major sources for visitors.

The garment industry is another bright spot in the Fijian economy. Wages in this industry are internationally competitive. In 1987 garment exports were valued at F$8.9 million, or 2.2 per cent of total exports. In 1990 they are projected to be F$100 million or 15 per cent of the total. Operating under tax free provisions, exports are primarily to Australia and New Zealand where there is preferential access under the South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA). The industry is also expanding into the North American and Singapore markets. In 1989, 75,000 garments were exported to the United States compared with 14,000 in 1988. This level of imports caused a decline in the market share of United States manufacturers leading to calls for protection. In a climate of increasing trade barriers and protectionism in the United States, the prospects for a greater expansion of garment exports have diminished. Exports to Europe also face constraints under the Multi-Fibre Arrangement.

The government's stimulus to private investment has borne fruit. In 1989, private investment rose by 30 per cent; yet this sizeable increase is not a basis for complacency. In its 1990 Budget Statement, the government noted that private sector investment is a key to further economic expansion but the 'major expansion needed to sustain economic growth in the nineties has not yet got under way, though the beginnings are apparent'. It is important, therefore, that the 'non-economic factors' restraining investment be carefully considered and resolved.

The reviving economy is having a positive effect on employment, which grew by 13 per cent in 1989. The two leading growth areas were manufacturing and the hotel sector. Again, the improved labour market reflected the upturn in the tourism and the garment industries.

Nevertheless, structural imbalances in the labour market are a risk to continued economic expansion. At present the skills base is still declining. The Reserve Bank of Fiji's *News Review* (4 April 1990) noted an 83 per cent increase in emigration in 1987 and ascribed this dramatic increase to political events in that year. While the rate of increase in emigration has slowed down considerably it is still increasing. In 1988, emigration increased by 7.4 per cent; in the first nine months of 1989 it rose by 1.5 per cent. The already high level of professional workers, as a proportion of all emigrants, has continued to rise. At present, the manufacturing and service industries are being affected by shortages of skilled labour. The Fijian government has sought to remedy this situation by upgrading training programs and by recruiting overseas. While these actions may ease the impact on the labour market, the upward pressure on prices, wages and other areas of the economy will, no doubt, continue to be felt.

In contrast to the 1988 budget, which was formulated in an atmosphere of economic uncertainty, the 1989 budget reflected the climate of economic recovery. Estimates of Inland Revenue collections were increased by 12 per cent, while estimated Customs and Excise collections were revised upwards by 10 per cent during the year. As a result of increased revenues and delays in implementing capital programs, the 1989 budget deficit was smaller than projected, at F$107 million, compared with an original estimate of F$112 million. In the 1990 budget, increased outlays are forecast for agricultural extension services, education, housing and health. The deficit is projected to decline further to F$25 million.

As noted earlier, Fiji's external accounts are dominated by the high levels of imports while receipts are dependent on the fortunes of the sugar and tourist industries. In 1989, Fiji's balance of payments showed a deficit of F$18 million. This sharp reduction from the previous year's surplus of F$155 million reflected the substantial increase in imports and a lower level of capital inflows. Earnings from sugar, unrefined gold, fish, timber, garments, molasses and coconut oil totalled F$452 million and accounted for 80 per cent of total domestic export receipts. However, exports increased only marginally in 1989. In contrast, imports increased sharply, largely because of restocking and an increase in mineral fuel imports. The widening trade deficit which rose from F$69 million in 1988 to an estimated F$237 million reflected this surge. The trade deficit is partly offset by earnings from tourism and other services at ports and airports. Net earnings from services increased from F$124 million in 1988 to F$228 million in 1989.

In 1990, the balance of payments is expected to be in surplus as the growth of imports slows and the trade deficit improves. The services account is also expected to move into surplus, reflecting the continued buoyant nature of the tourist sector.

In sum, a favourable external environment should continue to underpin the balance of payments, suggesting a good prognosis for continued economic recovery—all other things remaining equal.

Solomon Islands—a year of financial uncertainty ahead

Estimates for 1989 indicate that GDP grew by 6 per cent in the Solomon Islands. This outcome is in line with 1988 figures and is considered to be close to its long run potential growth rate. The benefits from investment in fisheries, telecommunications, forestry, flour and rice milling are now being realized.

The agricultural and social/personal services (excluding general government services) sectors contributed 30 per cent and 24 per cent of GDP, respectively. The fishing industry contributes some 7 per cent of GDP and provides approximately 38 per cent of export earnings. The tuna industry appears set to continue its recent growth. Output in other fishery activities, such as reef fishing and aquaculture, is also moving ahead albeit at a slower pace than the tuna industry.

Forestry accounts for 6 per cent of GDP and contributes 24 per cent of total exports. The prospects for a permanent, environment conserving forestry industry have brightened. The government is moving towards enforcing environmental standards. Sawn timber exports are expected to rise in 1990 to 4–5 times their average volume of recent years. The industry experienced a slight disruption late in 1989 as Japan the major export recipient, having become oversupplied with timber products, reduced its demand. This condition should ease in 1990.

Solomon Airlines has recently been authorized to operate two flights a week to Australia under an agreement with Qantas. The Solomon Islands government is also seeking traffic rights to Port Moresby, Port Vila and Auckland. New air services will go some way towards improving the potential of the tourist sector which is currently limited by poor air connections and limited accommodation and infrastructure. The recent sale of the government-owned Mendana Hotel may provide the necessary capital injection to upgrade this accommodation on the island of Guadalcanal.

In 1989 there was a marked deterioration in the trade and current account balances and an accompanying fall in foreign reserves. Increased volumes of agricultural exports combined with higher prices in early 1989 so that agricultural commodities earned 60 per cent more than in 1988. In spite of the rise in the agricultural output in early 1990, the downturn in world commodity prices resulted in a rise in the trade deficit from SI$43.2 million in 1987 to SI$81.2 million in 1988 and SI$83.8 million in 1989. The current account deficit increased from SI$37.7 million in 1988 to SI$68.6 million in 1989.

As noted earlier, the outlook for the cocoa, copra and palm oil industries is not optimistic. The difficulties facing the agricultural sector, which accounts for 30 per cent of formal employment, call for careful management. This may include industry restructuring and taxation reform. Exchange controls have also been proposed, although they would probably retard long-term progress in an attempt to achieve short-term balance.

Undoubtedly, external factors contributed to the deterioration of the balance of payments in 1989. However, an expansionary fiscal policy was also responsible for the decline in reserves. Fiscal management is difficult in the Solomon Islands. There is a growing demand for government services while private savings contribute much less than is required for the investment necessary to attain desired improvement in living standards. Although some changes to the taxation system have been implemented, additional revenues arising from these changes are not expected to be sufficient to offset expenditure. The 1990 budget deficit is expected to be SI$35 million, of which only SI$6 million will be finance for development. It has been suggested that the actual deficit could be higher than budgeted.

The increase in bank financing of government deficits, combined with deteriorating external accounts, have required a restriction of monetary policy in order to prevent domestic liquidity from rising too rapidly, and the loss of reserves becoming more severe. For example, the liquid assets ratio has been increased from 27.5 per cent to 30 per cent. This means that the government's requirements have imposed a burden on the private business sector.

Thus 1990 looks to be a year of increasing financial uncertainty for the Solomon Islands. The persistence of government deficits and the probable continuing low, even if improving, level of the terms of trade will continue to be problems confronting the Solomon Islands. While there is considerable agreement in both the government and the private community regarding the sources of difficulty, there is disagreement regarding the implementation of these measures which may apparently impose hardships on certain sections of the community, notably the government and social services and the advocates of some investments.

Western Samoa—the economy receives another setback

Economic conditions in Western Samoa were more favourable in 1989 than in 1988. GDP growth returned to a low, but positive rate. Agricultural commodities account for 80 per cent of total exports. Weak agricultural prices contributed to a decline in export revenues, while the value of imports rose. The trade deficit for 1989 of Tala 122 million was nearly Tala 5 million lower than in 1988. Tourist receipts and remittances also increased and foreign (chiefly Australian) aid was maintained. Remittances may decline as economic growth in New Zealand and Australia decelerates. The improvement in the current account surplus contributed to an increase in the overall balance of payments surplus. At the end of 1989, international reserves were equal to over seven months of imports of goods and services.

The favourable economic conditions of 1989 were abruptly reversed by Cyclone Ofa. The cyclone took the lives of twelve people. Its full economic cost will take some time to determine, but estimates put the damage at US$140–200 million. Damage to infrastructure has been extensive. Agriculture, which contributes 50 per cent of GDP and employs 60 per cent of the labour force and a larger proportion of the population indirectly, was badly affected. Banana and breadfruit crops have been totally destroyed, while copra and coconut crops have fared somewhat better. Taro exports, contributing 25 per cent of total exports, have been temporarily diverted from all destinations except American Samoa in order to supply the domestic market.

Following Cyclone Ofa, lower export revenues will widen the trade deficit further. Pressure on domestic prices may be alleviated by the donations, in the form of food and other necessities, that have flowed from international agencies, governments and from Western Samoans living abroad. International response has been generous. The governments of Australia, Britain, France, Japan, New Zealand, the United States and West Germany have given financial assistance and assistance in kind.

As a response to the cyclone, the government has implemented a supplementary budget. It has reduced the current budget but increased the development budget allowing for infrastructure to be rebuilt. The Central Bank, with the approval of the Ministry of Finance, enacted a series of emergency monetary measures to assist reconstruction and facilitate the provision of goods and services. Both lending and deposit interest rates are administratively determined. The maximum lending rate was reduced from 17 per cent to 12 per cent per annum. The interest rate on term deposits over six months was reduced from 12 per cent to 8 per cent. Qualitative guidelines were also altered to favour loans for cyclone relief. An export finance facility was also introduced. This facility will enable commercial banks to provide loans to exporters at concessional rates.

The cyclone has created overriding problems that will delay the solution of the structural problems facing the economy. These problems include a financial regime that favours investment in trade and services rather than in capital goods and the drain on human resource development arising from the migration of skilled labour. The reason for, and solutions to these obstacles have been discussed in earlier issues of the PEB. The recent cyclone will not only set back the resolution of these difficulties but will also delay progress towards economic self-sufficiency.

Vanuatu—tourism and finance lead to economic recovery

Economic activity is increasing in Vanuatu. GDP growth is thought to be of the order of 2–3 per cent in 1989 and is expected to increase. Capacity utilization is high and the finance, property and tourist sectors are doing well.

The Finance Centre consists of banks, trust companies and insurance, legal and accounting firms. It is a major source of government revenue and employment contributing 10 per cent of total output. The 1990 budget expects it to contribute Vatu 200 million to recurrent revenue. Foreign exchange earnings are another measure of the direct benefits from the Finance Centre. The balance of payments statistics showed that its earnings totalled Vatu 321 million in the three quarters of 1989 compared with Vatu 304 million for the same period in 1988. It is too early to conclude that changes in Australian and New Zealand tax laws will have an adverse effect on it. Any adverse effects from changes to tax laws may well be offset by the other advantages offered by the Centre such as confidentiality and an advanced state-of-the-art telecommunications network.

The long-running domestic airline dispute in Australia and an aggressive tourist promotion campaign led to a substantial revival of the tourist industry. The acquisition of a Boeing 727-200, partly funded by the Australian government, also assisted this revival. Receipts from travel in the first three quarters of 1989 were 25 per cent higher than for the comparable period in 1988. Of the 11,300 tourist arrivals in the first three quarters of 1989, 65 per cent were from Australia. The occupancy rate in the ten major hotels in Port Vila was 52 per cent in 1989 compared with 41 per cent in 1988. Most of the improvement occurred in the second half of the year. This rate is on a par with 1985 levels but remains below the 1984 figure of 70 per cent.

Vanuatu's small manufacturing sector contributes 7 per cent of GDP. Most activity in this sector concentrates on semi-manufactured products such as frozen beef and sawn logs for export. The sector will be given a boost with the opening of Vanuatu's first brewery later this year—a government controlled joint-venture with the Swedish company, Pripps.

Extensions to Bauerfield airport funded by Australian government aid, will allow wide-bodied jets to utilize the runway, giving rise to further expansion of tourism. Japanese aid is behind construction of a new international terminal which will be one of the largest and most modern in the Pacific when completed in early 1991. The Le Lagon and Iririki resorts have been bought by Japanese interests. More recently Raddisons Resort (formerly the Intercontinental Hotel) has been purchased by Australians and an extensive upgrading has commenced. This resort has also been granted a licence to establish a casino which is expected to be fully operational by mid year. Foreign investment in the Port Vila area and on Santo is occurring in both the tourist and property markets. The outlook for the tourist industry in 1990 remains buoyant but the concerns of ni-Vanuatu about land tenure will have to be carefully balanced against future industry development.

Over the last few years, management of budgetary finances has been difficult, partly because of various exogenous shocks. Productive capacity was severely cut by two cyclones in 1985 and 1987 which caused widespread damage to tourist resorts and infrastructure. In addition, France and the United Kingdom withdrew their budgetary aid in 1986 and 1988 respectively. The 1990 budget continues to reflect a cautious stance. The aim is to achieve a balanced budget, with the government tightening expenditure while endeavouring to widen the revenue base. Government revenue will finance 97 per cent of budgeted expenditure of Vatu 4.1 million revenue. Import duties comprise 55 per cent of income followed by rates and licences with 12 per cent.

External assistance to Vanuatu is also an important source of government receipts and is allocated to provide the bulk of government development expenditures. Under the Lomé IV Convention, Vanuatu will receive an increase in this aid of 10–15 per cent over Lomé III. This amounts to approximately Vatu 5 billion compared with Vatu 930 million under Lomé III. Although the details of the expenditure program are yet to be finalized, most of the money will be spent on agriculture, fisheries and forestry programs.

As in other Pacific islands, the expenditures arising from income produced in the financial centre and the tourist industry in particular, have a high import commodity content leading to a trade deficit of close to Vatu 5 million for the years 1987–89. These sources of foreign income and associated expenditure produce a continuing current account surplus. At Vatu 380 million for the first three quarters of 1989 it was substantially lower than for the same period of 1988 when it was Vatu 857 million. Increased tourist receipts, for the last quarter of 1989 and for 1990, should see this surplus increase. However, with world prices for coffee, copra and cocoa still lower than for most of 1989, even though trending upward, the outlook for increased export revenues is not promising.

Tonga—a position of steady state

Real GDP growth in Tonga is estimated to be 3–4 per cent for 1989 with a similar rate forecast for 1989–90. The consumer price index rose by 1.4 per cent in the last quarter of 1989, bringing the annual rate of inflation to 4.9 per cent. Much of this inflation is the result of cost increases in imported consumer goods.

Manufactures accounted for 40 per cent of total exports in the third quarter of 1989. The Small Industries Centre (SIC), which is geared to the production of goods for export, is performing well.[4] A joint Australian–Tongan venture called Sky High Bags Company Ltd will shortly commence manufacturing ladies handbags. This factory will employ 300 people and produce bags for export worth close to US$1.2 million a year.

The trade deficit largely reflects consumption based on remittance income and is a feature of Tonga's external accounts. It is expected to widen slightly in 1990. However, gross reserves should continue to equal 5–6 months of imports. Tourist receipts are running below expectations as evidenced by lower resort occupancy rates. A lack of airline seats is a major constraint on development of this source of income.

Under a comprehensive development plan (DP–V), some substantial gains have been made, most notably in the development of the manufacturing sector. The Central Planning Department is currently drafting the Sixth Development Plan, 1990–95 (DP–VI). All the Plans look to a deregulation of the economy as a means of achieving greater flexibility leading to progress.

4 PEB 4(1), June 1989:16–19.

The establishment of the National Reserve Bank of Tonga in July 1989 was a key measure in restructuring the banking system. Its immediate objectives are to determine an appropriate interest rate and an independent foreign exchange structure, with the Pa'anga no longer at par with the Australian dollar. Until the establishment of the Reserve Bank, the management of Tonga's foreign reserves was the responsibility of the Bank of Tonga (60 per cent foreign owned). With the Bank no longer receiving the income from the investment of the country's foreign reserves, it is rethinking its future lending directions and scope of banking services. The establishment of a second commercial bank is also being discussed.

Another emergent pressure on the banking sector is the decline in deposits. This situation has been caused in part by high interest rates in Australia and New Zealand and the administratively controlled rates in Tonga together with convertibility of the Pa'anga, leading to an outflow of deposits. As a result, the Bank is close to or exceeding its liquidity guideline ratios. This situation is forcing it to restrict new lending, and it will probably have to continue doing so in 1990. This shift in domestically-owned assets and the consequent credit restraint may dampen economic activity.

As the economic environment in Australia is likely to continue to require high interest rates, this policy casts doubt on the desirability of a country restricting interest rates to less than international levels if it wishes to encourage development, particularly investment by small businesses that do not have ready access to international finance.

'Foreign aid is supposed to help us get up and go, but mostly it encourages us to stay in bed.'

Quoted by A.V. Hughes, Governor of the Central Bank of the Solomon Islands, when presenting the bank's annual report.