Current economic trends in selected South Pacific countries

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Pacific island countries face problems in their efforts to achieve economic growth with macroeconomic and financial stability. This survey focuses on the current economic situation of island countries and recent policy and institutional measures taken in an attempt to improve upon the recent economic performance. Major developments in agriculture are highlighted as well as the immediate outlook for growth. Where appropriate, performance in the policy and institutional areas is assessed against suggestions made in the recent World Bank economic review of Pacific member countries (World Bank 1991).

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A sluggish world economy, characterized by near zero growth in the industrialized countries in 1991, has brought low commodity prices that have impacted adversely on the level of economic activity in Pacific island countries, and forced some to make significant policy adjustments. In addition, some island countries, notably Western Samoa and Vanuatu, have suffered cyclone damage to crops, infrastructure and buildings. In one or two cases economic prospects remain affected by a degree of political uncertainty. These factors are likely to remain significant for some time.

Agriculture, with fisheries and forestry, will continue to play a vital role in the development of Pacific island economies, particularly given the heavy dependence on this sector as a source of livelihood, employment and exports. However, almost without exception, Pacific island countries have enjoyed little success in generating growth in agriculture, and in fact, most have recorded a dramatic decline in the production of traditional tree crops, such as copra. Difficult problems are encountered: low productivity in the face of low commodity prices; poor management; weak support systems for farmers; insect pests and plant diseases; deficient marketing systems; weak motivation and incentives; and rigidities associated with customary forms of land

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tenure. Progress in dealing with these and related questions is essential if island countries are to succeed in revitalizing agriculture as a basis for balanced and sustainable growth.

Papua New Guinea

The long drawn out electoral process is over and a new 'captain' is at the helm of Papua New Guinea: Paias Wingti, a former Prime Minister, succeeds Rabbi Namaliu and his Pangu Pati led government. The margin of one vote, cast by the Speaker, was enough to make the change and gives the new leader an 18 month parliamentary challenge free period, provided his coalition of four parties and a number of independents hangs together. The Cabinet of 27 members includes veteran politician and another former Prime Minister, Julius Chan, as Deputy Prime Minister and Minister of Finance and Planning, and Masket Iangalio in the new portfolio of Mining and Petroleum. This is a crucial ministry given the boom in these two resources. Iangalio, former development bank and Air Niugini chief will face a great challenge which he is well capable of meeting.

It is early days yet to comment on likely new initiatives to be taken by the Wingti government but, on past performance, agriculture and education will have high priority. One thing seems certain, given the resources generated, the new government should not be stifled by lack of revenue. Of course, care in the disbursement of their new wealth will be of major concern (Parsons and Vincent 1991).

Papua New Guinea recorded significant growth in 1991, with real GDP rising by 9 per cent. With the onset of the mining boom, this country is poised for further strong growth in 1992. Underlying the growth in 1991 were a 50 per cent expansion in real output from mining, spin-offs from mining activities, a recovery in the prices of some export commodities, and an increase in government expenditure. This growth represents a dramatic turnaround from the 1989-90 period when, as a consequence of the closure of the Bougainville copper/gold mine and a steep decline in the terms of trade, real GDP fell by around 11 per cent over the two years.

Largely as a result of a series of structural adjustment measures taken during 1989-90 and designed to promote both financial stability and growth, the macroeconomic framework has improved considerably. Year on year inflation (to March 1992) was around 4 per cent as compared with 7.7 per cent over the previous corresponding period. The budget remains in deficit (at around 2 per cent of GDP) but this is narrowing as a result of more buoyant mining associated revenue conditions. The balance of payments has improved dramatically and is set to achieve a sizeable overall surplus (as opposed to a deficit in 1991), while the level of international reserves, currently equal to 3.5 months of non-mining imports, is growing. Real wages have been kept in check while the accommodating credit policy being pursued by the central bank appears to be appropriate under current economic circumstances.

While mining will be the driving force of the economy during the 1990s—especially during the first half of the period—government development policy is premised on the vital need to promote a broad-based and employment-intensive pattern of growth, primarily via agriculture. The aim is to develop Papua New Guinea's vast agricultural potential, both for import substitution and for export, as well as to provide a stronger basis for value-added processing. Insofar as export production is concerned, the recent record has not been good—among the major agricultural (tree) crops the export volume of copra and coconut oil has fallen dramatically since 1985-86, that for coffee, cocoa and tea has been sluggish and only palm oil has expanded. International prices for all these commodities have declined sharply, with only copra and coconut oil rising, so that in terms of total agricultural export earnings, the decline has been substantial (330 million kina in 1985 to 180 million kina in 1991).

Current approaches to agricultural development recognize the need to modernize key aspects of agriculture and undertake appropriate adjustment measures to overcome constraints. According to the Department of Agriculture and Livestock, the leading constraints include low productivity, poor program management, shortages of skilled labour, poor extension management, an absence of relevant and reliable farm level data, limited market access and infrastructure, and inadequate research services. The disincentive effects of low commodity prices and relatively high rural labour costs are also important (reinforced by the effect of a strong national currency).

Recent initiatives taken to address some of these issues, at least in the case of tree crops, include commodity price support, input and interest rate subsidies, and the establishment of commodity corporations. On the latter, the Government has already established the Coffee Industry Corporation, the Oil Palm Industry Corporation and, in the near future, will set up a Cocoa and Coconut Industry Corporation. These bodies are an interesting initiative and are designed to play a key role in the provision of research and extension services in their respective areas.

As part of the structural adjustment process, the Government has launched an 'Action Plan' (Medium Term Industry and Trade Development Plan) designed to provide an overall basis for fostering trade and industry development. The plan is based on an integrated approach, and specifies policies and strategies for achieving an open, deregulated and competitive environment for such development. Key measures to promote these goals have been (or are about to be) introduced, for example, steps to phase out quantitative restrictions in favour of selective tariff protection; the restoration of tax holidays and related tax incentives (under the Pioneer Industrial Development Act); an expanded tax exemption scheme for exports; the construction of an industrial estate in Lae (with others planned); and the establishment of a new trade office in Brussels. Other assistance measures pertain to industrial training, accelerated depreciation of capital assets, the promotion of small business and a wage subsidy scheme.

These initiatives are integral ingredients of broad-based, employment orientated, non-mining development. However, care needs to be taken to ensure that some of the measures do not conflict with the basic objectives of creating an open and enabling climate for development, or that they themselves create macroeconomic distortions. Moreover, given the current level of real wages and the exchange rate, these initiatives may prove inadequate as a means of fostering industrial and trade investment.

Tourism is small (apparently only around 4,000 visitors in 1991) and while it shows little prospect for significant growth in the medium term, has undoubted potential in the longer term. While there is no strong commitment to tourism development, major constraints are the high cost structure, infrastructural limitations, inadequate hotel facilities, and law and order problems.

The structural and stabilization measures taken so far will help lay the foundation for a more balanced and less distorted pattern of growth. However, many other critical issues (some of which have been noted above) remain to be tackled and resolved to ensure further success. Foremost is the need to show restraint in government budget expenditure to ensure both financial stability and efficient use of resources. Although the fiscal deficit is low (less than 2 per cent of GDP) current expenditure has picked up and, if uncorrected, could result in a widened deficit and a heavy drawdown from the Mineral Resource Stabilisation Fund (MRSF) and/or higher levels of borrowings from both domestic and external sources. Another vital and related issue is to ensure that the revenues accumulated in MRSF are wisely used. Rather than a source for underwriting unrestrained and unsustainable government expenditure, these resources should be carefully managed to assist in the funding of productive priority projects (e.g., agriculture and human resources development) and to build up savings as a protection for the future when mineral resources are depleted. The concept of a trust fund, similar to that operated by Kiribati, should be closely considered.

Other key issues relate to wages policy and exchange rate management. The introduction of a system of partial indexation introduced a degree of flexibility and, in fact, has led to a decline in real wages over the recent period, contributing to cost competitiveness. Further flexibility should be encouraged. The current level of the kina contributes to a high cost structure and may be a major factor in undermining international competitiveness. The exchange rate needs to be considered within the overall macroeconomic framework to see if it is, in fact, a significant constraint to development. Care also needs to be given to tariff policy to ensure that tariff protection is not overdone. Effective measures to deal with law and order problems and human resources development must also be developed.

An important milestone has been reached in Papua New Guinea's trade relations with Australia: for the first time, the balance of visible trade has moved in Papua New Guinea's favour. This is the result of large gold exports to Australia for processing. With oil beginning to flow from the Kutubu field this shift is likely to strengthen. First shipments of oil took place in August.

In sum, Papua New Guinea has been highly successful in combating the economic shocks of 1989-90 and in initiating structural adjustment measures that will help lay the foundation for realizing growth and related objectives. The challenge now is to persevere with the task of economic restructuring and to ensure that Papua New Guinea's abundant human, physical and financial resources are used wisely and in a way that will sustain future growth.

Fiji

Political issues remain a significant factor in Fiji's development. The June elections, the first since the military coups of 1987, resulted in the formation of a government dominated by the main indigenous Fijian party—the *Soqoqoso ni Vakavulewa ni Taukei* (SVT) —with the former coup leader, Major General Sitiveni Rabuka as Prime Minister. The return to parliamentary government is a welcome development, but whether it presages a more settled political future remains to be seen.

The new Government faces problems on several fronts—problems that can significantly undermine the political basis for sound and sustainable economic growth. The Constitution, promulgated in 1990 and heavily weighted in favour of ethnic Fijians, remains a divisive reality. The economic policies of the Government have yet to be enunciated, so future directions are unclear, although Minister of Finance, Paul Manueli has indicated a preference for the policies of his predecessor.

Part of a deal struck by Rabuka with the Fiji Labour Party, and which led to his appointment by the President as Prime Minister, was an undertaking to review

- the introduction of a value added tax (VAT)
- labour relations issues of the former Mara government
- the 1990 Constitution.

A further commitment given by the Prime Minister was to examine the implications of the Agriculture Landlord and Tenant Agreement as it affects the important sugar leases due to expire shortly.

As planned, the VAT came into effect on 1 July: the other issues have yet to be addressed.

Against this backdrop, the current economic situation is one of recovery from a sluggish position in 1991 when real GDP declined by 0.4 per cent. The projected 4 to 5 per cent increase in GDP in 1992 can be attributed to some improvement in commodity prices, and expected increases in sugar and garments production. The overall macroeconomic situation is fundamentally sound and characterized by a high degree of stability, with inflation at just over 4 per cent, the balance of payments in overall surplus, and international reserves at a high F$400 million (two years of imports). On the monetary side, high liquidity exists in the financial sector but appears to be under the control of the Reserve Bank.

Improved agricultural performance is a major factor contributing to the current recovery. Sugar, Fiji's largest single industry, is recovering after a decline in production in 1991. Improved prices can be expected to lead to increased copra production, while some of the lesser export items, such as ginger, timber and fish, appear likely to record further expansion.

Sugar, which accounts for around 45 per cent of agricultural output, 40 per cent of agricultural employment, and at least 30 per cent of total export earnings, experienced a decline in 1991, with total output falling by 5 per cent to 388,900 tonnes. This decline can be attributed to the politically linked boycott of the cane harvest which left around 40,000 tonnes of sugar cane unharvested. Weak prices were also a factor, although a large proportion (40 per cent in 1991) of sugar exports is sold to the United Kingdom at preferential prices. In addition, sugar quality was adversely affected by late harvesting. However, despite the termination of the boycott and a return to a more normal situation, the industry faces some uncertainty over the question of land leases. Sixty per cent of the leases held by cane farmers (predominantly ethnic Indians) are up for renewal in 1995-96. A satisfactory resolution of this issue will help restore confidence and hence investment, including that needed to develop new cane areas.

Prospects for other primary sector exports are somewhat mixed. Some recovery in copra and cocoa can be expected as prices improve but prospects for a significant expansion are not good. With adequate attention to quality and marketing aspects, ginger exports, particularly to the United States, could be expanded. Commercial tuna fisheries and forest products have significant growth potential, the latter based on the exploitation of both hard and soft woods. Taro exports have risen dramatically with the cessation of exports from Western Samoa (the result of the recent cyclone), but will fall back when supplies from Western Samoa resume.

Tourism remains sluggish, with the number of visitors down by 15 per cent to mid 1992, following a decline of 7 per cent in 1991 (from a record 280,000 tourists in 1990). The decline, due mainly to reduced tourists from Australia and New Zealand, reflects the effect of the recession in these countries, and airline deregulation resulting in cheaper domestic travel. However, longer-term prospects remain good, with many investment prospects in the pipeline, especially in the Western Division. There is also evidence of a growing market in Japan and the United States, although much will depend on Fiji's capacity to maintain competitiveness and promotional efforts.

Garments, Fiji's third major industry, grew rapidly in 1991, accounting for exports worth F$130 million and employment of 12,000. Dramatic growth has been largely due to generous tax concessions under the tax free factories (or zones) scheme which, among other things, provides for a tax holiday of up to 13 years. The industry appears to be entering a consolidation phase, but is expected to grow by at least 10 per cent in 1992. Future prospects will depend upon the capacity to compete with low cost Asian producers and to develop specialized products geared to niche markets.

The 1992 budget reiterated the then Governments' pledge to '... steer a small, commodity based island economy towards a dynamic, outward looking low tax and high growth economy'(Fiji, Government of 1991). The budget emphasized the need to limit the resources available to government in favour of the private sector, and to move progressively toward zero net deficits. Key budget strategies included the encouragement of export orientation, progressive deregulation, increased use of indirect taxation, and reliance on labour market competition.

The current budget provides for a net deficit of F$22 million, equal to 1 per cent of GDP. This compares with a deficit of F$32 million recorded in 1991. However, difficulties may arise in containing the planned deficit as budgeted revenue provides for a significant increase in revenue from the introduction of VAT, whose future is now uncertain. Another problem relates to the continued inability of many departments to keep expenditure within budgeted allocations.

As noted, the high liquidity of the banking system continues to be a major concern for the monetary authority—a situation that can be attributed to weak demand for credit as investors continue to adopt a wait and see posture towards the newly elected government. Fiji Reserve Bank has largely succeeded in mopping up excess liquidity by open market operations and the issue of central bank notes. This policy has been instrumental in keeping up interest rates, which have been deregulated as part of the liberalization strategy. With the balance of payments reasonably sound, international resources at comfortable levels, and modest inflation, financial stability appears likely to continue.

Fiji has made considerable progress in implementing some of the key measures suggested by the World Bank (1991: 115-120) for establishing international competitiveness via wage moderation, reduced trade restrictions, deregulation and tax reforms. However, key areas that still call for attention include the shortage of skills, the lack of private investment and the low efficiency of public enterprises.

A major achievement over the past few years has been the implementation of key measures designed to reduce distortions in the economy and to establish a more enabling structural and policy environment for investment and growth. Among the major reforms that have been introduced are:

- labour market deregulation, leading to diminished power of labour unions and a system of wage setting through enterprise negotiation (with government set guidelines);
- the elimination of price control and import licensing in all but a few areas;
- a significant reduction in the level of protective tariffs (the aim is to eventually operate a lower and uniform tariff system); and
- a dismantling of almost all import quotas.

The introduction of VAT was to lead to the removal of customs duty (as distinct from protective tariffs) and the implementation of a significantly lower (and simplified) system of income and company tax.

Major reforms in the area of public enterprises have been delayed but are expected to move ahead now the elections are over. The aim is to develop a suitable framework as a basis for reform, and to emphasize privatization via corporatization rather than the sale of assets. Regarding education and training, several initiatives have been taken that will, in time, greatly alleviate the shortage of technical and professional skills that remains critical since the exodus of skilled labour following the 1987 coups. Under support from the World Bank and several other donors, a project is being developed that will lead to substantial investment in technical and vocational training, teacher training and secondary school education. In the meantime, Fiji remains heavily dependent on expatriates (there are nearly 50 experts under the Australian International Staffing Assistance Scheme alone).

Fiji has achieved much in overcoming the economic reversals of 1987-88, and in carrying out basic macroeconomic reforms designed to pave the way for greater efficiency and economic growth. The challenge now is to build upon the recent achievements and to provide a political and economic environment that will allow it to realize its growth potential.

Solomon Islands

Perhaps more than any other World Bank Pacific member nation, Solomon Islands has yet to come to grips with key proposals made by the World Bank (1991: 211-7) if it is to realize its potential growth rate of over 4 per cent per annum. Fiscal imbalance remains a major obstacle to the attainment of macroeconomic and financial stability. However, other key areas that call for determined action include human resource development; natural resource management; improved land utilization; public enterprise reform; the design of clear investment guidelines; and an improved tax administration system.

For 1992, growth in real GDP is projected at slightly above the level of 3.9 per cent recorded in 1991, and will result in a marginal increase in real GDP per capita. A slight improvement in the balance of payments is expected, but severe imbalances on the fiscal side continue and represent the overriding challenge to economic policy in the medium term. Largely as a consequence of fiscal imbalance, inflation is high at 11 per cent, and international reserves are very low at SI$20 million, equal to around two weeks of imports.

The slightly improved prospects for the current year can be ascribed to exports and tourism, both of which are likely to record modest increases. Copra will benefit from improved prices; palm oil from further post-cyclone recovery; and fisheries and logs from higher levels of activity. Tourism will be stronger as heavy inflows of visitors are expected in connection with the annual South Pacific Forum meeting held in Honiara, and the celebration of the 50th anniversary of the Battle of Guadacanal.

With the exception of palm oil, agriculture is dominated by smallholders. Its potential for growth derives from both increased productivity and from the development of the considerable areas of unused arable land. Except for logs and possibly fisheries, prospects for achieving large increases in export production are not good. Many policies and programs are being pursued which, if successful and accompanied by favourable prices, will pave the way for significant growth in the future. In the case of copra, these programs include replanting with high-yielding hybrids; for cocoa, a consolidation of activity and a focus on increasing productivity; for palm oil, the development of a new plantation; and for cattle, the development of several ranches operating on a commercial basis, and improved marketing and related infrastructure. Developments in chicken and pigs, where a state of near self-sufficiency has been attained, will be further consolidated.

Effective efforts to boost productivity via research, training and extension services remain vital prerequisites to progress. At a broader level, however, more attention needs to be paid to improving institutional facilities, particularly improved access to credit, and developing clear and coordinated agricultural policies. Means of better coordinating the efforts of the central ministries and the provincial governments must also be devised, and existing obstacles to the development of customary land must be overcome.

Improved management of forestry resources needs urgent attention. The recent granting of many logging licences, mainly to Asian groups, has been attended by indiscriminate logging that threatens serious damage to the environment. Inadequate control and monitoring is a major problem and has meant that Solomon Islands is receiving little benefit from these activities.

Addressing the budget deficit, which was SI$70 million or 21 per cent of monetary GDP in 1991, remains a matter of top priority. The 1992 budget speech highlighted a commitment to a progressive reduction of the deficit towards a balanced budget. The current trend suggests that a much lower deficit will be recorded in 1992, around SI$20 million or 7 per cent of GDP. This result can be attributed to increased revenue resulting from the introduction of higher rates of duty on selected imports, a reduction of establishment post in the public service (chiefly through attrition), and some improvement in budgetary control and management. Pressure on the budget will also be eased by the suspension of capital projects that have large recurrent costs, and a payroll tax is to be reintroduced, after previously being rejected in Parliament. Additional funds will be received from the planned sale of government investments and assets as part of the privatization program.

However, the above measures are inadequate to restore fiscal balance. More substantial structural changes are called for, including further tax reforms to broaden the revenue base, and an incomes policy aimed at containing unwarranted increases in public service salaries. Key structural adjustment policies needed include those designed to revitalize the private sector, promote vital public enterprise reforms, strengthen the domestic savings base, and further implement suitable privatization.

The monetary situation has been dominated by heavy government borrowing from the banking sector to support the high and unsustainable budget deficits and, in the case of the exchange rate, to maintain a degree of international competitiveness. To support the deficit, Government has had to rely heavily on the Central Bank which, largely as a consequence, has had to increase the liquid asset ratio to near statutory limits (of 40 per cent). Significant monetization of the deficit has led to high interest rates (up to 19 per cent on loans), significant inflation and pressure on the balance of payments, and a serious overcrowding of the private sector. Persistent government deficits combined with a lack of restraint on the incomes side, have, of necessity, thrown a heavy burden on the exchange rate as an instrument of macroeconomic policy. The resultant decline in the exchange rate has itself contributed to inflation and wage increases. This situation highlights the importance of budgetary restraint.

The most immediate challenge facing the Solomon Islands is to restore macroeconomic balance and stability as a vital precondition for continued growth. Controlling the budget deficit and restraining public service salary increases are particularly critical.

Vanuatu

Vanuatu has had considerable success in addressing a key concern expressed by the World Bank (1991:278-92) namely, the need to achieve fiscal stability as a basis for a sound macroeconomic environment. Other key areas are being addressed, although in the case of some of these, progress is likely to be slow. Among the key areas are human resource development; a high-cost dual education system; land use; and the need for a coherent set of investment guidelines.

Over the recent period, Vanuatu has maintained impressive economic growth and a significant degree of financial stability. The growth in real GDP, averaging just over 4 per cent per annum since 1986, matches the potential growth rate identified by the World Bank (1991: 288). Despite the adverse effects of three highly destructive cyclones (plus two less destructive ones) experienced earlier in the year, the growth rate for 1992 is expected to be around 2 per cent.

The pursuit of a sound macroeconomic base has met with considerable success. Over the past three years government has adhered to a balanced budget; inflation has been significantly reduced (6 per cent per annum); the balance of payments is virtually in equilibrium; and the level of international reserves, currently around 20 billion vatu, is equal to two years of imports. Through both the budget and monetary policy, the recently elected Government has stated its commitment to the maintenance of financial stability as a vital condition of further growth.

However, the shortfall in government revenue and the possibility of a modest deficit by year end, is cause for some concern. Even though this shortfall can be largely attributed to a sluggish tourism sector reflecting, in part, visitor cancellations due to the cyclones, the Government has responded by giving consideration to across-the-board cuts in current expenditure as a means of achieving a balanced budget.

Together with tourism, agriculture has been the main source of growth in recent years. This has been led by cocoa and beef (where export earnings have more than doubled) and, to a lesser extent, kava. Heavy damage to crops inflicted by the cyclones, particularly on outer islands, will reduce export production this year, although higher prices for copra will partly offset the impact on overall export earnings. Copra production is projected to fall slightly below the 1991 level of 29,000 tonnes, and cocoa to less than half the 2,500 tonnes recorded in 1991. Beef production seems likely remain much the same as last year when production was 1,230 tonnes.

Agriculture's recent impressive performance demonstrates the robustness of smallholder agriculture, which currently accounts for over 80 per cent of copra, 70 per cent of cocoa, 60 per cent of beef and the entire kava crop. Apart from this favourable aspect, smallholder agriculture is significant for another reason: from the viewpoint of balanced development, it fosters broad-based participation in the development process.

Sustaining the growth momentum of agriculture will be a major challenge. While the immediate prospects for copra appear favourable because prices are expected to rise further, the reverse is true for cocoa—there is an over-supply in world markets. Overall, agricultural production should be stimulated by recent government initiatives including duty exemption on imported agricultural equipment and materials, free seedlings for planting and the provision of breeding stock. Not withstanding these measures, further efforts are needed in the case of copra, cocoa and coffee to improve drying, storage and handling facilities. In the case of beef, key requirements for realizing the considerable potential of this industry include efforts to ensure quality, expand exports to Japan, and identify new markets (e.g. in Asia). Regional markets for kava also need to be explored.

In the longer term, a critical factor in agricultural development is the capacity to improve land utilization. While a continuing effort is needed to improve productivity, by far the greatest potential lies in the development of large areas of presently unused arable land. With only around 40 per cent of the country's total area of arable land presently under cultivation, much of the remaining arable area, possibly as high as 50 per cent, remains unused because of disputes among customary owners over land rights.

Significant investment in these areas will greatly depend on a clarification of land titles.

As a result of effective promotions and improved air services, including the purchase of a B727, tourism has grown strongly. Visitor numbers have doubled over the past four years to reach 35,000 in 1991. Though currently sluggish, tourism has considerable potential and attention should be given to enhancing the competitiveness of the local industry through continuing promotions, increased investment in the hotel sector, diversification of tourist amenities, and improved access to outer island destinations. The preparation, with United Nations Development Programme assistance, of a tourist master plan, should be of value in future development.

Manufacturing, which is presently small and dominated by import substitution, has the potential for modest growth. Largely overshadowed by efforts in tourism, manufacturing development appears to need serious attention to improve the overall policy and institutional framework. The foreign investment guidelines currently under consideration may help to provide the clearer and more coherent policy guidelines so badly needed. Licensing, work permits and related administrative procedures need to be streamlined, access to industrial land needs to be improved and greater emphasis needs to be given to industrial development based on export orientation and processing of agricultural materials.

Vanuatu's monetary system remains relatively open ended: guidelines are provided by the Reserve Bank but the commercial banks are free to pursue their own policies regarding credit and interest rates. An interesting question is how effective this system has been in serving the financial needs of Vanuatu, and whether there is a case for the Reserve Bank to play a more active role in the conduct of monetary policy and the overall supervision of the financial system.

Traditionally viewed by the monetary authority as an instrument for maintaining financial stability, especially as a means of containing inflation, the exchange rate has undergone considerable depreciation over the past seven years, thereby helping to promote international competitiveness. Flexibility in this area needs to be maintained in order to preserve this competitiveness.

Government efforts to strengthen the tax base have been low key and so far consist of an extension of the turnover tax into a few more areas beyond hotel services. The present taxation system relies heavily on trade imposts which account for around 70 per cent of total domestic revenues. Further tax changes seem necessary to provide a revenue base that is both elastic and diversified, while further extension of the turnover tax seems warranted.

Attempts to narrow the human resource gap are necessary because Vanuatu faces a critical shortage of skills in the professional and technical areas and relies heavily on expatriates. In addition, the illiteracy rate is one of the highest in the region, reflecting deficiencies in basic primary education. With strong donor support, efforts are being made to upgrade basic, technical and post secondary education.

The current turnaround in the world economy and prospects of improved commodity prices, mean that the outlook for Vanuatu in the immediate term is reasonably bright. Assuming favourable weather and adherence to sound economic management, Vanuatu appears capable of achieving its growth potential of around 4-5 per cent per annum.

Western Samoa

The two highly destructive cyclones which struck Western Samoa over the last two years have undermined economic growth and threatened financial stability.

Cyclone Val, which struck at the end of 1991, will in the immediate term lead to lower growth than projected by the World Bank (averaging 2.8 per cent per annum during 1990-94). This cyclone caused heavy damage to subsistence and commercial crops and infrastructure—damage which has been estimated at over WS$700 million, or nearly twice the level of national income. Cyclone damage will result in a significant decline in export earnings from agriculture, a reduction in tourism, and lower levels of manufacturing due to shortage of materials for processing and disruption to power supplies. The effects of the cyclones will continue to be felt for some time.

Cyclone Val forced the Government to implement emergency measures to alleviate adverse effects. Until June, taro exports were halted (other than to neighbouring American Samoa) in favour of the domestic market; the Central Bank relaxed credit controls to allow the commercial banks to increase loans for rehabilitation and related purposes; and a supplementary budget was introduced to reallocate funds for emergency reconstruction work.

While these and related measures have contributed to easing the detrimental effects of the cyclones, the damage was so extensive that overall economic recovery will be slow. Real GDP is projected to decline by between 4 and 5 per cent in 1992 compared with an increase of 2 per cent (real provisional) over 1991. A considerable increase in manufacturing exports is anticipated, largely because of a major increase in export production of automotive wiring by the recently established industrial venture, Yazaki Samoa Ltd. Despite this, reduced exports of agricultural products combined with increased imports will lead to a weakening of the balance of payments and this will be reflected in international reserves. Inflation, which has picked up from near zero at the end of 1991 to 4 or 5 per cent per year, can be largely ascribed to the shortage of local food supplies following the cyclone.

Despite heavy damage, root and other subsistence crops have recovered well and supplies of taro and bananas in particular appear to have returned to pre-cyclone levels. However, in the case of the traditional tree crops, notably coconut and cocoa, production will remain low for several years. This year, cocoa exports will be negligible and the output of coconuts will be well below that achieved in recent years. Due to this shortage, two of the three coconut cream factories have closed, the third continuing operations by importing coconuts from Tonga.

The recent catastrophes offer an opportunity for the Government to take stock of agriculture and review development policies and strategies in that sector. While continuing to foster traditional tree crops, particularly through replanting and hybridization schemes, a greater effort is needed to diversify into new and potentially more productive lines of activity. This particularly applies to high value niche products that are less vulnerable to cyclones, for example, ginger, *ava* (kava), and a range of tropical fruits. Selected livestock and horticultural products also offer opportunities while the further development of mixed cropping systems, including cattle under coconuts, should be pursued more vigorously.

Government assistance to agriculture has been reorganized over the recent period and now takes the form of a cash bonus for the planting of coconuts and kava, the provision of free cocoa seedlings, the leasing of agricultural machinery at below cost, the provision of extension and advisory assistance, and exemption from income tax. Agricultural marketing has also been reorganized, allowing the private sector to take over this function. However, a great deal more needs to be done to revitalize agriculture which, with the exception of taro, has been a stagnant sector over the last two decades. Efforts to clarify development policy, improve access to credit, improve management skills, open up new markets, and achieve greater productive use of customary land are essential. In addition, more needs to be done to encourage investment in processing of local produce, especially tropical fruits and coconut.

Regarding the other productive sectors, tourism has a considerable potential but needs further encouragement. Efforts are needed to expand hotel capacity, improve local amenities and undertake promotion in major markets. With the establishment of Yazaki Samoa Ltd., which has a capacity to employ over 1,000 Samoans, the manufacturing sector has taken a large step forward. A continuing effort, however, is required to establish a more diversified and balanced manufacturing structure. Attention needs to be given to increasing export orientation, improving the level of industrial skills, encouraging processing activities, improving power supplies, and streamlining administrative procedures through, for example, the establishment of a 'one-stop-shop' facility. The establishment of appropriate incentives for private sector development is also vital.

Government remains committed to maintaining a sound macroeconomic framework as a basis for accelerated economic growth. The 1992-93 budget provides for a small surplus and, to ensure this, cost-saving measures have been introduced, including a small cut in non-salary expenditure and a freeze on the filling of public service vacancies. Although the balance of payments is projected to weaken international reserves, at around WS$380 million, are at comfortable levels. The Central Bank is keeping a tight rein on commercial bank credit while administering a flexible exchange rate policy, bearing in mind Western Samoa's trading situation. Inflation is not expected to go beyond the projected 4 to 5 per cent, while GDP is expected to recover by the end of 1992 to reach the 1991 level.

Given a reasonably sound macroeconomic situation, the major challenge for Western Samoa is to tackle a range of structural measures that are essential for accelerated growth. These measures, which have been highlighted by the World Bank, include those designed to revitalize agriculture, foster domestic savings and investment in productive sectors, reform the public enterprise sector (including privatization measures), strengthen entrepreneurship and foster export-oriented manufacturing. Also crucial is the formulation of appropriate policies that encourage foreign investment in key productive sectors and facilitate the development of customary land.

Tonga

In recent years, Tonga has pursued sound macroeconomic policies and carried out structural reforms. This has resulted in a reasonable rate of economic growth and financial stability. However, this year's expected budget deficit represents Tonga's most pressing problem.

Over the 1989-90 period, real GDP grew by an estimated 2.5 per cent with growth in real GDP per capita slightly lower at 2 per cent. The 1990 balance of payments figures showed an overall surplus of T$6.8 million for the calendar year, reflected in Tonga's international reserves which were equivalent to six months of imports at the close of 1990. By the end of 1991, the level of official reserves had risen to the equivalent of almost seven months of imports due to receipts of squash imports in the final two months of that year. After a period of relative price stability, inflation accelerated sharply, peaking at 17 per cent early in 1991 then levelling off to 6-7 per cent by the end of the year. Public sector salary increases and a weakening of the pa'anga against the New Zealand dollar were the main contributing factors.

After a balanced budget last year, it appears that this year's budget will show a deficit of between 2.5 and 3 million pa'anga. This is despite tightening of recurrent expenditure and the introduction, last year, of fiscal measures including a move from direct to indirect taxation and increased customs duties. In response to this deficit, Government has just introduced new measures including increased export duties on alcohol and tobacco and an innovative new tax on remittances.

Although declining in importance, agriculture remains the leading productive and export sector. For the past decade there has been a negative trend in the export production of coconut products, bananas and watermelons. Factors contributing to this include aged trees, depressed world prices, weak institutional support, a failure to control insect pests and disease and labour shortages. The leading export crops now are squash, vanilla, fish and coconut products.

There are several possible strategies for strengthening the agricultural export base: raising vanilla production through improved management techniques, utilizing fertile arable land more productively, rehabilitating the coconut industry, and exporting new crops such as cocoa, coffee, Irish potatoes, yam, beans and new varieties of disease-free bananas. Government needs to develop new markets as well as expand current markets for vegetables such as capsicum, lettuce, tomatoes, and squash and other niche products.

With Tonga's extensive export processing zone, there is considerable scope for expanding fisheries. Extending licensing arrangements is one means of realizing this potential, and expanding existing commercial fisheries, another. The Asian Development Bank has provided a loan for the further development of commercial fisheries and technical assistance to strengthen the newly established fishing corporation. Government efforts to develop commercial fisheries for export need to be increased. Measures to strengthen small-scale commercial fisheries should include improvements in transport facilities to markets, training programs and quality of fishing vessels.

While policies such as the provision of agricultural credit, extension and advisory services, marketing reform (the most notable being the corporatization of the Commodities Board in 1992), tax holidays and eligibility for export incentives are already in place, there is an overall need to strengthen basic support services including technical and advisory assistance, agricultural research and marketing facilities.

Manufacturing and tourism show significant potential for expansion, but one area which needs to be watched is the upward pressure on wage rates, which, unless matched by productivity gains, will erode the country's competitive edge. Manufacturing is presently dominated by import replacement, but the country's two largest enterprises, leather jackets and woollen knitwear, are export oriented. As part of an attempt to promote manufacturing production, Tonga's Small Industries Centre is being expanded and new sites developed. Notwithstanding the fact that these centres are expected to act as catalysts for further manufacturing development, the time has come to carry out an assessment of the industrial situation. Some industries are not flourishing while others are too highly protected. Future expansion should concentrate on export-oriented ventures such as fish, vanilla and coconut processing. Expansion of manufacturing will call for the active involvement of investors who can provide, among other things, necessary capital and technical expertise. In addition, changes need to be made to the incentives framework which tends to favour import replacement. Exchange rate management must ensure adequate incentives for exports.

Unlike many other regional countries, in 1990-91 Tonga showed a 21 per cent increase in tourist arrivals. The country has a largely undeveloped tourism potential and further development can be facilitated by government activity to improve international air links, strengthen infrastructure, undertake overseas promotion and encourage private sector investment in hotel and related facilities. Government has already carried out infrastructural works, including runway extensions and a new airport terminal, and is committed to tourism development as is evidenced by plans to prepare, with Asian Development Bank assistance, a comprehensive national tourism plan.

Tonga's chances of achieving the World Bank's projected GDP growth of 3 to 4 per cent per annum will depend on its capacity to restore short-term macroeconomic stability, design a coherent set of development strategies and undertake fundamental structural reforms with environmental impact a prime consideration. Key issues that need to be examined are agricultural revitalization with an emphasis on high value non-traditional and niche export crops; greater emphasis on domestic resource mobilization; encouragement of a more dynamic private sector; and the carrying out of appropriate public sector reforms including a stronger push for privatization and human resource development.

Kiribati

Following a decline in the 1990-91 period, Kiribati is now well on the way to recovery. Disciplined management has kept inflation to a moderate level, held wages down, achieved a sound balance of payments position, and substantially augmented foreign reserves. Meeting the challenge to achieve improved economic performance and self reliance will depend on the country's capacity to develop its resources—physical, human and financial — for greater diversification, with the largest potential lying in sea-based resources, tourism, and overseas employment.

Kiribati is in a sound economic position with projections for this year showing an increase of 2 per cent in real GDP and a record overall surplus in the balance of payments brought about by a significant increase in fishing royalties and stronger export performance. Sizeable surpluses over most of the past decade have allowed Kiribati to augment its stock of foreign assets and reserves, in particular its Resource Equalization Revenue Fund (RERF) currently equal to A$260 million, or over seven years of imports. Inflation, which is likely to remain a modest 4 to 5 per cent per annum, largely reflects imported inflation from Australia, Fiji and Japan—the country's leading import sources.

The Government has adhered to a highly disciplined macroeconomic policy with a fiscal policy based on a balanced recurrent budget. However, this conservative fiscal approach has meant reliance on external aid to finance almost the entire development program and government revenue has failed to grow in proportion to GDP. To combat this, Government will have to strengthen domestic revenue, possibly through a broadening of the tax base.

While the harsh atoll environment will severely hamper agricultural development, there is room for improving and expanding agricultural production. First, underutilized land in the Northern Line Islands, Phoenix Group and Kiritimati can be brought under cropping with government assistance given to financing small-scale indigenous investment activities. Second, it is imperative that subsistence production be revitalized and strengthened through appropriate development initiatives such as improving the quality of livestock; the introduction of new exotic varieties of fruit and vegetables not part of the traditional diet; and coconut replanting. However, appropriate technical assistance and training measures are important prerequisites for improving agricultural production and productivity.

While increased agricultural output is important to reduce dependence on imported foodstuffs, Kiribati's greatest potential for sustainable growth lies with pelagic and other marine resources. Apart from the vagaries of weather, this sector has been beset with problems including limited air links to markets for chilled fish; inadequate financing; paucity of managerial, marketing and technical expertise; and bait shortages, among others. One possible solution, favoured by the Government, is to seek overseas partners in joint venture arrangements particularly in areas such as fish farming, sea weed harvesting and other forms of aquaculture, and the national fishing company, Te Mautari Ltd. In addition, a concerted effort is needed to extend fisheries licensing arrangements so that maximum financial and related benefits may be derived from the country's extensive fisheries resources. One recent initiative has been to extend the work of the Marine Training School into the area of training, a venture undertaken with the Japanese.

Kiribati has many unique features for tourists, such as sports fishing on the Line Islands, war relics on South Tarawa and fishing and bird watching on Kiritimati. The main stumbling block to date has been a paucity of tourism infrastructure and if Government is serious in its desire to boost tourism it will have to make infrastructure improvements such as the recently completed airstrip. The establishment of a Visitors' Bureau and the preparation of a tourism master plan are moves in the right direction.

Overseas employment and remittances are already important to the economy, and in the light of limited employment opportunities within Kiribati, there is a need to make a stronger effort to expand overseas employment including possibilities for employment, on foreign fishing fleets.

Kiribati's manufacturing base is heavily dominated by small-scale labour-intensive operations oriented to import replacement. Future possibilities lie in expanding import substitution in areas that enjoy natural protection from high transport costs—aerated water, coconut products such as cream, aluminium (from recycled cans) and handicrafts. Other opportunities lie in upgrading solar salt production and promoting the recently developed tuna jerky. The industrial estates on Kiritimati and South Tarawa and plans to develop another on Betio are positive moves to facilitate manufacturing development. The Government's commitment to privatization, through corporatization, and the extent to which private ownership and control can bring about improved efficiency are important, but once again overseas partners are needed to supply the necessary capital and know-how.

Kiribati has established a sound macro-economic framework vital for economic growth. According to the World Bank (1991), Kiribati has the potential to grow by an average of 3.3 per cent over the next two years and then 4.5 per cent to the end of the decade. Such a scenario is based on expectations of a rapid expansion of fisheries production, further infrastructure investment and significant expansion in tourism. While efforts to develop the considerable potential of fisheries resources will be crucial for future growth, a more intensive effort to improve labour skills, foster the development of the private sector and strengthen basic infrastructure are also imperative.

Conclusion

It is apparent that Pacific island countries face many difficult problems in their efforts to achieve high rates of economic growth. Papua New Guinea, which is currently experiencing a mining boom, is an exception. Even so, this country faces challenging problems in efforts to achieve a broad based pattern of development that will help to alleviate a situation of high unemployment. A promising feature of the recent experience is a much improved capacity by almost all Pacific island countries to carry out macroeconomic policies designed to foster financial stability. The key challenge is to persevere with fundamental reforms and adjustment measures that are vital for the building of efficient and growth oriented economic structures.

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