Current economic trends in the South Pacific

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The reform of the public sector is a prominent issue in all of the Pacific island economies surveyed here. Efforts are being made generally to improve management accountability and service delivery and to streamline operations in the civil service. It is in the area of public (business) enterprise reform where significant gains could be achieved more quickly. All of the Pacific island economies have adopted policies to improve the performance of their public enterprises through commercialization, corporatization or privatization strategies. The main constraint to further progress is not a technical one but rather a political one. There is a need to generate a greater understanding of the issues and for wider acceptance of the need for serious reform.

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Several of the Pacific island economies surveyed in this issue have had difficulty in establishing policy credibility in 1992. In Papua New Guinea the Wingti government's first budget has introduced some wide-ranging tax and expenditure changes. It is not clear that the budget can be financed without substantial recourse to mining revenues, much of which would be needed to sustain longer-term development. The mining sector has also been alarmed by proposals to renegotiate mining agreements. And despite rhetoric to the contrary Papua New Guinea's trade and industry strategy contains many elements that will encourage costly and inward-looking development.

A new democratically elected government in Fiji is having difficulty managing a wide coalition of political interests. The budget is under strain from many competing demands and the reform process has slowed.

In Solomon Islands the budget deficit has improved in 1992 but continued progress will need to be made to redress the undisciplined approach to fiscal policy that was adopted in recent years. Structural reforms are generally on hold until after the next election in mid-1993.

In Vanuatu business confidence and the effectiveness of the public sector have deteriorated as a result of a serious lack of clarity and coherency in government policy. Tensions in the coalition government have also increased.

The Western Samoan economy has been recovering steadily from the destructive cyclones of 1990 and 1991. Sound economic

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policies have assisted economic recovery. Increasing emphasis on economic efficiency and public sector reform is well placed.

Economic activity has weakened in Tonga but the macroeconomic environment has improved. The fiscal deficit has stabilized, inflation is declining and there is ample liquidity in the banking system. A lower real exchange rate and an improvement in investor confidence would help promote recovery.

The reform of the public sector is a prominent issue in all of the Pacific island economies surveyed here. Efforts are being made to improve management accountability and service delivery and to streamline operations in the civil service but with limited success. It is in the area of public (business) enterprise reform where significant gains could be achieved more quickly. All of the Pacific island economies have adopted policies to improve the performance of their public enterprises through commercialization, corporatization or privatization strategies.

Governments are finding that public enterprise reforms raise a variety of difficult issues. These include the roles of property rights, management accountability and competition in achieving better performance. They are also finding that the reform process is above all a political process.

So far the reform of public enterprises in the Pacific island economies has mainly involved commercialization of business functions within government departments and the corporatization of public enterprises as companies or statutory authorities under government ownership.

Privatization is difficult to achieve in the Pacific island economies for a number of reasons

- lack of understanding of the benefits of private incentives and competition
- inadequate business and entrepreneurial skills
- small domestic capital markets and resistance to foreign ownership.

Where commercialization and corporatization have been implemented there has not been enough recognition of the benefits of facilitating private sector competition and implementing rigorous performance monitoring. Public enterprises often operate with special advantages and disadvantages that confuse accountability and deter private-sector competition. Monopoly power often exists because of legislation which restricts entry. The performance monitoring which has been undertaken has emphasized accounting measures with little recognition of the importance of benchmarking productivity as a means of controlling monopoly power.

The main constraint to further progress is not a technical one but rather a political one. There is a need to generate a greater understanding of the issues and a wider acceptance of the need for serious reform. In this respect it is important to implement manageable reforms for some small enterprises first, to achieve early success. This means that substantial reform of those enterprises that are the largest drain on public resources would be delayed. But it should help ensure wider success in the longer term through developing more robust political support for further change.

Once wider support is achieved, the problems of inadequate business skills and insufficient domestic capital might be resolved through franchising arrangements where the government retains ownership of the assets but the private sector runs the business with an appropriate management contract.

Papua New Guinea

The 1993 budget represents a significant departure from past economic policies in Papua New Guinea. It features expansionary fiscal policy and reliance on 'supply side' measures to stimulate non-mining private sector investment. Labour market reform, substantial increases in social services and increased support for the agricultural sector are also prominent features of the Wingti Government's new policies.

Change in policy direction

Papua New Guinea's change in policy direction has arisen because of concerns about the inability of the non-mining private sector to generate jobs for a rapidly growing labour force. Gross fixed capital formation outside of mining and petroleum declined in the three years prior to 1992. GDP grew by 5.7 per cent in 1991, 8.5 per cent in 1992 and growth in excess of 10 per cent is projected for 1993. However, most of the growth has occurred in mining, as a result of the Kutubu petroleum project, completion of the third stage of the Porgera mine and investments at the Ok Tedi and Misima mines. Since 1991 agricultural production has stagnated, manufacturing has declined and construction activity has diminished considerably, due to the completion of most mining projects and deferment of infrastructure projects. As a result, employment in the formal sector declined by 3.7 per cent in 1991 giving rise to high levels of unemployment.

The first six months of 1992 featured a slight recovery in the non-mining sector, primarily due to stronger growth in agriculture and services. The inflation rate has declined from 7.0 per cent in 1991 to 5.0 per cent in 1992. The mining boom is now beginning to provide a substantial financial cushion, with a sizeable balance of payments surplus expected for 1993 and the next few years.

Fiscal policy

The expansionary fiscal policy, outlined in the 1993 budget, relies heavily on increased revenues from the minerals sector, including forward payments of income taxes by mining and petroleum companies. Mining revenues are expected to finance around 30 per cent of government expenditure which is expected to grow by 7.1 per cent in real terms in 1993. Some of the highlights of new expenditure initiatives are full subsidization of school fees to grade 8, a K150 subsidy per secondary student (to be gradually increased until education to grade 12 is free), increased health services, a village services scheme, and infrastructure development.

Tax reform

Tax reform is central to the government's economic strategy. The budget's boldest move is to use over 50 per cent of mineral revenue to finance tax cuts for households and businesses and provide agricultural price support. Significant income tax cuts include a reduction of the top marginal personal rate from 45 to 28 per cent, reduction of the corporate rate from 30 per cent to 25 per cent and reductions of indirect business taxes. The combined effect will make the Papua New Guinea tax regime one of the lowest in the Asia–Pacific region. It is hoped that higher disposable incomes will increase saving and investment and significantly boost production.

A budget deficit of K161.7 million or 3.3 per cent of GDP is projected for 1993, slightly lower than the estimated 1992 deficit. The 1993 budget deficit will be largely financed by commercial borrowing. Sustainability of the deficit will depend on the realization of anticipated mineral revenues, the expected overall growth of the economy, nominal wage growth of 4 per cent, savings from the abolition of provincial governments, and the government's ability to contain other government expenditure. The budget indicated that the abolition of provincial governments would provide approximately K50 million but the abolition may be difficult to achieve. The abolition of the provincial governments involves a constitutional change that requires the support of two-thirds of the Members of Parliament and there are indications that this support will not be forthcoming. A broadly-based consumption tax is being considered for introduction in 1994 to help develop a more stable revenue base.

Investment incentives

The success of the government's economic strategy will greatly depend on the responsiveness of the private sector to increased incentives. Whether higher disposable incomes will lead to higher savings and investment in Papua New Guinea and increased work effort remains to be seen. In order to encourage investment in Papua New Guinea it will be critical to make significant progress in

- improving the law and order situation
- achieving wage flexibility
- developing workforce skills
- facilitating access to land
- and increasing the availability and efficiency of infrastructure.

Stability in the mining sector will be critical to future economic growth. Papua New Guinea has had a good record in promoting investment in the mining sector. However, recent statements by the government that resource agreements will be reviewed have undermined confidence. Bans on direct flights to mining sights from abroad have also been criticized by the mining sector as imposing unnecessary costs.

Exchange rate

The mining boom and the expansionary fiscal policies may generate significant pressures which will appreciate the real exchange rate. This could arise through both appreciation of the nominal exchange rate and higher inflation. The government is hoping that interest rates will fall by 2 percentage points in 1993 and this should help stabilize the nominal exchange rate. However, if strong demand emerges and persists there is a risk of a loss in competitiveness through a rise in inflation. Thus it will be important for the authorities to monitor the monetary aggregates carefully and to achieve competitive wage outcomes.

Wages policy

The government's emphasis on wages policy as one of the main instruments to pursue competitiveness is therefore well placed. The high level of wages in Papua New Guinea relative to productivity has been a major contributor to the country's lack of international competitiveness. The government supported the Minimum Wages Board determination to reduce the urban minimum wage (K62.00 per week) to the level of the rural minimum wage (K22.96 per week), establish a youth wage at 75 per cent of the minimum wage and abolish wage indexation. The Minimum Wages Board determination, although only covering new entrants in the labour force, is a positive step towards reducing labour costs and expanding employment opportunities. It is expected that the direct impact of the determination will be largely borne by urban unskilled and semi-skilled workers, while the wages of skilled and rural workers are unlikely to be significantly affected. Another part of the determination allowed for future wage levels to be determined by employer–employee negotiation, based on productivity and capacity to pay. No details have been provided on the extent to which future wage negotiations will be undertaken at the enterprise or industry-wide level or of the role of the Minimum Wages Board. In order to achieve a market-based outcome, it will be important to develop arrangements that recognize the individual circumstances of different firms and the need for speedy adjustments.

Industrial development

Industrial development is central to Papua New Guinea's development policies. The industrial sector accounts for approximately 15 per cent of GDP and it provides around 25,000 jobs, mainly in Lae and Port Moresby. Products with promising development possibilities include food and agricultural processing, textiles and footwear, petroleum processing, furniture and other timber processing, and metal smelting. The Medium Term Trade and Industry Plan, recently endorsed by the government, provides a detailed description of industrial policies. The establishment of the Small Business Development Corporation and the development of a Small Scale Business Credit Facility for 100 per cent nationally-owned businesses aim to encourage the participation of national entrepreneurs in ownership and management of businesses. The development of the Lae Manufacturing Zone which is expected to be completed by January 1993 and planning of more zones in Port Moresby and the Highlands are further efforts to facilitate industrial development.

Protection

The government's recent emphasis on import substitution and 'infant industry' protection runs the risk of locking the economy into inward-looking, costly industrial development. This is contrary to the government's emphasis on the need for sound macroeconomic policies and improved international competitiveness.

Overall the 1993 budget provides mixed signals. While cuts in duty on a range of business inputs were introduced in the budget, the basic rate of duty has increased from 8 to 10 per cent and several items have had their duty increased from 8 to 30 per cent and others to 50 per cent. A number of manufactured inputs that attracted the now abolished excise tax have had their rate of duty increased from zero to 10 per cent. These changes, as well as the increase of agricultural input duties to 10 per cent, have attracted wide criticism. In addition industry protection is increasingly being considered on a case-by-case basis, using measures that are highly distortionary. Import bans for a number of products are being used. Cabinet approval was recently provided for the construction of a new mackerel cannery in Lae, with a five year import ban and 100 per cent tariff for the subsequent five years.

The industry development policies that are being pursued will impose significant costs on the most efficient import-competing and export-oriented sectors of the economy. For example, simulations with the National Centre for Development Studies general equilibrium model of the Papua New Guinea economy show that a ban on food imports would increase production in the food processing sector by almost 3 per cent but reduce production in other sectors generally and the economy as a whole by 0.6 per cent. Overall employment would fall by 1 per cent. Lowering industry protection would motivate businesses to look critically at their operations, become more efficient, and identify new markets.

While the current approach to industry development is seen to be flexible it also creates incentives for entrepreneurs to spend considerable efforts in lobbying for special assistance. As more special assistance is provided greater costs are imposed on the rest of the economy and the incentives to lobby are further increased.

Price support

A major initiative in the budget is the substantial increase in guaranteed prices for the major tree crops (coffee, copra, cocoa and palm oil) for the next five years: prices considerably higher than world prices. Price support is expected to cost approximately K500 million in the next five years. The government's objective is to support rural incomes, discourage rural–urban drift and encourage investment and production in rural areas. It is recognized that this assistance scheme should be closely linked to an enhanced program of research, extension and marketing development. Efforts are still under way to establish the Cocoa and Coconut Industry Corporation and the Copra Marketing Authority.

While price guarantee is widely supported within Papua New Guinea, its magnitude has been surrounded by controversy. The Coffee Industry Corporation recently requested less emphasis on price support and more on structural measures to improve quality and efficiency. Certain parts of the Papua New Guinea bureaucracy have also stressed research, extension and, particularly, infrastructural development. Investment in infrastructure would help increase productivity not only in the tree crops sector but for other crops as well. Another concern is that if price support is not closely linked to production costs, there will be little incentive to improve efficiency and encourage more viable diversification.

Public sector reform

Efforts to improve the efficiency of the economy through public sector reform are continuing. Reduction in the size of the public sector, pursued under the previous government's structural adjustment program, has however been moderate (a reduction of around 650 positions out of a planned 2,500). A national training program and improved expenditure controls for government departments are features of the policy.

Reform of public enterprises has been seen as a means of increasing efficiency, reducing the financial burden on the budget and assisting private sector development. The public sector in Papua New Guinea comprises a large number of public enterprises. The four main public enterprises, known as statutory commercial authorities, are the Electricity Commission, the Post and Telecommunications Corporation, Air Niugini and the Harbours Board. A substantial number of smaller public enterprises are scattered across a wide range of different activities particularly in the rural and primary sectors. Profitability of these enterprises has varied widely with a significant number of them incurring losses.

Corporatization of statutory commercial authorities since 1983 has significantly improved their financial performance. Substantial losses were turned into profits and modest contributions have been made to government revenue. The overall return on the government's investment of K232 million in 1989 was 5.6 per cent but this was lower than the target range of 15–20 per cent. Under the corporatization program, statutory commercial authorities are required to operate along commercial profit-making lines. Their operational guidelines include clear commercial objectives, separate identification and funding of non-commercial community service obligations, obligations to pay normal business taxes and dividends and accountability to central agencies. While the financial performance of statutory commercial authorities has improved considerably, the high utility costs in Papua New Guinea suggest that increased profitability in some statutory commercial authorities could have been due to exploitation of monopoly power rather than efficiency improvements.

Privatization has been given a new impetus by the Wingti Government with the establishment of the Papua New Guinea Holdings Corporation. The Corporation is to be managed by a commercially experienced board of directors. It is to develop a privatization program for approval by Cabinet. It remains to be seen whether large-scale privatization will be carried out. The lack of a stockmarket and a strong entrepreneurial class and a strong preference for local ownership are important constraints. Attempts to privatize the Niugini Insurance Corporation in the past few years have yielded poor results, illustrating the importance of these constraints. Furthermore the sale of statutory commercial authorities to the National Provident Fund is not likely to generate any significant efficiency gains as it does not make use of the energy and incentives of the private sector. Another issue which needs to be addressed is the regulation of private monopolies. Air Niugini could be a serious contender for privatization as competitive arrangements could be developed, it is not too large and it is currently under-capitalized.

In the absence of a significant domestic entrepreneurial capital base, more emphasis may have to be given to divestiture of smaller enterprises. Franchising arrangements, where the government owns the assets but the private sector manages the operations, are likely to be more feasible for large enterprises such as the Electricity Commission and the Post and Telecommunications Corporation. Contracting out is also a form of privatization that could be used for many smaller commercial functions in order to achieve a more efficient service and support private sector growth.

Fiji

In mid-1992 a new democratically elected government replaced the interim administration that had been in power for the five years following the political crisis of 1987. The interim administration had achieved an impressive economic performance with a policy of economic liberalization that included average reductions in border protection of over 50 per cent by 1992. The new government has adopted policies that generally remain conducive to achieving good economic performance. Export orientation, further deregulation, restraint of growth in government expenditure and broadening of the tax base continue to be important policy features of the 1993 budget. However, the challenge of managing a wide coalition of political interests is proving difficult for Prime Minister Rabuka, with many groups seeking various claims on government resources.

Investor confidence

An important feature of the economic environment is that investors are still not very confident about the commitment and the objectives of the government. The government could help promote investor confidence by

- demonstrating firm commitment to a consistent and wider liberalization process
- alleviating adjustment pressures only through transparent, generally available measures
- spending considerable time and effort in selling the benefits of liberalization reforms.

After a strong economic performance in 1989, growth slowed in 1990 and a mild recession developed in 1991. The weak performance in 1991 was associated with a decline in tourist arrivals and labour unrest in the sugar and gold mining industries. Economic growth resumed again in 1992 at around 3 per cent, and similar growth is expected for 1993. Strong growth in tourism, buoyancy in construction activity and increased sugar exports have been notable features.

The measures that have been taken to achieve a more competitive, internationally-oriented and business-friendly environment represent a very good start for Fiji in securing better economic performance. However, so far the dominant highlights have been a substantial real devaluation and reductions in import-competing protection. It will be important to sustain the competitiveness achieved by the real devaluation through market-based wage outcomes and extend the policy of economic liberalization to other sectors of the economy. There are still many frictions and imperfections in labour, capital and land markets in Fiji.

Wages policy

The 1993 budget documents confirmed that wages policy is one of the key measures to achieve export success. In August 1991 the government repealed its wage guidelines that were in operation since mid-1988 and introduced legislative changes to facilitate market-determined outcomes. These arrangements still apply and are designed to improve the accountability of unions to their members and to the community generally. They include: the removal of union immunity from prosecution for damages where the union has not held a secret ballot; banning unions from participating in disputes outside their own trade; recognition of company unions; and abolition of wage councils that were responsible for minimum wages in some industries. Employers and employees are now expected to negotiate enterprise agreements that reflect market forces. Employers will normally negotiate with a branch of an industry-wide union and there will be provision for official arbitration where agreement cannot be reached. The arrangements are currently under review to identify and remedy various anomalies, particularly measures that unduly restrict freedom of association.

In the public sector, wages for unskilled labourers are noticeably higher than those prevailing in the private sector. In 1992 the public sector unions have been seeking an average wage increase of 12.5 per cent, with a higher increase at lower levels. This follows increases of 7 per cent in both 1990 and 1991. The matter is currently under arbitration, with the government preferring an increase of 4 per cent. In order to sustain the competitiveness of the economy it will be important for the government to make continued efforts to ensure that public sector wages are not out of line with those in the private sector, with appropriate adjustments made for job security. Another issue of concern to the unions is that compulsory deduction of union fees has been abolished and agreement has not been reached on administrative arrangements in the public sector for voluntary deductions.

Investment

The level and productivity of investment have been disappointing for many years in Fiji. Gross fixed capital formation declined from 25 per cent of GDP in 1981 to around 12 per cent in 1991. Declining public investment prior to 1987 is the main explanation. However, private fixed investment also declined, from relatively low rates of 10–12 per cent of GDP before 1987, to less that 6 per cent more recently. The main growth area has been construction (hotels, factories, shops and housing). The level of private fixed investment will be a key indicator of confidence in the government's policy reforms. The 1993 budget announced the re-introduction of an accelerated depreciation allowance at an annual rate of 20 per cent for three years for new commercial buildings with a ceiling cost of F$20 million. This fiscal incentive should help encourage investment, but of more importance for investor confidence are political stability and general economic conditions.

The foreign direct investment regime still does not provide a speedy, transparent service. Investors need to deal directly with several government authorities to resolve matters relating to work permits, customs clearance and exchange controls. There are proposals to establish a one-stop shop to facilitate and attract foreign investment. This will only be successful if other authorities agree to appropriate transfer of their powers.

Exchange controls

Exchange controls still apply to all flows of money associated with commercial transactions. While the exchange rate controls were considered appropriate, following the instability associated with the 1987 political crisis, they increase the costs and perceived risks of doing business in Fiji. The 1993 budget relaxes a number of exchange rate controls: exporters will be able to retain a portion of export proceeds in a foreign currency bank account and exchange rate controls relating to payments for services, emigration, and travel by residents are to be relaxed. Further relaxation of the controls may help reduce the current excess liquidity in the banking system and foster investor confidence.

The system of exchange controls coupled with domestic borrowing restrictions for non-resident firms and the confidence problem has led to excess liquidity in the banking system. The commercial banks have a large surplus of liquid assets over requirements. There has been a lack of demand for credit on the terms provided by the banks and interest rates will probably fall considerably in 1993. The recent budget also relaxed borrowing controls for non-resident firms which should also contribute to a sizeable increase in the demand for funds. Whether these factors are enough to offset general confidence effects is uncertain.

Sugar

The future of the sugar industry is the overriding issue in the agricultural sector. The cultivation and processing of sugar-cane contributes around 10 per cent to GDP. Approximately half of all sugar exports are sold under preferential agreements (mostly with the EC) at prices three times that of the world price. Under the Lomé convention Fiji is guaranteed a quota at a price based on the price range obtained in the EC. The EC has already announced that a decrease in prices of 15–20 per cent will apply over the remainder of the decade, and there is an increasing possibility that the EC price could fall further, placing pressure on Fiji. Uncertainty about land tenure continues to affect the industry as well. Most cane farmers are of Indian Fijian descent and many leases are due to expire from 1996 to 2000. With frequent claims that the rents currently prevailing for sugar-cane land are too low and concerns about political representation, the incentive to replant more regularly and invest in more productive methods is weak. The outcome of the current administrative review of the Agricultural Landlord and Tenants Act is difficult to predict but it is clear that native lands will not be made alienable. If arrangements could be developed which would restore confidence in the sugar industry, it is likely that general confidence in the economy would be restored as well.

Tax reform

Major changes have been made in the tax system in recent years to remove numerous *ad hoc* concessions and reduce distortions. A 10 per cent value added tax (VAT) was introduced on 1 July 1992. The tax is very broadly-based, with the main exemptions being banking products, education, domestic rents and exports. The general acceptance of the tax by the community is a good example of the importance that marketing can play in the successful implementation of policy reforms. The VAT is working well for large firms but nearly 1,700 people face prosecution for non-payment.

Since 1989, protective licences have been replaced with tariffs, and public enterprises have been subject to full company tax. Fiscal duties on imports have been progressively reduced from over 50 per cent (generally) to 30 per cent in 1992, with a further reduction of 5 percentage points for most products announced in the 1992 budget. Five more products were removed from import licence controls in 1992 and it is proposed to remove the controls from the remaining three agricultural products and tinned fish in 1994. A capital gains tax will apply from 1994 and a new taxation regime for mining is expected to be tabled by mid-1993. For non-residents, the income tax-free threshold will be removed and new tax rates applied retrospectively from 1 July 1992, with the top marginal rate being 35 per cent. A full dividend imputation system is proposed for residents in the future.

The budgeted net deficit for 1993 is 2.5 per cent of GDP, down from an estimated 3.5 per cent for 1992. The proposed deficit limit for future years is 0.5 per cent. The broadening of the tax base will help to achieve revenue buoyancy. The greater risks to achieving fiscal prudence are on the expenditure side. The high priority for infrastructure expenditure (mainly roads and bridges) will facilitate private sector development but expenditure has grown rapidly in other categories that may not be productive for the economy as a whole. The allocation to the Ministry of Youth, Employment Opportunities and Sports increased by several hundred per cent and there were substantial demands for funds to promote Fijian business involvement.

Market regulation

Prior to 1989, markets in Fiji were heavily regulated. Import licences provided high levels of protection and raised costs, reducing the competitiveness of exporters. Price control was extensive. Since then, policy makers have demonstrated commitment in achieving a more flexible and productive economy, but the achievements so far cannot be taken for granted. The government will need to be vigilant in pursuing reforms to maintain and secure the confidence of investors. As further activities are exposed to market forces, those adversely affected will provide strong resistance and seek special assistance. However, the more that the government concedes to special pleas, the more difficult it will be to sustain the reform process. If assistance is considered necessary it will be important to make it generally available and transparent: for example, in the form of retraining schemes or explicit subsidies that are subject to regular budgetary review processes.

The government can also make liberalization more effective by extending it to other sectors. This would help generate a sense of fairness and help reveal the true comparative advantage of the economy more quickly, so that investments are undertaken benefiting the economy as a whole.

Reform of the public sector

Reform of the public sector, including public enterprises, is one area where more rapid progress is feasible and important. The 1993 budget confirmed that better performance will be pursued in the civil service through measures that provide permanent secretaries with greater powers within well-defined areas of responsibility. Accountability will be pursued through performance contracts. The details of the proposals have not been worked out, however, and implementation is not expected until some time in 1994.

Public enterprise reform is intended to be a leading priority in 1993. The ultimate aim is reported to be privatization but no specific program has been developed yet. Initially the focus will be on continuing the corporatization and commercialization process that began under the interim government and culminated in the corporatization of the Post and Telecommunications Department, the Fiji Pine Commission, the National Marketing Authority and a fishing company. A new Public Enterprises Act will be implemented. It is intended to apply the full set of 'corporatization principles' namely: pure commercial objectives set by the government; managerial autonomy balanced by appropriate accountability; and removal of special advantages and disadvantages (competitive neutrality). It has been announced that barriers to entry will be removed wherever possible and public enterprises will be subject to fair trade legislation to encourage competitive outcomes.

Public enterprise reform has the potential to provide substantial benefits for the economy. There are more than 50 public enterprises (including several financial institutions) representing around 13 per cent of GDP in Fiji. In 1990, 12 out of 27 major public enterprises incurred net operating losses. Although fewer public enterprises (nine) incurred losses in 1991, the net operating surplus of the overall public enterprise sector declined by 1.5 per cent in nominal terms.

As well as the major utilities, there are numerous government business functions that could be commercialized or corporatized. These include maintenance of roads, buildings and equipment, printing, provision of computer hardware and software, laundry and catering services, dredging, plantation activities, surveying, rental and housing activities, shipyards and the marine fleet. All will be considered in the new program.

The reform of public enterprises is a complex process that involves considerable economic and political management. On the economic side, the proposed reforms will need to incorporate persistent efforts to ensure that competitive disciplines develop. There is a danger that profit objectives could be achieved mainly through the exploitation of monopoly power. Care will need to be taken to set appropriate productivity targets in order to ensure that efficiency effects are realized. This should be the responsibility of the Public Enterprise Unit that has been established in the Department of Finance.

On the political side, the case of Fiji Post and Telecommunications Ltd is a good illustration of the difficult issues that can arise during implementation of a reform program. Fiji Post and Telecommunications Ltd employees went on strike in support of the managing director who was allegedly forced to resign by the board. The dispute was resolved when the board subsequently resigned and the managing director was reinstated. It is clear that, if the public enterprise reform program is to be successful in Fiji, the government will need to embark on a patient, dedicated process that clarifies the issues and achieves a broad-based consensus on how to make implementation effective.

Solomon islands

Government expenditure

Unsustainable growth in government expenditure in recent years has been the key economic policy issue in Solomon Islands. Government recurrent expenditure—mainly wages, but with a rapidly growing debt-service component—has grown from 25 per cent of GDP in the mid-1980s to over 30 per cent in the early 1990s. The result has been large budget and current account deficits. Net external debt has risen from about 10 per cent of GDP in the mid-1980s to almost 100 per cent in 1990, half of it on government account. Foreign exchange reserves have at times been at critically low levels—at one stage in 1991 dropping to ten days of import cover—although there has been notable improvement through 1992. Persistent inflation, in the 10–15 per cent range, has been another consequence of the expansionary fiscal policy. Aid dependence has also increased—official transfers have increased from around 8 per cent of GDP in 1984 and 1985 to 25 per cent in 1991.

The government has financed the deficits through inflationary financing. In 1987, the government was a net lender to the Central Bank (SI$15.4 million) but by the end of 1991 it had become a net borrower (SI$56.1 million). The net claims on the Central Government by the whole banking system rose from SI$8 million in 1987 to SI$118 million by end 1991. The private sector has been crowded out of the domestic credit market since 1989, with a decline in credit in absolute terms of SI$16.6 million. This decline is, however, partly attributable to private firms strengthening their balance sheets by retaining earnings and repaying debts.

From 1988 to 1990 the economy grew at an annual average rate of 6 per cent, with strong contributions from agriculture, forestry, transport and utilities. Growth weakened to less than 4 per cent in 1991 and will probably be less than 3 per cent in 1992. However, even with the improved performance in recent years, real GDP per capita was virtually the same in 1990 as it was a decade earlier.

Generally, the recent levels and pattern of government expenditure do not augur well for improving the productive capacity of the economy. The build-up in public debt has been used to finance higher wages for public servants, subsidies to public enterprises and transfers associated with the decentralization and provincial development policy. Operations and maintenance funding has been seriously neglected. Should external conditions weaken and financial terms harden, Solomon Islands could be under considerable pressure. It is likely that foreign taxpayers would be called on to assist through providing more aid.

The budget situation has improved in 1992 and there are indications that the forecast reduction in the domestically-financed fiscal deficit from SI$71 million in 1991 to SI$25.5 million in 1992 may be largely met. Nevertheless, little progress has been made on longer-term issues such as public sector reform. Structural adjustment has been extensively discussed with the IMF and the World Bank and the basis of an acceptable program has been worked out, but no final agreement has been reached. There is a marked reluctance to accept the advice of outsiders. In the 1993 budget, which includes major taxation changes and a domestic deficit similar to that in the 1992 budget, the government has signalled that it intends to reduce the size of the public service, but it seems likely that most of the changes will be on hold until after the next election, scheduled for June 1993.

If proposals to reduce the civil service by 1000 positions over the next three years and to introduce a broadly-based goods and services tax of 8–10 per cent are implemented, there are good prospects that public finances will improve further. There are risks, however, that election promises could offset these influences, leading to continued fiscal pressures.

External conditions

Despite the overall growth in the economy in recent years some sectors have continued to face adverse conditions. STABEX funds have been used on a significant scale to offset the loss of earnings from copra and also palm oil and cocoa products. Performance in fishing and manufacturing has also been weak.

In 1992, the economy benefited from an upsurge in timber log exports, stronger prices for vegetable oil, palm oil and coconut products, and overdue STABEX transfers.

Private sector investment

Private sector investment in the natural resource-based activities of fisheries, forestry and agriculture has proved resilient but has been financed almost entirely by foreign capital. The boost to the economy from such investment is unlikely to be sustained, unless continued progress is made in achieving lower fiscal deficits.

Timber

The timber industry has been one of the mainstays of the economy in recent years, being the largest source of foreign exchange in 1990. It is also at the centre of one of the main development issues facing the country. Logging operations have been removing around 8,000 to 10,000 hectares of natural forest per year. There is virtually no replanting on existing logging sites and the government's replanting program is very modest. It is estimated that at the present rate of exploitation, all of the commercially viable forests will have been removed within about twenty years. Environmental damage has also reduced the capacity to use logged and adjacent areas for agriculture. In order to address these difficulties, improvements will need to be made in regulatory and monitoring arrangements, mechanisms for effective local involvement and educational programs.

Growth potential

The growth potential for Solomon Islands is good. A favourable natural resource base includes good agriculture, forestry and fisheries potential, minerals and hydropower resources. The export base is more diverse than in other small Pacific island economies, with notably less dependence on copra and more on forestry. Tourism has considerable undeveloped potential. The economy remains largely free of price distortions, the commercial banks are profitable and, provided government borrowing is controlled, have funds to lend. Exchange rate policy has helped preserve international competitiveness. Important longer-term constraints and problems continue to be low educational attainment and poor workforce skills, malaria, cumbersome and restrictive land tenure arrangements and weak administrative and economic management capacity.

Public sector reform

In recent years the government has sold the sizeable assets of the Mendana Hotel and the National Fisheries Development Limited. A number of other shareholdings are currently on the market. However, the government is retaining its involvement in a number of enterprises. It is proposing to retain ownership of 60 per cent of Solomon Telekom and to sell its 49 per cent share in the National Bank of Solomon Islands to the National Provident Fund. It is selling its 49 per cent share in Kolombangara Forests Products Limited to the Western Province Government. It is also proposing to retain its 51 per cent shareholding in the fishing company, Solomon Taiyo Limited, and is pressuring the foreign partner into making local appointments.

Continued government involvement, even if on a partial and indirect basis, runs the risk of political interference. Government involvement also tends to create adverse incentive problems for private and public managers because the fear of bankruptcy and takeover is removed. It also tends to blur accountability for performance where noncommercial objectives are poorly specified and conflict with commercial objectives. The benefits of privatization will not be fully realized unless these matters are effectively addressed.

The decision to put the sale of the government's 70 per cent shareholding of Solomon Airlines to public tender was long overdue. Solomon Airlines improved its performance in 1991 with a small profit for its international operations, but the domestic operation continued to make a loss due to government direction to keep fares below the break-even point. An injection of government equity of SI$5 million was made in the second half of 1992 to keep the airline operational. The cumulative losses for 1991 and the first eight months of 1992 were close to SI$15 million. It is hoped that a new owner will be in place by the end of 1992.

Although it is important to encourage local involvement in economic development, care will have to be taken to avoid implementing change too quickly. It is apparent that the provincial governments have not had adequate capacity to handle the range of responsibilities assigned to them.

Vanuatu

As in Papua New Guinea, Fiji and Solomon Islands, establishing policy credibility has been a major problem for the government in Vanuatu in 1992. Political conflict and policy uncertainty have continued to be the dominant influences. The coalition government of the Union of Moderate Parties, and the National United Party, seem to have deep philosophical differences—largely in relation to their attitudes to the support they receive from France. In the second half of 1992 the tensions became more obvious.

Investor confidence

Investors are understandably uneasy in the current economic environment. The government has not clearly articulated the priorities for economic and social development in a consistent manner. Many decisions have been left to the discretion of individual ministers and taken on an *ad hoc* basis without reasonable consultation or careful assessment. The controversial business licensing legislation highlighted the discretionary and damaging nature of approaches that are being adopted. The proposed legislation contained sweeping powers to revoke business licences without appeal to the courts. After a long period of deliberation, the Bill was ruled unconstitutional by the Chief Justice and an amended Bill is now before the Parliament. Another cause for concern is the immigration law, under which foreign nationals can be expelled without reason. Previous governments regularly used the law to issue 'green letters' instructing foreigners to leave the country.

Business can never flourish in an environment where there is little respect for protecting capital and rewarding work effort and skills. Until clear signals are provided that give security to working and investing in Vanuatu and policy clarity is established, it is unlikely that good overall economic performance will be achieved on a sustained basis. The lack of policy clarity is also affecting the operations of the public sector. It is impossible to usefully assess, monitor and implement broad policies and specific projects unless there is a clear and non-conflicting statement of government priorities.

After average annual growth of 5 per cent in the period 1989–90, the economy slowed somewhat in 1991, and recorded near-zero growth in 1992. Tourist arrivals increased towards the end of the year and modest growth is expected in 1993. Inflation rose to a moderate level of 6.4 per cent in 1991, but declined considerably through 1992.

Budgetary pressures

The two major areas of concern in terms of budgetary pressures relate to the Vanuatu Commodities Marketing Board and Air Vanuatu. The government has injected V1.3 billion into the Vanuatu Commodities Marketing Board in the past five years using substantial STABEX resources. The Vanuatu Commodities Marketing Board has no clear policy guidelines and efficiency targets and does not produce timely accounts. There are plans for a review and this is urgently needed. It will be important for the study to cover issues such as funding and subsidy policies, handling and shipping and marketing.

The government has injected V2 billion into Air Vanuatu since 1989 and in the same period it has accumulated losses of around V1 billion. Careful consideration needs to be given as to how effective this strategy is for generating net benefits from tourism. It is notable that the real value added of retail trade and hotels was the same in 1990 as in 1983.

The government experienced difficulties in balancing its recurrent budget in 1992. Expenses have escalated more than expected and revenues have fallen. Since Vanuatu has very low levels of debt, the deficit could be covered by borrowing. However in the longer term, Vanuatu will need to develop a more revenue-elastic tax system.

Fear of alienating the offshore finance centre has been used as a reason for avoiding the introduction of an income tax system. Revenue growth has been stagnant, with a distortionary tax system based on import duties. Low income earners have been penalized by the high protection of the food and beverages sector. Milk, frozen chicken, beer and coffee are among the most expensive retail items in the Pacific, and associated import duties exceed 40 per cent.

The dispersion in effective rates of assistance to domestic industries is likely to be high because the revenue loss from exemptions has amounted to about one-third of duties collected from 1989 to 1991. The average nominal duty is 40 per cent, but exemptions mean that the effective rate of collection is around 25 per cent of total import value.

The government budget is expected to come under increasing pressure as a rapidly growing and poorly educated population will be making increasing demands for social expenditures. A failure to deal adequately with these demands would affect general standards of living and contribute to serious social problems.

The government will need to reform the tax system soon in order to improve competitiveness, provide a more elastic revenue base and establish credibility. Investors will be aware of budgetary pressures and longer term expenditure needs, and are likely to be nervous when they do not have clear signals about how the tax and general economic environment will develop.

Experience from other successful finance centres suggests that while low taxes are important, it is not essential to have a completely income tax-free status. The Caribbean experience suggests that a critical ingredient is suitable legislation. The new modern legislation that is being developed in Vanuatu should be of great help in sustaining the attractiveness of the finance centre. However it will be important for the government to develop good working relationships and an effective dialogue with the private sector in order to establish confidence in the stability of the environment.

Vanuatu has a good record in achieving financial stability. It has avoided budgetary and external account crises, high inflation and exchange rate instability. Much of this stability has been underwritten by generous aid. Official development assistance in 1990 was US$335 per capita—higher than in all other Pacific island economies and several times higher than the level of all least-developed economies. A major concern is that the aid program has not been effective in achieving a competitive price and cost environment.

High cost structure

The high cost structure is particularly notable for energy and telecommunications, where costs are amongst the highest in the Pacific. Land tenure restrictions mean that only half-full small coastal oil tankers can unload fuel. The French company UNELCO–Vanuatu has monopoly supply rights in the major towns of Port Vila and Luganville. Although the reliability of supply is highly regarded, there are concerns about its high cost, particularly since there are no import duties on fuel used for electricity in Port Vila.

Public sector reform

In comparison with other Pacific island economies, government involvement in business activities is not high in Vanuatu, but the public sector is involved in a number of activities of a commercial nature where improvements can be made. Some encouraging reforms have begun, but greater attention needs to be given to developing an appropriately rigorous accountability framework and to providing more emphasis on competition. Public works, water supply and waste management, ports, postal services, telecommunications, electricity, Air Vanuatu, the Development Bank and the National Bank of Vanuatu could all benefit from improved performance monitoring and greater competition.

Infrastructure

Another major issue with infrastructure is the serious neglect of operations and maintenance programs. The annual maintenance expenditure on transport infrastructure is estimated to be only 18 per cent of assessed requirements in 1992. The shortfall amounts to almost V1 billion. A visible example of the neglect is that funding can not be currently provided to pay insurance premiums for the donor-funded airport terminal completed in 1991.

Growth prospects

Vanuatu has reasonable growth prospects in agriculture and tourism. An offshore business centre could also offer good prospects for processing basic information for the Australian market. But if the prospects are to be realized it is imperative for the government to restore investor confidence.

Western Samoa

The Western Samoa economy has been recovering steadily from the destructive cyclones of 1990 and 1991. Most of the infrastructure damage has been repaired with the bulk of the services sector restored. From a longer-term perspective, the 1992–94 Development Plan provides for consolidation of public investment in infrastructure, particularly in the transport and energy sectors, emphasis on economic efficiency and revitalization of agriculture.

Economic activity

GDP grew by 2.0 per cent in 1991 but probably declined by 5.0 per cent in 1992. This reflects the significant decline in agricultural production, particularly the tree crops sector, and the collapse of agro-processing industries. Economic activity is, however, projected to increase significantly in 1993 supported by recovery of agriculture, construction and services. Construction activity has been boosted by a temporary reduction of import duties on building materials for rehabilitation purposes, to 5 per cent, and increased public investment programs. Substantial declines in the production of traditional agro-processing products such as coconut oil and coconut cream have been offset by higher production of automotive wiring, beer, paint and corned meat.

The contribution of tourism has been modest, with tourist arrivals declining slightly to 26,369 in the first eight months to September 1992 compared with 27,118 in the same period of the previous year. Efforts are being made through overseas missions to attract investors for the establishment of tourist facilities. The establishment of an EC-sponsored pilot project at Vanau village and the preparation of a Cabinet report to recommend better utilization of communal land are expected to improve the outlook for tourism.

The substantial decline in exports of traditional agricultural products and strong rise in imports of capital and consumption goods has widened the current account deficit to T70.4 million in the first half of 1992, more than double that for the same period of 1991. However, increases in capital inflows gave rise to a balance of payments surplus of T6.4 million. Foreign reserves declined slightly over the year but at the end of June 1992 were sufficient to cover 6.2 months of imports of goods and services.

Government expenditure

Government expenditure in 1992–93 was contained at the 1991–92 level and government revenues have risen more slowly than expected. Unless special measures are introduced to enhance revenue collection by departments, particularly Customs, the projected budget surplus of T3.7 million in 1992–93 may be difficult to achieve. While no revenue measures were introduced for 1992–93, broadening of the goods and services tax base is expected to be implemented in 1993 or early 1994.

The high liquidity in the economy, accumulated through 1991, and the emergence of inflationary pressures in 1992 led to a tightening of monetary policy through stricter lending controls on commercial banks. Inflation was contained at an annual rate of 3.5 per cent in the year to June 1992.

Wages policy

Wage increases in the Western Samoa public sector have been modest in recent years. A general wage increase of 7.5 per cent was granted in April 1991. In view of the need to contain government expenditure and maintain competitiveness, further increases in public sector wages should be avoided. The new minimum wage of T1 per hour for adult workers in the private sector, which became effective in January 1991, will help to keep Western Samoa's unskilled wages internationally competitive.

Private sector activity

Agricultural and agro-processing industries are expected to remain the backbone of the Western Samoan economy. However, low-wage export processing industries are being encouraged to take advantage of the country's large reservoir of unskilled labour and broaden the productive base of the economy. Generous incentives are provided to businesses which export at least 95 per cent of their output, including an income tax holiday of up to 15 years and duty and excise free concessions on all inputs. Two international investment promotion missions were undertaken earlier this year with encouraging results. Negotiations are under way for Yazaki Samoa Ltd to expand its operations to supply automotive wiring harnesses to Ford Australia. This will increase Yazaki's workforce by 500 people to a total of 1,835 and lead to a significant increase in exports. Overseas interest has been expressed for projects in aquaculture (farming of prawns), the energy sector and exports of garments.

Public sector reforms

A number of initiatives were introduced in the 1992–93 budget to improve efficiency in the public sector. These include measures to contain the size of the public sector, expenditure controls and institutional reform. Privatization of public enterprises continues to be central to the government's policy to increase efficiency, encourage private sector development and reduce costs.

As in other Pacific economies there is substantial public sector involvement across a wide range of economic activities in Western Samoa. Many public enterprises have experienced financial difficulties. This has seriously affected the government's budgetary position, the domestic credit system and the country's external debt position. The poor financial performance has occurred despite a decline in total employment by public enterprises over the past five years, with significant reductions occurring over 1990–92 as a result of the restructuring of the Western Samoa Trust Estates Corporation (WESTEC) and Samoa Coconut Products Ltd (SCPL). Recently large losses were reported by SCPL, Polynesian Airlines and the Development Bank of Western Samoa.

Privatization of public enterprises commenced in 1986 with assistance from the Asian Development Bank. Since then, around seventeen state-owned enterprises or government departments have been privatized or liquidated. In 1988 a State-Owned Enterprises Unit was established in the Treasury Department to oversee the activities of public companies and to advise on privatization priorities.

The government policy has been to privatize those public enterprises that require the greatest level of government support and those that can achieve the highest level of economic efficiency in a competitive market environment.

Recent developments include a joint venture agreement with a private firm to utilize the assets of Samoa Forest Products Ltd, and the sale of 75 per cent of the government's shares of the Bank of Western Samoa to the ANZ bank. There has been little success in selling or leasing of WESTEC land to the private sector.

Further progress on the privatization program will require stronger political commitment and strengthening of the institutional capacity to undertake privatization. Greater attention should also be given to the implementation of corporatization, with firm adherence to principles as outlined above for other Pacific economies. This will help improve efficiency and profitability for larger enterprises that are difficult to privatize such as power, water and telecommunications.

Tonga

Slower economic activity was the main feature of the economic environment in Tonga in 1992. Agricultural output was low, reflecting the drought in the first half of the year, and lower squash exports in the second half. In marked contrast to Fiji, tourist arrivals declined substantially—by 30 per cent in the first half of the year. Manufacturing output has been stagnant. Although consumption has been sustained at higher levels by rising remittances, slightly negative overall growth probably occurred in 1992.

Squash exports

In 1987, a New Zealand company identified a seasonal opportunity for squash in the Japanese market. From trade that did not exist at all, squash exports have risen to be larger than the total of all other merchandise exports. However, the rapid growth led to quality control problems in 1991. Fearing that the whole market would be lost, the government set an export quota for 1992–93 at less than half the level of exports for the preceding year and introduced rigorous and comprehensive quality control mechanisms. The measures have stabilized the situation but the value of squash exports was one-third lower than a year earlier. Demand was stronger than expected due to reduced supply from competitors and towards the end of the season the Japanese asked for a reduction in quality control but it was too late. Consideration should be given to developing a grading system and to removal of the quotas as it makes little sense to forego or destroy squash which are in demand. The squash production is also being affected by a major virus so continued success is quite uncertain.

Fiscal deficits

In recent years large fiscal deficits developed into a serious policy concern. The deficits were due to large increases in civil servants' pay in 1989–90 and subsequent increases in development expenditures. They led to an acceleration in the growth rate of the money supply and markedly higher inflation. The government switched from being a net lender to the banking system of around T$12 million in 1988–89, to being a net borrower of around T$5.5 million for the first half of 1992. However, in the past year, the fiscal deficit appears to have stabilized. government expenditure declined in the first half of 1992 and revenues also improved as several tariff concessions were revoked. On present trends the overall deficit for 1992–93 could be reduced to half the level of the previous year. But the improvement in the fiscal deficit may not be robust. Import taxes are the major source of revenue and they have been seriously eroded in recent years with the use of discretionary exemptions. Most of the decline in expenditure has been for non-wage components, notably such items as operations and maintenance expenditure, and materials required for education and health services.

If durable progress is to be made in reducing the fiscal deficit, it will be important to continue to emphasize wage restraint and a more uniform tax system rather than higher tax rates. In this respect there would be considerable merit in being committed to a more outward and market-oriented environment. In the past, fiscal incentives have encouraged the production of inefficient import substitutes. The abolition of the foreign exchange levy in November is a move in the right direction.

Inflation and the exchange rate

Inflation rose during the first half of the year reflecting the effects of the drought. However, when food prices are excluded, the underlying inflation rate declines to around 3 per cent in the second half of 1992 compared with 6–7 per cent a year earlier. In recent years Tonga recorded higher inflation, relative to its trading partners, that has not been offset by nominal exchange rate depreciation. As a result there has been a substantial loss in competitiveness with the real exchange rate appreciating by 15–20 per cent since 1987.

Labour market

Despite weak overall growth, labour market conditions remain relatively tight in Tonga. Rising squash and vanilla exports, high emigration and a relatively high reservation wage (that is sustained by large remittances, the family support system, and the high value attached to leisure) have been contributing factors. Under these conditions, any attempt to restore competitiveness through exchange rate depreciation is likely to have immediate inflationary effects. Further reduction in the fiscal deficit and efforts to improve the efficiency of the economy are likely to be the most effective means of improving competitiveness.

Credit

The demand for credit in the private sector remains weak. By end-September 1992 it was at the same nominal level as for 1989–90 (around T$35 million). Recent lending has mainly been for housing and short-term credit for farmers. The lower fiscal deficit should provide more resources for the private sector. In addition, improvements in the current account and more favourable interest rate differentials between Tonga and major trading partners suggest that lending rates should soon fall significantly.

Public sector reform

Direct government ownership of businesses and involvement in commercial functions is relatively high in Tonga. The reform of government commercial functions has mainly involved commercialization and corporatization rather than privatization. In time, the government intends to privatize many enterprises. So far the policy has not been developed in a consistent, well understood framework. The 1993–94 budget is likely to contain a more coherent and focused strategy.

There are numerous functions in the public sector that could be undertaken by statutory corporations or publicly owned companies and, in some cases, privatized. The post office, ports administration, government stores, Tonga Chronicle, printing and visual aids, and visitors bureau would be prime candidates for corporatization or privatization. Other possibilities include shipping, hotels, stores, airlines, construction, importing and fishing enterprises.

In addition, there are a number of commercial activities in the civil service where the potential for corporatization or privatization needs to be determined. They include the machinery pool, the sawmills, boat building, and the income earning activities of the Ministries of Agriculture and Fisheries. Some have economic or social development objectives as separate functions. This should not, however, preclude the adoption of a more commercial approach. Non-economic objectives should be clearly specified, separately costed and transparently funded in order to ensure effective management and efficient operations.

There is also considerable scope for contracting out a wider range of service functions in the maintenance area, in relation to government buildings, vehicles, schools, parks, and recreation facilities. Small private firms could also be involved in providing printing services, refuse collection, construction of facilities and buildings, and construction of rural roads. These activities could be allocated on a competitive tendering basis.

With the objective of improving efficiency in the marketing of various agricultural products, the Commodities Board was recently transformed from a statutory body to a number of independent self-financing companies. There are concerns, however, that all the shares of the new companies are still held by the government and government ministers are on the Boards. This is not an effective form of privatization as the threat of bankruptcy and the profit incentive will not provide the same motivating force, and government ministers are unlikely to have appropriate business skills. In addition, it seems that in the transition to privatization, the employees were not equipped with adequate commercial skills.

The program to reform government enterprises in Tonga warrants careful review in order to ensure that genuine privatization occurs where possible, appropriate business skills are developed, and genuine competition is given prime importance. A number of commercial enterprise units have been established that compete directly with the private sector. This competition extends beyond simply vying for the same market. The costs of these enterprises have been subsidized by government through aid or the budget, and pricing policies have often been determined by Cabinet for social and political reasons rather than as a reflection of the true cost of providing the service.

As in the other Pacific island economies the absence of a local venture capital market will be a constraint on privatization, especially if foreign ownership restrictions apply. It will also be important to develop a strategy to communicate the benefits of public enterprise reform to those directly affected and the wider community.

Remittances and aid

Longer-term issues for Tonga continue to be stagnant real per capita incomes, and increasing reliance on private remittances and aid. As aid and remittances have increased as a percentage of GDP, total exports have remained stagnant. The vigorous growth of the squash industry shows, however, that there are international opportunities that the Tongan people can capitalize on if sensible economic policies are pursued. Fisheries, agricultural niche products and tourism offer the best prospects for growth.