The Fiji coup: a spate of economic catastrophes

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The most recent (third) coup in Fiji will have catastrophic consequences for the economy. Modelling suggests output could decline 10 per cent or more for the year as a direct result of the coup, with the impact likely to be felt most by the poor. Moreover, the implications for investment will have perennial consequences. Sanctions and reprisals by the international community, unless clinically applied, will exacerbate the impact and will push the economy further back in terms of economic development.

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The consequences of Fiji's third coup in May 2000 will be disastrous not just for the legitimacy and credibility of democracy and social order, but for the economic welfare of the population. There was growing optimism about Fiji's economic performance prior to the coup. Emerging from the drought which devastated the economy in 1997 and 1998, GDP growth hit more than 6 per cent in 1999 and was forecast by the government to grow a further 4 per cent in 2000. The government had been working on the National Development Plan in which was incorporated a target growth rate of 6 per cent per annum. But these hopes have been wrecked in the wake of the coup.

Investor confidence has been devastated. Investment has ground to a halt; foreign direct investments are being postponed indefinitely. Exchange controls have been put in place to prevent a foreign exchange crisis, and short-term lending rates have been increased from 8.4 per cent to 15 per cent. Further, there remain several unknowns in assessing the full damage to the economy including the extent of international reactions. Post-mortems of the economic and social costs of the coup will continue, but there is little doubt about the qualitative effects.

Recent evidence of buoyant economic times included strong growth in tourism, with the landing of a record 400 thousand

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tourists on Fijian shores in 1999; approval of investments totalling US$300 million of which US$160 million were for tourism projects; the four sugar mills in the country having crushed some 4 million tones of sugarcane; gold and copra production both on the rise; and the garment sector continuing its strong export-based growth. Inflation has remained low, partly the result of the remaining excess capacity in the economy, with the exception of a shortage of skilled labour in the garment sector. The balance of payments position was healthy due to a growth in exports in excess of growth in imports—foreign reserves at the end of the first quarter of 2000 were sufficient to cover six months of imports. The exchange rate had remained stable and interest rates had been falling. The underlying budget deficit of 1.3 per cent for last year is low by historical standards (Reserve Bank of Fiji 2000).

Fiji has continued to face major challenges: the resolution of the land-tenancy problems for sugarcane farmers; the lowering of unemployment, particularly amongst the unskilled and rural workers; and the containment of rising absolute and relative poverty in the country. But now the foremost challenge is for political stability, good governance, and effective democracy.

Fiji experienced two coups in 1987 causing the economy to go into free-fall with output declining 6 per cent. Using a model of the Fiji economy, the economic impacts of the 2000 coup are assessed using some of the impacts in 1987 as a benchmark for what will happen this time around. But there are some important differences. Fiji has over the last decade opened the economy to international trade; tax free zones have been in operation for more than a decade now; and garment exports to Australia, New Zealand, and the United States accounted for approximately 30 per cent of total merchandise exports in 1998. The economy is now less dependent on sugar, with exports of textiles and garments almost matching exports of sugar, and international tourism earnings exceeding both combined. Capital flows are more fluid than in 1987 with advances in communications technology. Capital controls were put in place in 1987 and the Fiji dollar was devalued by 30 per cent with interest rates left untouched. The difference this time is that the Reserve Bank of Fiji (RBF) has been quick to put in place capital controls and has raised interest rates in the hope of stemming capital flight. The violence and looting has been a lot worse than in 1987. There is also the likelihood of more punitive actions by the international community, including overseas trade unions, in the form of economic sanctions.

Some sectoral issues

Construction. From the experience of 1987, the construction sector is likely to be the immediate casualty of the coup. Sectoral output then fell about 10 per cent; this time around there are several construction projects either underway or in the pipeline, many of which will now be stalled. Property prices fell by more than fifty per cent in the immediate aftermath of the first coup, despite there being much less looting and violence in Suva compared to the May 2000 coup. Employment and output in construction will be hit hard.

Retail. The retail sector, particularly in Suva, will see a downturn. The damage to property of some US$11 million dollars will not be compensated through insurance claims. The damage to business confidence from the violence and looting will stall growth of retail investment. The credit squeeze and repair bills for damage done to stocks and capital could drive businesses to the wall with the smaller and local operators being most vulnerable. Losses in tourism revenues will hit the retail sector hard.

Sugar. The sugar industry could face harvest boycotts if the experience of 1987 is an indication of the reaction to be anticipated from the farmers. This would be most inopportune given the bumper crop expected this year, thanks to the consistent rain over the last twelve months in the sugarcane growing regions. Delays in harvesting now could push the harvesting season into the rainy season when transportation of cane becomes very difficult. This could be devastating for an industry emerging from the severe drought two years ago.

Tourism. Tourism suffered last time and will suffer again. However, this time the consequences will be more severe. Tourism is far more important now than it was prior to the first coup with tourist numbers 60 per cent higher and earnings from tourism now comprising nearly 20 per cent of GDP, making it easily Fiji's biggest export earner. Fiji was anticipating a further boost in tourist numbers due to the Lomé meeting to be held in the country in June 2000, now cancelled, and from the Sydney Olympics in September. The negative publicity of violence and instability associated with the coup will be catastrophic for the tourism industry. All of Fiji's major source countries for tourism (Australia, New Zealand and the United States) have issued warnings to potential tourists against visiting Fiji. Major developments due to commence construction has been postponed indefinitely. In the aftermath of the coup, the tourism industry could experience the loss of up to 7,000 jobs in the hotel industry and many thousands more in associated tourist industries.

Human and financial capital flight. Financial capital flight will be much harder to contain than in 1987 and skill shortages will become even greater from a surge in emigration. Some 4,500 Fiji nationals have emigrated annually since the coups of 1987; this number will rise in the short term but is unlikely to increase substantially unless the receiving countries ease entry to those seeking refuge—a result more likely in view of the violence this time around. Fiji has already been losing its skilled workers at an unsustainable level, with stocks now considerably depleted. The domestic labour market will see shortages of professional and skilled workers, which in turn will see rises in their remuneration. Moreover, skill shortages can become an important deterrent to investment.

The downward spiral for the economy has just begun and it will be a long while before the economy returns to its pre-coup status, assuming the political environment returns to normal. In the meantime, foreign reserves will continue to fall, interest rates may have to be raised further, and the dollar will almost certainly have to be devalued to avoid a liquidity crisis. Investment will suffer further and the risk premium associated with investment in Fiji will rise substantially. There will be little prospect of investment in tourism for many years to come. The outcome of all this will be a surge in poverty with an increase in unemployment, particularly amongst the unskilled and those in the private sector.

Quantifying the economic impact of the coup

In so far as it is measurable, the extent of damage to the Fiji economy from the coup has been estimated using a computable general equilibrium (CGE) model of the Fiji economy. The CGE model is a comprehensive map of the Fiji economy, incorporating 38 industry and commodity groups and accounting for the labour market, the capital market, government, the household sector, and the production sector. The model has recently begun to be used by the Fiji Government for planning and forecasting purposes. The objective of the CGE model is to perform simulations of changes affecting the economy, and the results produced by the model are the impacts projected over the subsequent year.

The considerations thought to be the most important economic consequences of the coup were incorporated into the simulation: the impact on international tourist numbers; a drop in investment and building and construction activity; flight of capital; a drop in sugar production; and a rise in interest rates. The extent of the impact of the coup on these remain uncertain, but in view of the earlier discussions it would be reasonable to expect more severe consequences than those of 1987, given that this coup is a lot worse, on every count, than the previous two. In view of the uncertainty, two scenarios are tested using the CGE model. A repeat of the consequences of the 1987 coup is taken as the benchmark for a 'best-case scenario', while a second 'realistic scenario' assumes the impacts will be of greater severity.

The assumptions for the 'best-case scenario' include

- a fall in international tourist numbers of 38 per cent (as occurred in the 12 months following the 1987 coup)
- a drop in investment of 25 per cent
- building and construction activity fall by 10 per cent
- private transfers abroad increase by 1.1 per cent of GDP (US$18.3 million)
- sugar production falls 10 per cent
- real interest rates rise 5 per cent.

A conservative approach is taken for the 'realistic scenario' with only the assumptions regarding investment and tourism changed

- international tourist numbers drop 50 per cent
- investment drops 30 per cent.

Table 1 outlines the results for the main macroeconomic variables across three scenarios; the 'best-case scenario', the 'realistic scenario', and a hypothetical 'no-coup scenario'. All results are forecasts for the 12 months from May 2000. In the absence of the coup, the model predicts real GDP would have grown about 2.4 per cent. But now Fiji can expect a drop in GDP of at least 7.1 per cent according to the 'best-case scenario'. More importantly, the economic welfare of the Fiji population is expected to decline 13.1 per cent and this is reflected in the drop of 12.9 per cent in real private consumption expenditure. The economic welfare variable measures the change in real income accruing to Fiji as distinct from GDP which measures the change in domestic production. The reason for the greater impact on welfare is the demand slump associated

Table 1 **Fiji: forecast of macroeconomic variables for year beginning May 2000** (per cent)

	No-coup scenario	Best-case scenario	Realistic scenario
Economic welfare	-0.3	-13.1	-14.8
Real GDP	2.4	-7.1	-8.7
Real consumption expenditure	-0.8	-12.9	-14.3
Change in tax revenue (per cent of GDP)	1.2	-2.2	-2.6
Change in current account (per cent of GDP)	-0.3	-1.1	-1.4
Change in imports (per cent of GDP)	3.8	-0.4	-1.0
Change in exports (per cent of GDP)	3.5	-1.6	-2.4
CPI	3.3	-3.1	-4.1

Note: The 'no-coup' scenario refers to what would have been the case had there been no coup; the 'best-case' scenario applies to the May 2000 coup the impacts of the 1987 coups; and the 'realistic' scenario assumes the negative impacts will be greater than in 1987.
Source: Simulation results using the Fiji CGE model.

Table 2 **Fiji: net impact of the coup on macroeconomic variables for year beginning May 2000** (per cent)

	Best-case scenario	Realistic scenario
Economic welfare	-12.8	-14.5
Real GDP	-9.5	-11.1
Real consumption expenditure	-12.1	-13.5
Change in tax revenue (per cent of GDP)	-3.4	-3.8
Change in current account (per cent of GDP)	-0.8	-1.1
Change in imports (per cent of GDP)	-4.2	-4.8
Change in exports (per cent of GDP)	-5.1	-5.9
CPI	-6.4	-7.4

Note: This table is calculated as the difference between the 'coup' scenarios and the 'no-coup' scenario in Table 1.
Source: Simulation results using the Fiji CGE model.

with the ensuing recession. This in turn leads to weakness in prices of non-traded goods and services, so profitability and factor incomes fall—as captured by the economic welfare number—but reduced prices enable an offsetting positive demand effect for non-traded production, hence the less severe consequences for GDP.

The net effect of the coup in the 'best-case scenario' is a fall in GDP of 9.5 per cent compared to the benchmark of no-coup, and the net change in economic welfare is a fall of 12.8 per cent (Table 2). The story gets worse when looking at the 'realistic scenario' with a fall in GDP of 8.7 per cent leading to a net fall of 11.1 per cent. Economic welfare contracts by 14.8 per cent which translates to a net fall of 14.5 per cent. The collapse in economic activity will also create severe problems for the budget with tax revenues expected to fall 3.4 per cent in the 'best-case scenario' compared to what would otherwise have been the case, and 3.8 per cent in the 'realistic scenario'. The current account will deteriorate to a small degree according to both scenarios, on the back of a sharp drop in both imports and exports. The forecast negative inflation outcome is due to a collapse in domestic demand. However, this result is very much contingent on how the monetary authorities respond. In view of the likely fiscal crisis and the need to fund this shortfall, there is a risk of monetising the deficit, leading to inflationary and exchange rate pressures.

Immediate effects

The violence experienced by Indo-Fijian businesses in Fiji has already seen the withdrawal of services, including access to supermarkets and transport services. Banks were closed for much of the period immediately after the coup, as were several other businesses. Shortages of goods and services have already shown up in higher prices with media reports of widespread shortages of sugar, flour, rice, etc. Some of these shortages have resulted from hoarding of food supplies in anticipation of further violence. The trade unions are likely to react adversely to the coup; this in turn will create further hardship for the general population and dissuade tourists from visiting Fiji.

Unemployment will rise and as a consequence poverty and crime will increase. Security threats will entice workers away from working in garment factories and any boycott of Fijian exports into the industrial world will translate into loss of more jobs. The possibility of inflation due to currency depreciation will be most obvious in food purchases, given the large share of imports in the consumer food basket. There could be a continued breakdown in law and order due to a growing lack of employment opportunities and as a result of increased tensions between the two communities and within the Fijian community itself.

International sanctions

Both Australia and New Zealand have threatened to withdraw aid to Fiji—this on its own will not have a serious impact but is likely to signal to investors that all is not well in Fiji. The Lomé IV agreement and the sugar protocols expired in February 2000, with the successor agreement now unlikely to be signed in Fiji as originally planned. The import credit scheme with Australia expires in July 2000 and the South Pacific and Regional Trade Agreement will expire in August 2000. Non-renewal of these preferential trade agreements will have an adverse impact on output and employment, particularly in the sugar and garment sectors, which are intensive users of unskilled labour.

Blanket use of trade sanctions would be ill-advised since such blunt instruments inevitably have significant undesired effects on the innocent masses. The sanctions would impact on workers, the bulk of whom can least afford to sustain such punishment and have had little if any role in the political events. A more targeted strategy in imposing sanctions would be preferable. Examples could include bans on participation in sporting activities, travel restrictions on individuals directly linked to the coup, expulsion from the Commonwealth, or other diplomatic sanctions. Indeed, these kinds of sanctions have already come into play—the embarrassment of the cancelling of the Olympic torch relay in Fiji is a powerful example.

In the longer term, removal of the price subsidy to sugar via the sugar protocol and to garment exports to Australia and New Zealand through SPARTECA could in fact be beneficial to the economy by raising the efficiency of resource allocation. Price subsidies to these two sectors in the form of trade-aid has distorted resource allocation and is at least part of the reason for the inefficiency of the sugar industry in particular. Removal of these subsidies would be likely to lead to rationalisation of resource use in the economy and hence gains in economic efficiency. Furthermore, the presence of economic rents due to subsidies provides the incentives for rent-seeking behaviour. Some of the tensions around land for sugarcane farming result from competition for the rent from the European Union sugar protocol.

Another positive and targeted form of support would be to allow the innocent workers of Fiji access to employment opportunities in the industrialised neighbours—at least as temporary residents. Such access would ease unemployment and associated problems in the country while providing a ready pool of labour for the host countries. Furthermore, the availability of such an option to workers in the country would deter those in power from abusing their rights to the disadvantage of the rest of the population. However, there is the risk that the coup leaders would regard the permanent emigration of Indo-Fijians in a positive light.

Some pressing issues

If the policy responses of 1987 are any indication, then further incentives in the form of tax free factories (TFF) and tax free zones (TFZ) will soon be offered to potential foreign investors. However, the benefits to investors will have to be more lucrative than those offered in 1987 for reasons of the credibility of such offers and the greater risk in view of the political instability. Moreover, the country will have to provide assurances and incentives to its nationals to contain the exodus of skilled personnel. Trade unions may be able to bargain wage rises for their members but this in turn will reduce competitiveness of exports and raise unemployment. Some considered thought will need to be given to ways of encouraging professional and skilled workers to remain in the country without triggering a wage-push inflation.

The Fiji Visitors Bureau will need to embark on a concerted campaign to contain the damage done to Fiji's image as a tourist destination. A lot of work will have to be done on the diplomatic front to regain international acceptance and support in order to revive trade and investment in the country. This, without doubt, will be a very difficult task if the coup leaders are given long-term political power.

Some final points

The results from the economic modelling exercise show just how devastating the coup will be for the economy over the next 12 months. But this is not all, as the modelling exercise only captures measurable economic consequences. It does not include, for example, the psychic costs associated with the breakdown in law and order and in social organisation and stability. Moreover, there are important long-term economic effects to be considered. For example, if the coup were to lower the trend annual growth rate of the economy by 3 percentage points, this would translate into a fall in the level of income of 35 per cent by the end of the decade. Such an outcome would mean loss of educational opportunities, reduced access to health facilities, and access to fewer employment opportunities. This is a price the country cannot afford to pay at this juncture. Yet these kinds of losses in output over the long run are not unrealistic. The foundation of economic growth is effective investment which, in turn, allows increases in productivity and productive capacity. The profound losses in private sector investment now will have implications for economic development that will reverberate for many years to come.

Several unknowns in terms of the severity of international sanctions and the final political solutions to the crisis will impact on the magnitude of economic damage. Nevertheless, the damage done to date is already profound. The biggest losers will be the poor; the unskilled workers; particularly those dependent on the construction, tourism, and retail industries—all intensive users of unskilled labour.

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