

The economy of French Polynesia: past, present and future

Bernard Poirine

French Polynesia has a history of economic dependence on French public transfers. The dependence on military spending grew during the 1960s and 1970s due to France's atomic-testing activities in the Tuamotu Archipelago, which ended in 1995. Since then, the official strategy, stated in the Pacte de Progrès in 1993, has been to promote export and tourism revenues, as a substitute for French public transfers. The strategy has not, however, been successful because the policy measures necessary to reach this goal have not been implemented. High costs and prices due to protectionist policies, the high cost of public administration and the Pacific franc's high real exchange rate continue to have negative effects on export and tourism.

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French Polynesia is a group 121 islands in the South Pacific, a French '*collectivité d'outre-mer*' with an autonomous assembly and government, a president, a flag and a hymn. The French government is responsible for money, credit, international relations, higher education and the military and police forces, while the local government is responsible for all other matters. The 260,000 people are French citizens and hold EU passports. Per capita GDP was €17,216 in 2005 and per capita French government transfers amounted to € 4,864, or 28 per cent of GDP (ISPF 2008). The resources of the public sector (including social security) accounted for 68 per cent of GDP in 2003, compared

with 49 per cent in France (IEOM 2006). French taxpayers pay all military personnel, teachers, professors and policemen (61 per cent of public expenditure). Local taxpayers are responsible for all other expenses.

Compared with independent island states of the Pacific, French Polynesia is rich. Depending on the exchange rate, per capita GDP is sometimes higher than New Zealand's. That, however, is not the case when measured in purchasing power parity (PPP) terms, since the price level is much higher in French Polynesia. The traffic jams in Papeete, the large number of four-wheel-drives on the road, the good level of public infrastructure and health

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coverage, and the sophisticated welfare system all point to a 'rich' economy. It is rich but fragile, with a huge trade deficit (imports were 10 times exports in 2007, or 2.6 times including services exports), poor tourism performance, weak industrial and agricultural sectors and above all a high dependence on French transfers. Will French Polynesia remain a 'rent' economy or will it develop a strong tourism sector, as has been the case in Hawai'i and Guam when military spending began to decline?

This article first outlines the history of economic dependence on French public transfers. It then shows how protectionism and a costly public sector have driven up the cost of living and the real exchange rate over the years. It is then argued that the import-substitution strategy has failed to develop a strong, self-reliant economy, before we propose a strategy for a more self-reliant economy.

A history of economic dependence

Before and after 1964

The building of the infrastructure and military bases for the French atomic experiments began in 1964, coinciding with the opening of the first international airport on the island of Tahiti. Before 1964, the economy was based on the revenue from a few export staples: phosphate, copra, vanilla and mother-of-pearl. There was a small trade deficit due to the dwindling phosphate production on the island of Mataiva. Per capita GDP was only a fraction of that of metropolitan France.

From 1964 onwards, huge military spending led to a radical change in the economic structure. The military used local workers to build the facilities in Tahiti and in the Tuamotu islands of Hao, Mururoa and Fangataufa. In 1965, French public transfers

amounted to 61 per cent of GDP. In 1975, the military's share of the total wage bill was 35 per cent. In 1980, the public sector (civil and military employees) paid 69 per cent of the total wage bill. Imports rose sharply, while exports declined steadily, although they picked up slightly with the development of the pearl culture beginning in the 1980s (Figure 1).

As a result of the rapid increase in French public transfers, all economic and social indicators improved rapidly. Infant mortality fell and medical coverage and life expectancy rose. Per capita GDP grew faster than in metropolitan France, partly reflecting the higher inflation rate.

The local public service grew rapidly after 1974, when the first statute of autonomy was granted to French Polynesia. The public service union managed to obtain wages similar to those of the French expatriate civil servants, who were paid more than twice the metropolitan rate at that time. As a result, the cost of the local civil service grew exponentially, financed mainly by increasing import duties—that is, through price inflation of imported goods.

A dominant public sector plus protectionism add up to a high cost of living

Today the public sector's share of GDP is 24 per cent, but the resources of the public sector (French public transfers plus local revenues from import duties and taxes, as well as social security contributions) account for 68 per cent of GDP. Since most of the local budget is financed by a value-added tax and import duties (in the absence of an income tax), local industry is very much under a protectionist umbrella.

On average, import duties amount to about 30 per cent of the total value of imports. The value-added tax was introduced in 1998,

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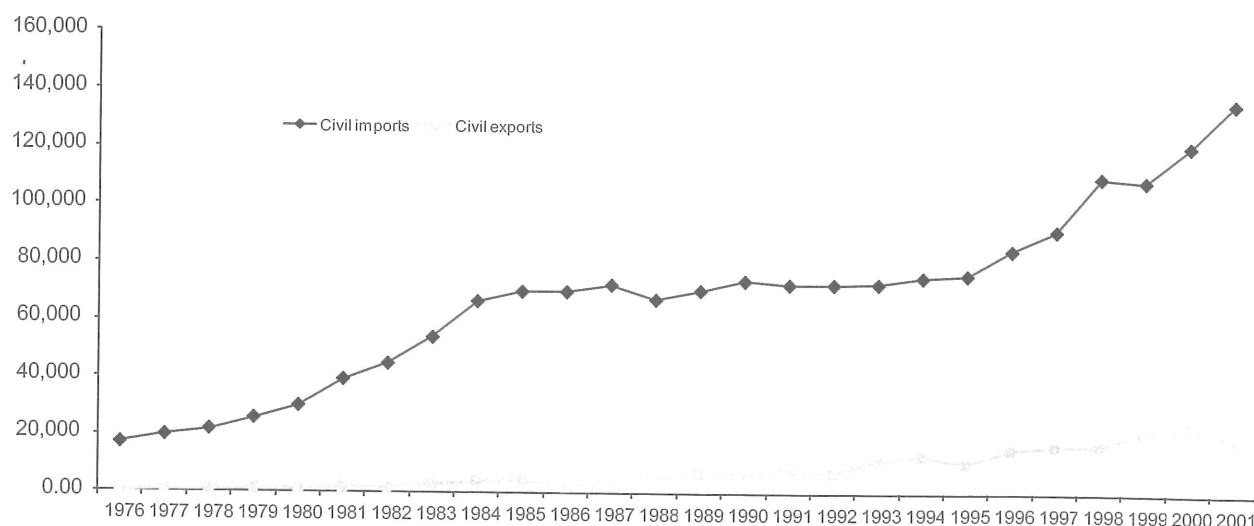
replacing 'entrance duties' (*droits d'entrée*) on imports from the European Union and a general tax for social security on all imports. As a result, the average import duty declined from 42 per cent in 1996 to today's level. A new import tax was, however, added in 2001, called '*taxe de développement local*', which was levied specifically on import goods that were in competition with locally produced goods. This tax can reach punitive levels (from 30 to 90 per cent, on top of other import taxes). It is levied on imports of beer (82 per cent), mineral water (20 per cent), soft drinks (60 per cent), chocolate (51 per cent), car batteries, plastic tubes, toilet paper, boats, screws and bolts, and so on.

In addition, there are quantitative import restrictions (such as bans on ham, corned beef and sausages and import quotas on oranges, tomatoes and other vegetables). As a result, local prices for such items are 50–100 per cent higher than in France. In

2007, for example, French Polynesia had the sixth most expensive price in the world for a Big Mac.

As a result of the rapid increase of the average rate of import duties during the 1970s and 1980s, the local price index grew faster than in France—at least until 1986. Since 1949, the local Pacific franc has been linked to the French franc and subsequently to the euro by a fixed exchange rate. This meant that the real exchange rate increased until 1986. Since the Pacific franc has been linked to the euro since the end of the French franc—while most exports and tourism services go to non-European countries (pearls to Japan and China, and tourism to the United States, Australia and New Zealand, which are much closer to Tahiti than Europe)—the competitiveness of the export sector has been adversely affected by the rising euro against the US, Australian and New Zealand dollars.

Figure 1 French Polynesia's imports and exports, 1976–2001



Source: Institut statistique de Polynésie française (formerly Institut territorial de la Statistique), comptes économiques, 1976 to 2005.

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A parliamentary report (Brard 2007) revealed some large price discrepancies between French Polynesia and metropolitan France. For example, compared with France, in French Polynesia, prices are three times higher for yoghurt, imported cookies and local tomatoes, two times higher for chocolate bars, liquid shower soap, imported jam, dishwashing liquid and locally made coca cola, and 62 per cent higher for imported UHT milk. For 29 items of current consumption cited in the Brard report (most of them imported), the median price was 62% higher in French Polynesia than in France.

The failure of the import-substitution strategy

The rapid growth of French public transfers made it superfluous to consider any development strategy until 1993, when atomic testing was suspended—and finally ended in 1995. At that time, import substitution was considered the most desirable way to enhance the multiplier effect of French public transfers, by minimising import leakages. In 1988, the President of French Polynesia, Alexandre Leontieff, stated in the French magazine *l'Expansion* (no. 320, 18–31 March 1988): 'import-substitution, our development strategy, seeks to promote the local manufacture of products to satisfy the needs of the domestic market, thus reducing imports.'

Although imports were reduced significantly for a few products (such as beer, soda, mineral water, car batteries, aluminum doors and windows, ham, sausages, corned beef, screws and bolts, and toilet paper), total imports continued to grow at a rapid rate, since local industry was unable to provide most of what local demand required—mostly durable consumer goods, such as vehicles, motorcycles, bicycles, television

sets, cameras, radios and computers. In addition, most food is imported fresh or canned.

After more than 30 years, the import-substitution strategy had failed to develop a strong and diversified industrial base; most of the manufactured products were still imported and the manufacturing sector accounted for only 6.1 per cent of GDP in 2005 (excluding energy, construction, transport and telecommunication) and 8 per cent of total local employment (excluding French military and civil servants).

This outcome is not surprising, since the constraints of distance, the high shipping cost of raw materials and energy and the lack of scale economies for most products catering to the domestic market make it very difficult to engage in competitive manufacturing of products for the very small domestic market.

The very few 'successes' of import substitution (beer, corned beef, ham and sausages, spring water and sodas) entail a very high cost to the consumer. A recent report by a local assembly commission on the high cost of living noted that the retail price of locally produced corned beef varied from XPF321–408 for a 320 gram can, while it would be possible (if legal) to sell imported corned beef from Brazil at a retail price of XPF115 or from New Zealand at a retail price of XPF163. The cost of manufacturing a can of corned beef in French Polynesia (with local and imported beef) varies between XPF242 and XPF282 (Assemblée de la Polynésie Française 2009:121). Similar import bans were imposed in the past on coffee and pasta. The consumer outcry was so loud (especially since the local products were not only more expensive but of a lower quality) that the bans were lifted.

The protectionist policies, together with the high wages of public servants, explain the high cost of living in French Polynesia and the difficulties of exporting

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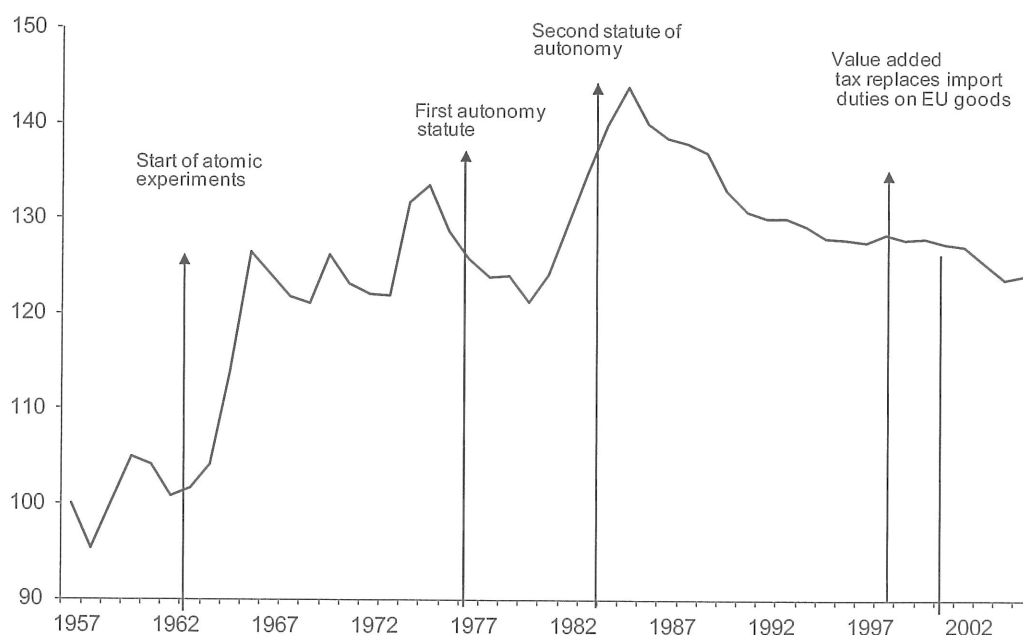
and tourism. Because domestic prices increased faster than foreign (metropolitan) prices, the real rate of exchange of the Pacific franc relative to the French franc increased by more than 40 per cent between 1957 and 1986; subsequently it decreased slightly. If 1957 is taken as the base year, the Pacific franc remains overvalued by more than 20 per cent (Figure 2).

The high cost of building materials, local and imported beverages, fruits and vegetables, and electricity, telephone and internet services makes it difficult for hotels and restaurants to be competitive with other tourist destinations (in contrast, cruise ships are allowed to import food and beverages free of tax). Other export services are also uncompetitive. For example, Air Tahiti Nui, the semi-public domestic airline, with a fleet

of five Airbus long-haul planes, has been losing money since it was established. In 2008, it lost US\$55 million and cost the local taxpayer US\$916 a household, even though it benefited from a special subsidy from the French government to buy its planes (through a complex tax-exemption system called '*loi de défiscalisation outre-mer*'). This added cost (to the taxpayer) of subsidising the hospitality and air transportation industries (as well as the copra-oil export industry) is a by-product of the already costly (for the consumer) policy of import substitution.

One could ask why, in the face of such a general failure, the protectionist policy has been maintained—especially since 2004, with very frequent government and majority changes occurring, in contrast with the

Figure 2 Real exchange rate of the Pacific franc (ratio of local consumer price index to French consumer price index)



Source: Author's graph from data collected by Vincent Dropsy from Institut national de la statistique et des études économiques (INSEE), 1959–72. *Comptes de la Polynésie française*; and Institut de statistique de Polynésie française (ISPF), 1973–2007. *Comptes de la Polynésie française*.

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former period dominated by the presidency of Gaston Flosse and his ruling party.

There are several reasons for this.

- The decision to finance the escalating local public sector spending (with public wages higher than in metropolitan France and the very high cost of local institutions such as the presidency and the local assembly) mainly through import duties and value-added tax, rather than through income taxes or taxes on capital gains or bequests. For wealthy residents, French Polynesia is a tax haven; this is paid for, however, through import duties by the less well-to-do people.
- The decision to create a clientele of businessmen devoted to the ruling party, with the president the ultimate decider of who benefits from a tax or protection against foreign competition, thereby providing lucrative rent from the captive domestic market. Moreover, such a favour can be granted or suspended at will by the local government, which certainly provides an incentive to please politicians.
- The misguided belief that promoting domestic industry through protectionism will ultimately help build a more self-reliant economy, less dependent on imports. Instead, the local economy has become more dependent on imports and on the French taxpayer.

Promoting external resources

Le pacte de progrès

In 1993, French President, François Mitterrand, decided to suspend nuclear experiments in the Pacific. In 1995, President Jacques Chirac decided to resume them for a year and then ended them. The

local government suddenly became very conscious of the economic dependence of the local economy on military spending. Several studies showed that the end of the military bases in Mururoa and Tahiti would represent a loss of French military spending of approximately €1 billion a year, stalling economic growth for a long period and possibly create much unemployment, since many local civilian workers were employed by the military bases. I wrote a book at that time called *Tahiti: stratégie pour l'après nucléaire* (Poirine 1996) wherein I recommended a radical change in economic strategy: from import substitution to the promotion of exports and tourism services.

In 1993, the local government decided to hold brainstorming sessions to imagine a future for French Polynesia. The aim was to propose a strategy to cope with the next decade of predicted dwindling public transfers from France. The ensuing document became known as *Pacte de Progrès* (Charte du développement 1993). It contained an estimate of expected external resources from 1995 to 2005 and highlighted the need for faster growth of exports and tourism receipts to compensate for the decline of French public transfers.

In 1993, exports and tourism receipts accounted for only 26 per cent of external resources; French public transfers provided the remainder. The official goal was to bring the share to 43 per cent by 2005, by promoting exports (Tahitian pearl, fish, copra-oil and vanilla) and tourism. In order to reach this goal, fiscal reform was recommended to lower the share of import duties in local revenues (Figure 3).

The goal for 2003 was attained in 1998 thanks to the rapid growth of pearl exports and tourism receipts. From 2000 onwards, however, declining pearl exports and tourism receipts led to a decline in the share of external revenues from domestic origins

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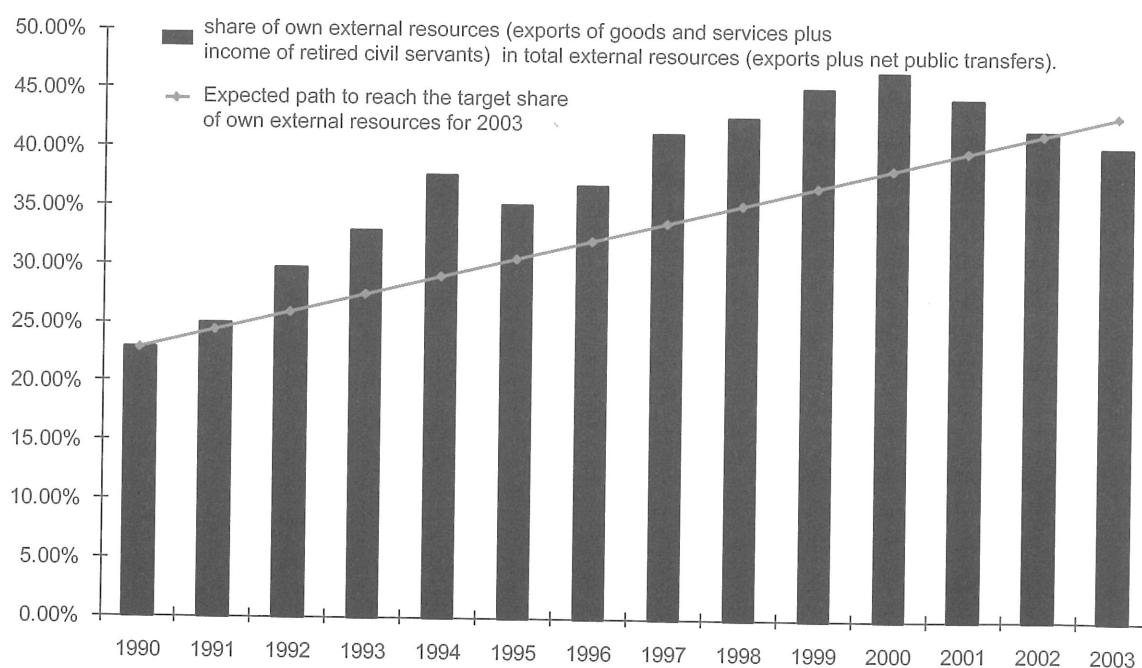
and, worse still, a decline in total external revenues of domestic origin. Failure to reach the goal of developing external revenues from domestic origins has been due to the decline in tourism and a steep decline in the price of Tahitian pearls—French Polynesia's main export.

The main reason for this poor performance of exports and tourism is that the protectionist policy has been continued, despite fiscal reform introducing a value-added tax in 1998 to replace some of the import duties.

Towards a new development strategy

It is obvious that, since 1993, the official development goals and the real policy decisions have been in complete contradiction. The official aim is to promote exports and tourism in order to become less dependent on public transfers. In practice, however, protectionism is still in place. Fiscal reform (1998–2001) in fact replaced high average 'across the board' import duties with a '*taxe de développement local*', targeted much more to specific imports and therefore generating less income for the budget, but with a much higher degree of protectionism to the benefit of targeted industries. The end result is that the export and tourism sectors

Figure 3 The share of own external revenues (exports and tourism receipts) in total external revenues (exports, tourism receipts, French public transfers), 1990–2003 (per cent)



Source: Institut statistique de la Polynésie française (formerly Institut territorial de la Statistique), comptes économiques, 1983 to 2004; Institut d'émission d'outre-mer, rapports annuels, 1983 to 2004.

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cannot become competitive, since the causes of the high price level and the overvaluation of the currency have not been treated. In other words, there is no coherent long-term economic policy to promote tourism and exports.

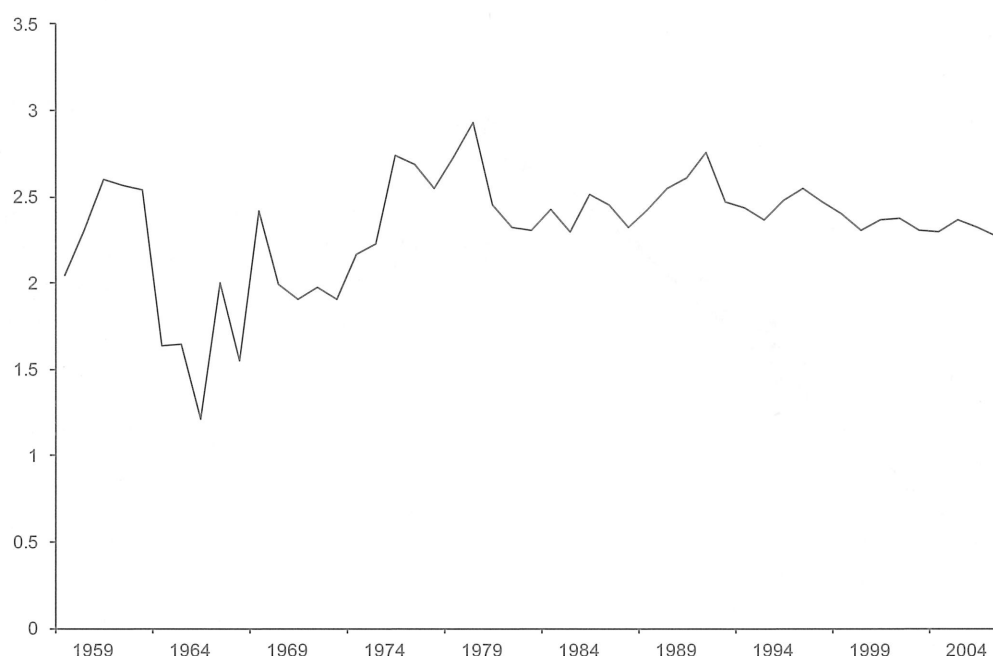
There is a fairly stable multiplier of external resources of between 2.5 and 2.6 (Figures 4 and 5), meaning that any increase in external resources results in a proportional increase of GDP and therefore employment.

Promoting the growth of external resources is therefore the only way to make a small island economy grow (Poirine 1995, 1996; Crusol, Hein and Vellas 1988; Galbis 1984; Demas 1965). Because of the 'Dutch disease' effects of public transfers (through

the high level of public wages and the high level of import taxes to finance the high wages in the local administration), there should be an effort to minimise the costs of the public service and public corporations.

There is a definite need to do away with protectionism—to minimise the welfare cost to the consumer, to minimise 'crowding out' effects on the non-protected sectors and to steer capital and labour towards the export and tourism sectors. The island of Guam successfully took this road years ago, repealing all import duties, to become a shopping haven for Japanese tourists (Guam has five times more tourists than French Polynesia, with approximately the same resident population).

Figure 4 French Polynesia: multiplier of external resources (ratio of GDP to exports of goods and services and public transfers), 1959–2007



Sources: Author's graph from data collected by Vincent Dropsy from Institut national de la statistique et des études économiques (INSEE), 1959–72. *Comptes de la Polynésie française*; and Institut de statistique de Polynésie française (ISPF), 1973–2007. *Comptes de la Polynésie française*.

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The overvaluation of the local currency has to be corrected through an exchange rate adjustment. The inflation effect of devaluation on import prices would be mitigated if fiscal reform simultaneously repealed all import duties (30 per cent of the value of imports). The French government could partially compensate the local budget for the lost fiscal revenues in Pacific franc terms since the same transfers in euros would provide an increased amount in Pacific francs after devaluation.

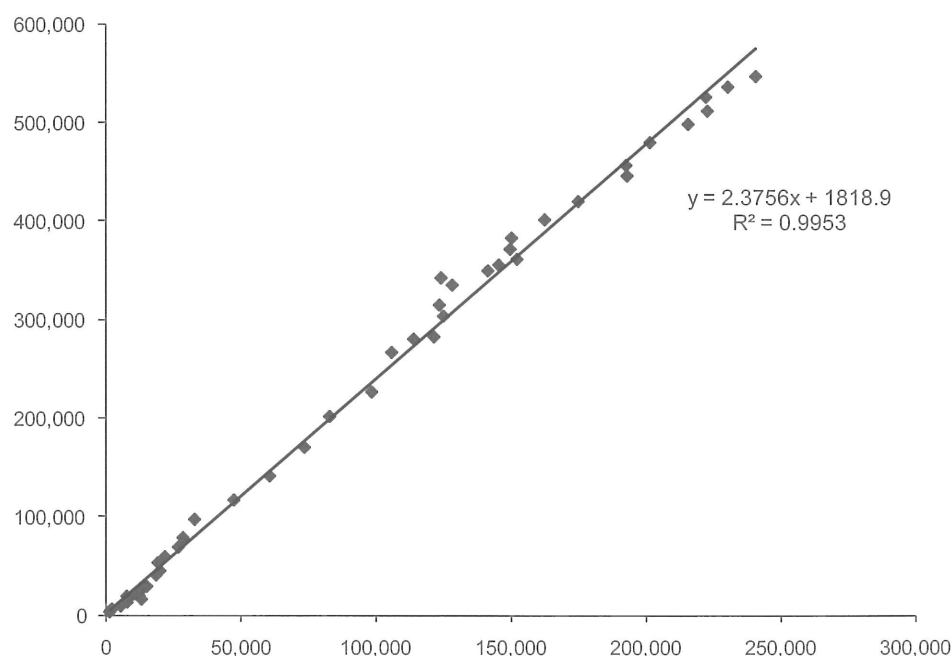
Further, the French government could save on the wage bill of state civil servants by keeping their wages unchanged in Pacific francs (which would mean paying them less in euros, by reducing the 84 per cent premium on the metropolitan public servants' pay scale). The local government

could replace import duties with an income tax, which would be less inflationary and socially more equitable.

Since the level of exports is presently only a small fraction of that of imports, even a high elasticity of exports to changes in the real exchange rate would not guarantee that the net effect of the devaluation would be to improve the trade balance. The slow growth experienced in the past 10 years makes it hard to believe that the economy will be able to create sufficient jobs to prevent an increase in the already high unemployment rate. It would be necessary to create at least 3,000 jobs each year to prevent an increase in unemployment.

Thanks to the nickel boom, New Caledonia has much better growth prospects than French Polynesia. There already is

Figure 5 French Polynesia: the relationship between external resources and GDP, 1959–2007 (million Pacific francs)



Note: External resources = exports plus tourism receipts plus public transfers.

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a significant Tahitian diaspora in New Caledonia, dating back to the 1960s and 1970s. A second wave of migration is currently under way. As French citizens, all citizens of French Polynesia may migrate freely to any European country. Up to now, however, very few Polynesians have chosen to emigrate to Europe; the high cost of the airfare is one of the reasons why — the high unemployment rate in France is another.

It would be possible to do away with French public transfers (US\$6,121 per capita) if tourism receipts (US\$1,740 per capita) were multiplied by 4.5. A goal of quadrupling tourists per capita is not out of reach if a correct policy is engaged, including building adequate infrastructure: more golf courses, congress centres, casinos, more tourist promotion, special zones reserved for natural parks in the lagoons, low-cost airlines, and so on.

Conclusion

French Polynesia has been surfing a wave of military spending by the French government for three decades. It has had good short-term direct effects (multiplier effects on income and employment) and bad long-term crowding-out effects (on inflation, the real exchange rate and the competitiveness of the export and tourism sectors).

Political autonomy transferred the responsibility for economic policy to the local government (except for monetary policy). The choice made by all local governments has been to finance increased local public spending through higher taxes on imports, rather than by taxing income and wealth or by curbing public wages. The protectionist policy was strengthened after 2001 with the introduction of a new import tax that imposed very high rates on imports in competition with locally made products. This has had the effect of driving

local prices even higher. This policy is in direct contradiction to the official goal of promoting exports and tourism.

The overvaluation of the currency resulting from high inflation rates from 1964 to 1986 makes it difficult to compete with foreign imports and even harder to compete in world markets for pearl exports and tourism. Only radical reforms, including the ending of protectionism and a devaluation, or an incomes policy (to reduce the cost of the public service and its burden on import duties) would make it possible to replace a rent economy with a tourism-led economy, as Guam and Hawai'i have done. Even with such reforms, the outlook for the French Polynesian economy is not good, since escalating energy costs will probably keep the remote islands of Polynesia the most expensive destination for tourists from Europe and one of the least cost-effective destinations for tourists from Japan and the United States. The major export industry, black pearls, is also in bad shape because of increasing competition from lower-cost producing countries such as China, Indonesia and Cook Islands.

It therefore seems that to preserve the living standards of today and prevent mass unemployment, it will be necessary to limit the growth of the island workforce, by promoting emigration to New Caledonia and France.¹

Note

¹ Emigration is a way out for remote islands with declining external resources and a lack of scope for scale or agglomeration economies (because of the small internal market and their remoteness, which limits specialisation in industrial exports): migrants can send remittances to the island families. This was suggested by the World Bank (2009), as pointed out to me by an anonymous referee.

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