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CURRENT ECONOMIC TRENDS IN SELECTED SOUTH PACIFIC COUNTRIES

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Regional development

Growth necessarily involves changes in techniques including changes in land use. The achievement of these changes while respecting traditional land ownership customs creates a dilemma in the Pacific area in which the apparent conflict between material progress and traditional values frequently need to be balanced.[1] This conflict was an important element in the recent disturbances in Vanuatu and was one of the alleged elements contributing to the *coups* in Fiji; on occasion, it has arisen in Samoa and Papua New Guinea as well as elsewhere.

However, the recent riots in Vanuatu, coming almost a year after the *coup* in Fiji, may have more serious repercussions for countries other than Vanuatu. These foreign attention attracting events may destroy the vision of a pacific Pacific and discourage foreign investment and aid to all countries in the area at a time when the island governments are tending to relax their attitudes regarding foreign investment and attempting to delay the possible declines in aid.

In the past year, Papua New Guinea, Solomon Islands, Vanuatu and Tonga have issued development plans and Fiji is struggling to reverse the declines in output that characterized 1987. The plans published in late 1987 and early 1988, with the notable exception of Papua New Guinea, tended to appear after, rather than before the beginning of the period in which they contemplated their proposals being implemented. This was the result of efforts to include operational government departments in the planning process. These departments tended to be late in presenting their proposals for inclusion in overall plans. The attempts to include departmental contributions reflected the view that development plans should be integrated in the structure of government policies and operations and hence be less detached from some of the difficulties faced in any development program.

These plans tended to have, among others, one common theme. More resources should be directed to the promotion of agriculture, particularly smallholder production. In several instances, governments are continuing or embarking on policies that restrain or reduce the appropriations available for the development of human re-

[1] See R.V. Cole, Land Policies and Issues in the South Pacific, Islands/Australia Working Paper 86/12, Canberra, National Centre for Development Studies, 1986; and A.V. Hughes, Climbing the Down Escalator, Islands/Australia Working Paper 88/2, Canberra, National Centre for Development Studies, 1988.

sources so that more can be devoted to agricultural development. This transfer of resources is defended by the argument that, in countries in the South Pacific, agriculture is the foundation of the economy. An increase in this basic output that can be achieved as quickly as possible by encouraging smallholder output will provide resources, some of which may be devoted to the development of such things as education and health. (This argument is also consistent with egalitarian considerations and the objective of encouraging the growth of the incomes of national residents rather than those of foreigners.) It is a conscious deferment of investment with long-run returns in favour of investment with short-run returns, so that in the long term, human resource development may be greater than if more support were given to it today. In all probability, any immediate assessment of the validity of this agreement must be highly conjectural.

At the same time, there is a tendency to think that there is a direct relationship between agricultural output and the amount of money devoted to its encouragement. This view is held despite the comments of many observers that governments could usually increase their contributions to agricultural programs more by improving the quality of their services than by increasing their budget allocations. In many cases getting extension workers to farms rather than keeping them engaged in headquarters operations is an obvious step to improve notoriously inefficient government services.

Vanuatu

The disturbances of May 1988 will probably have little effect on the physical output of the Vanuatu economy unless they break out again. However, they can only have had a depressing effect on tourist income which accounts for almost 20 per cent of Vanuatu's total receipts on goods and services.

The Second Development Plan (1987-91) (DP2) has been presented to Parliament, fifteen months after the starting date of the Plan period. It concentrates on the development of the natural resource sector, primarily agriculture and tourism, and the development of human resources. With very few trained ni-Vanuatu, the government will have to rely heavily on foreign technical assistance and foreign investment, including joint ventures.

While copra export earnings are expected to achieve negligible growth during DP2, other major agricultural industries are expected to grow rapidly, particularly cocoa and coffee (the latter admittedly from a low base). The beef industry should also continue to expand. The extent of this expansion will be dictated to a large extent by the success achieved in development projects currently being implemented in the agricultural sector.

During most of 1987, the economy was recovering from the effects of the 1985 cyclones and one in early 1987. The value of copra production and exports was more than 50 per cent higher than the depressed levels of 1986, largely because of the upturn in copra prices (the tonnage of exports was the lowest for many years). However, the receipts for copra exports were considerably lower than in 1985 and just over one-quarter of those in 1984. The volume and value of cocoa exports, on the other hand, were at record levels. Some of the benefits of earlier plantings in both the smallholder and plantation sectors are beginning to be realized. The beef industry also performed well in 1987 with VT250 million of exports, the highest value ever.

The Vanuatu Commodities Marketing Board (formerly the Copra Marketing Board) operates a domestic price stabilization scheme for copra. The price it offered copra producers fell to VT13,000-18,000 per tonne in May 1986. These prices were below the peak levels in 1984, but well above those of 1985 and subsequently. The Board was prepared to accept losses designed to encourage copra production in the belief that it would receive STABEX funds intended by the European Community to stabilize producer incomes through offsetting fluctuations in world prices (see below). With falling copra production through 1987, the Board increased its payout prices to VT25,000-30,000 – over twice the world price – in October. It is difficult to see how, with this price differential, the Board can maintain its solvency.

Between 1984 and 1987, the ratio of commodity exports to imports declined from 0.65 to 0.25, mostly because of plummetting receipts for copra. The value of imports increased by only 12 per cent between 1984 and 1987 - that is, below the rate of inflation.

The government's projections of economic developments included a forecast that tourist arrivals would increase by 250 per cent during 1987-91. As yet, this forecast has not been realized. Arrivals in 1987 were little more than one-half of those in 1983. In part, this disappointing performance is linked to bad publicity that tends to link Vanuatu with New Caledonia as a strife-torn French outpost.

Increasing uncertainty has also had a dampening effect on the growth of the financial centre, which was negligible in 1986, but accelerated slightly in 1987, with some recovery in its foreign exchange earnings after their decline in 1986.

The government accounts have been in deficit since 1985. These shortfalls have been largely covered by the commercial banks, thereby absorbing any tendency for them to have excess liquidity that might have encouraged credit expansion leading to inflationary pressures and increased imports.

The broad money supply increased by 27 per cent in 1987, but a large part of this was a rise in foreign currency deposits associated with operations of the financial centre rather than with domestic activity. The statistical definition of money might be revised to exclude all foreign owned deposits from quasi-money.

Interest rates on both deposits and loans continued to decline during 1987. Both sets of rates are well below the rate of inflation. Hence, real interest rates are now negative. The banks have little difficulty in keeping interest rates on loans to productive sectors below the official ceiling of 14 per cent. This ceiling may, in fact, contribute to the repression of the financial system.

Export activity has continued in an economy where the currency is, despite the devaluations of 1985 and 1986, overvalued. Vanuatu is still probably the most expensive of all the Pacific island tourist resorts. Until February 1987, the vatu was linked, subject to discrete devaluations, to the SDR. Since then it has been linked to a group of currencies as in Papua New Guinea, Fiji, the Solomon Islands and Western Samoa.[2]

The acceleration of price increases could lead to pressures for substantial urban wage increases. Some bureaucrats have suggested that minimum wage rates should be almost doubled. Fortunately, most government officials are aware of the dangers in such a move.

There is a conflict within government circles regarding the utilization of STABEX funds. The Commodities Marketing Board considers that these funds should be transferred to the producers through higher pay-out prices. Elsewhere in the government, it is considered that these funds are intended to be used for macroeconomic stabilization and this purpose can best be achieved by the government retaining the funds as part of its general revenue.

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[2] See A. Yusuf, 'Fiji's weighted real exchange rate' PEB, 1(1), June 1987 for a description of such a system.

Fiji[3]

The first anniversary of the military takeover took place on 14 May 1988. In 1986, GDP was 5.6 per cent above the depressed levels in 1985. The pre-*coup* forecast of growth in 1987 was 1.4 per cent. It is now estimated that output declined by 9 per cent, virtually wiping out all the small economic gains made in the 1980s. Earlier predictions of further severe declines in output during 1988 now appear to be unduly pessimistic. Nevertheless, even if there are no further political disruptions, output is likely to decline slightly.

Since the first *coup*, economic policy has been directed primarily to avoiding price inflation and an evaporation of international reserves. These targets have been achieved largely because the government was able to maintain relatively tight fiscal policies (even so, the budget deficit has risen), by the Reserve Bank maintaining rather restrictive monetary policies and strict exchange controls, and exchange rate devaluations.[4]

Initially, the fate of the sugar crop brought about one of the greatest fears with regard to the outcome of political events. The fear turned out to be groundless: output was over 400,000 tonnes. This was less than the 500,000 tonne record level of 1986, but 40 per cent higher than in any earlier year. Early estimates indicate that the 1988 output should be similar to that of 1987. It will clearly take considerable time for the (admittedly optimistic) target in the current development plan (DP9) of 540,000 tonnes to be achieved. The area of cane harvested in 1987 was actually larger than in 1986, reflecting pre-*coup* plantings. However, severe drought and late harvesting (largely a reaction to the *coup*) resulted in reduced cane production. On the other hand, the sugar-to-cane ratio rose, so that final output was not unduly depressed. For 1988, it is estimated that the area planted has declined by approximately 7 per cent, but that there has been adequate rainfall and, as yet, no hurricanes. Consequently, there should be an almost 15 per cent increase in cane harvested, but a decline in the sugar-to-cane ratio, so that sugar output is expected to remain constant. Fiji is essentially isolated from the price gyrations in this international market (see comments on sugar prices in 'Pacific island commodity prices' in this issue).

The tourist industry, badly hurt by the *coups*, has recovered slightly. Hotel occupancy rates have moved up in recent months, mainly at the inexpensive end of the market and only after substantial discounting. Consequently, the foreign exchange receipts are much lower than in earlier years, and below the levels that were one of the basic assumptions of DP9.

The 1987 drought also reduced agricultural output other than sugar. Lack of pasture and water resulted in 300 cattle deaths. Another month of drought could have led to losses in the thousands and to the widespread cartage of water. However, beef production declined by only 3 per cent and is expected to rise by 8 per cent in 1988. Copra production also suffered from the lagged effect of the 1985 cyclones as well as drought. Output fell from 22,500 tonnes in 1986 to 13,000 tonnes in 1987. The Ministry of Primary Industry forecasts a 30 per cent increase in 1988. Cocoa output reached a record level in 1987 as a result of a determined push in recent years by the Ministry of Primary Industries to increase production. It is anticipated that this output will decline by almost 20 per cent, but from record heights. Fresh

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[3] See S. Siwatibau 'Macroeconomic policies under adverse conditions' in this issue and R. Cole and H. Hughes, The Fiji Economy May 1987: Problems and Prospects, Pacific Policy Paper 3, Canberra, National Centre for Development Studies for more detailed discussions of some of the issues considered here.

[4] See K.G. Gannicott, 'Current economic trends in the South Pacific', PEB, 1(2), December 1987.

produce supplies to the local markets were also much reduced in 1987.

The recent initiative to establish Tax Free Zones and Tax Free Factories, to be operated by the Fiji Trade and Investment Board, should raise exports of manufactures. Its aim is to supplement local entrepreneurship with foreign management skills, increase the inflow of capital, increase exports and boost domestic employment. The timing of this policy initiative indicates that efforts are being directed towards replacement of Indian and ethnic Fijian entrepreneurship lost in the aftermath of the *coups*, and to encourage those still thinking of leaving to reconsider. Another reason for the policy is the belief that rural-urban migration will proceed regardless of relative incomes in rural and urban areas and that urban unemployment must not be allowed to rise.

A tight fiscal policy has been necessary over the past twelve months to deal with the economic problems caused by the *coups*. The public service has accepted a 15 per cent cut in salaries, shorter working hours, a continuing freeze on wages and salaries, and substantial non-salary cuts to both recurrent and development budgets.

The maintenance of some semblance of external balance constituted the centrepiece of the government's economic rescue efforts after each *coup*. Before the first *coup*, gross external reserves stood at F$177.3 million. By the end of June 1987 they had fallen to F$120 million. At this point, the government was forced to take drastic measures to slow the rate of fall. Without this action, reserves would have dried up by the end of 1987. Despite a further setback because of the second *coup*, the recovery in gross external reserves has been as dramatic as the decline. By the end of March 1988, reserves had climbed to F$237 million, representing almost seven months of net imports. This figure was F$54 million higher than the corresponding figure twelve months earlier. Thus, the emergency action that was instigated enabled reserves to be accumulated to well above pre-*coups* levels. A major factor enabling this rapid build-up in external reserves has been depressed conditions in the domestic economy that have led to much reduced import demand.

The build-up in external reserves has been the major factor behind increases in broad money (M3) during 1988. Private sector credit is still depressed, largely because of investor uncertainty regarding the future, with outstanding loans and advances still well below the established ceiling of F$422 million. Consequently, bank liquidity is very high: banks held surplus funds of more than F$80 million at the end of February 1988, and their liquidity position improved yet again in March.

The high level of liquidity has meant that deposit interest rates have continued to decline dramatically. The weighted average rates on deposits of F$250,000 and over fell from 20 per cent in the third quarter of 1987 to 6 per cent in the first quarter of 1988.

The impact of the devaluations of the Fiji dollar and the 1987 drought have caused the inflation rate to show a steady rise in recent months. The annual rate for March 1988 reached almost 8 per cent. It is expected to reach double figures before the end of the first half of the year and is not likely to decline before the end of 1988. An inflation rate of at least 10 per cent could well prove to be one of the most challenging problems facing the interim government. With high unemployment and those already employed suffering from shorter working hours and reduced wages, a high rate of inflation might lead to substantial industrial unrest and a deterioration in social conditions.

There are a number of reasons to be cautious about a quick return to sustained economic growth. The emigration of a sizeable portion of the managerial and business classes must have an impact on productivity, in both the private and public sectors. The successful holding operation carried out on the economy has been a tribute to the expertise Fiji has built up in economic management. Erosion of this expertise could be calamitous in the event of further political instability. The present situation is very largely a product of the 1987 political unrest. Any further conflicts could well have almost catastrophic long-term consequences.

Papua New Guinea

The five-year Public Investment Programme (PIP), included in the 1988 budget papers, places emphasis on economic growth led by smallholder agriculture. The greater priority given to investments in rural areas reflects the view of planners that economic growth has been too slow in recent years, especially in the rural areas where the bulk of the population lives. It is forecast that public investment in agriculture will increase from K31 million in 1988 to K51 million by 1992. This increase in investment will be partially offset by a decline in recurrent expenditure.

In addition to increasing investment for economic and infrastructure growth, the government plans to create a more favourable environment for private investment by adopting more flexible wages policy, deregulating, privatizing, reforming the tax structure, and giving greater credit assistance (particularly to PNG citizens engaged in agriculture). To this latter end, in January, the Minister of Finance announced the first bank credit guidelines. By 1990 two-thirds of each bank's lending must be to PNG citizens or enterprises that are 75 per cent PNG-owned. At the end of 1987, approximately half of banks' lending was to these borrowers. Further, 20 per cent of a bank's credit outstanding must be in loans to agriculture or in bonds of the Agricultural Bank. Finally, 5 per cent of all loans must be to housing for PNG citizens.

Private investment picked up strongly in the second half of 1987, with a substantial growth in commercial bank lending against a stagnant level of deposits. There is some evidence that private investment in agriculture recently has also been growing more strongly. However, such investment has been quite dismal, falling from 2 per cent of GDP in 1982 to a miserly 1.4 per cent in 1986. This compares with total private investment of 13.7 per cent of GDP in 1986.

The four major agricultural export crops - coffee, cocoa, palm oil and copra - have all experienced rising output in recent times, despite depressed world markets in 1986-87 and depressed yields caused by climate and disease. The increases in exports have been mainly the product of new plantings in recent years.

Coffee production and exports continue at record levels. Lower than average rainfall has temporarily reduced the effects and delayed the spread of coffee rust that continues to be a major threat to almost all coffee production.[5] The record export volume of 53,000 tonnes in 1986 was easily surpassed in the first nine months of 1987 (almost the full coffee production year) and there are prospects for a 60,000 tonne crop in 1988. The f.o.b. price settled at K1.7 thousand a tonne in October 1987, after starting the year at K3.5 thousand. It recovered some lost ground before slipping again in recent weeks.

Cocoa exports scaled new heights in 1987 despite a sliding world price. Unlike coffee, the price fall for cocoa continued into 1988, and prospects for a revival are gloomy at present. Nevertheless, output is expected to remain close to 34,000 tonnes in 1988, then gradually increase to 50,000

[5] See D. Shaw, M. Bourke and S. Bell, 'The coffee rust problem in Papua New Guinea', PEB, July 1986.

tonnes by the mid-1990s. Palm oil exports almost trebled between 1981 and 1986. In response to low world prices in 1986, they fell slightly from 130,000 tonnes in 1986 to 123,000 in 1987. However, the recent gradual improvement in prices should ensure that the 1988 crop is above 130,000 tonnes. A rapid recovery in copra exports, from 75,000 tonnes in 1982 to 135,000 in 1986, was halted in the wake of a depressed world market from late 1986. Copra exports for the first nine months of 1987 were only 87,000 tonnes despite a rise in world prices. Some recovery in export volume can be expected as payout prices to producers began to rise above the floor of K200 per tonne in December 1987.

Copper prices increased sharply in 1987 and continued to rise in 1988. At the same time, the volume of copper mined increased, so that revenue from this source made a strong contribution to the balance of payments. With continued exploration and development, the output of copper should rise through most of the 1990s unless there is a marked decline in final output in the industrial countries, with associated more than proportional declines in copper prices.

The gold price is well above the cost of production of mines currently operating. If it remains close to US$450 per ounce, production should continue and exploration and development leading to further increases in output should persist. This will happen even if the gold price continues to oscillate, as it did after the October stock market crash. Optimistic forecasts suggest that Papua New Guinea will become the world's fourth or fifth largest gold producer in the 1990s.

Government expenditure has not been matched by tax revenues in recent years. The difference has been covered by increased statutory dividends and withdrawals from the Mineral Resources Stabilization Fund[6] as well as the use of overdraft facilities at the Bank of Papua New Guinea, and, finally, by foreign borrowing. In 1988 Australian aid will decline further, and debt servicing increase.

Despite the reasonably good medium-term prospects, the balance of payments outlook for 1988 is uncertain. Coffee exports are likely to be well down because of stockpiling of 25,000 tonnes, or 40 per cent of the anticipated 1988 crop, to keep within the quota set under the International Coffee Agreement (although there are some prospects of increasing the quota level). By the early 1990s there should be a current account balance of payments surplus. Private capital inflows are expected to remain strong as mineral exploration and development continue. The longer run is somewhat clouded by the current increases in borrowing to finance rural capital expenditure.

The continuing high foreign exchange value of the kina is still a matter of controversy. There was a small devaluation against the reference basket of currencies in late 1987. In early February 1988, weights in this basket were altered (the exact composition and weights in this basket have never been published). This re-weighting involved a small devaluation of the kina against the SDR and the previous basket of currencies. The relatively high value of the kina has affected the competitiveness of the agricultural sector. The outcome of a devaluation for export-oriented and import-competing agricultural industries depends on a complex set of factors. These factors include many indirect (and often positive) macroeconomic and input price effects in addition to the positive direct effects on domestic agricultural export prices. Therefore, while agriculture is almost certainly disadvantaged by the high value of the kina, the extent of this disadvantage

6 Described in 'The Papua New Guinea Mineral Resources Stabilization Fund' in PEB, 1(2), December 1987.

and any probable results of a devaluation are difficult to discern.

Inflation has continued to ease, helped by the high value of the kina and moderate wage increases. The inflation rate is expected to remain below 5 per cent in 1988. The official inflation rate is calculated on the basis of a basket of goods and services decided upon before independence. The relevance of this basket to today's conditions is a matter for conjecture.

The copra stabilization funds were used up by October 1987, and the Copra Board had to resort to commercial bank loans to retain a payout price at K200 per tonne (that is still approximately K50 below the long-term average payout price). Recent increases in copra prices have enabled the Board to move back from a bounty to a levy situation in order to commence paying back the commercial bank loans.

Solomon Islands

The Solomon Islands has embarked on an ambitious development program, concentrating on the rural and resources sectors, particularly smallholder agriculture. The most important shift in development expenditure in 1988 is increased funding for the resource sectors and decreases for industry, commerce, finance, and public administration.

Recovery by the agriculture sector from Cyclone Namu has been delayed by fairly widespread drought conditions persisting until December 1987. The drought has had adverse effects on export crop yields, notably copra. Copra exports shrank to 8 per cent of total exports in 1987, a record low level except for the previous year, when output was drastically reduced as a result of Namu. Cocoa, on the other hand, was less affected by the dry conditions, with output at record levels in 1987 - almost 50 per cent above the 1986 level and almost double the 1985 level. The dry conditions also led to reduced volumes of fresh produce coming into the Honiara market, with consequent price increases. For example, in the three years to November 1987, local food prices increased at double the rate for imported food. Better seasonal conditions in recent months have led to an easing in fresh produce prices.

There has been a gradual recovery from low levels of world prices for two of the three major agricultural exports. Palm oil and copra prices are higher. However, expansion in cocoa output has occurred at a time when world output in the major producers has been rising and mid-1988 prices are only approximately 70 per cent those of a year ago.

In 1986 government current receipts (almost all being taxes on international transactions) increased by approximately 6 per cent or SI$10 million. This, together with a rise of SI$24 million in foreign aid and increased foreign borrowing enabled the government to increase developmental expenditure by more than SI$50 million. Government policies are partly based on the principle that most of these expenditures be financed by overseas borrowings, largely on concessional terms, and by foreign grants. However, some domestic borrowing was necessary to finance recurrent expenditure and development budget items not eligible for concessionary overseas loans. Total expenditure on recurrent operations is budgeted to fall by approximately 4 per cent in 1988, with similar declines in future years. Recurrent expenditure in 1987 was over 30 per cent higher than in 1986. The 1988 budget is partly based on forecasts of pay settlements that appear to be overly optimistic. Finally, 1988 is an election year.

A disquieting trend is emerging on the expenditure side. Debt financing costs will have risen from less than SI$3 million in 1986 to almost SI$16 million in 1988. These costs should continue to increase rapidly for the short to medium term at least. No less than SI$275 million worth of projects have been approved for future implementation, with funding agencies already identified. To put this figure in perspective, GNP between 1982 and 1985 was in the range US$126-143 million per annum. The Solomon Islands government will need to watch that it does not commit itself to overseas development loans that it will have trouble repaying in a few years time.

Broad money has been increasing substantially, largely because of large government deficits. In recent years there has been a large spread between bank deposit and lending rates. The government desires to increase both private domestic saving and investment, and, therefore, is exerting pressure to reduce this spread. Efforts to increase productive investment in agriculture have suffered a major setback with the poor arrears and default record of the Development Bank of Solomon Islands.

Prices, as measured by the consumer price index, have increased moderately. The index rose by approximately 6 per cent during 1987 compared with 14 per cent in 1986. This figure disguises some large differences among components. Food and miscellaneous prices increased by approximately 15 per cent, and the prices of imported goods and services rose by almost 12 per cent. This fall in the average rate follows a slowing down in the depreciation of the currency and the lessening impact of Cyclone Namu. The prospects for keeping inflation at moderate levels depend predominantly on the inflation rates in countries such as Australia that supply most of the imports. They will also depend on the capacity of the government to continue to finance any budget deficits through domestic borrowings from other than banking sources, as failure to attract this finance could lead to an increase in money in circulation.

Western Samoa

Samoa has achieved stability but not growth. The inflation rate has been close to 5 per cent in recent years. Agricultural and industrial production were both stagnant from 1984 to 1987. The limited growth in GDP (approximately 1.5 per cent per annum in these years) came mainly from the construction, electricity, transport and service sectors. The sixth development plan (DP6), covering the period 1988-90, emphasizes the need for increased self-reliance and productivity but proposes no important changes in policy. It is hard to be optimistic about the acceleration in the near future of the disappointing growth performance.

The Asian Development Bank noted in its Agriculture Sector Survey that 'though the key role of agriculture has been recognized in every development plan, the stated importance attached to the sector has not been matched with either resources allocation or performance'. In the period of financial stringency between 1982 and 1986, when total expenditures by government departments were constrained to an overall increase of less than 10 per cent, the Department of Agriculture suffered a reduction of almost 50 per cent, the highest proportional reduction of any major department.

The main agricultural policy measures in the recent past have been: (i) lending to farmers through the Development Bank of Western Samoa; (ii) an aid-funded Suspensory Loan Scheme for cocoa, whereby repayments of some crop development costs are waived upon the achievement of certain levels of crop management, yields and record keeping; (iii) the continued work with farmers of the Extension Services Unit of the Department of Agriculture; (iv) some tax incentives and input subsidies; and (v) measures implemented through the various marketing boards, such as price stabilization schemes for cocoa and copra that are at best of dubious value and some of which clearly inhibit increases in output.

DP6 suggests that a land tax be considered. Specific targets are set for plantings of high-yielding hybrid coconuts, cocoa, coffee, taro and bananas, and for increasing the size of the national cattle herd. The coconut replanting scheme is to be continued 'with added vigour' as well as schemes for expanding cocoa production and other minor crops. A national beef production strategy is also mentioned. These generally 'more of the same' prescriptions sit uncomfortably against the list of major impediments to agricultural development identified by the Asian Development Bank: high transport and marketing costs, shortage of labour in certain locations, paucity of trained and skilled manpower, general low returns on agricultural inputs that reflect low productivity, weak and inadequate pricing policies, and inadequate institutional support and over-dependency on a few export crops. In view of the evidence of the responsiveness of smallholder producers to economic incentives,[7] it is particularly disappointing to find no mention of proposals to correct pricing inefficiencies for agricultural export commodities.

Agriculture, which accounts for approximately 36 per cent of GDP, showed a 2.8 per cent annual decline in production over the period of DP5 (1984-87). Producer prices for coconuts and cocoa remained depressed in 1987, providing little incentive for expansion of production. In fact, agricultural output for 1987 was provisionally estimated to be the same as for the previous year, with taro, cocoa and beef showing increased production and copra showing a decline. Both the fishing and timber sectors also recorded lower levels of production in 1987.

Taro is a smallholder crop that has been doing well in recent years. Although exports have levelled off, the crop now takes second position behind coconut products in terms of commodity export value. Taro production has received relatively little promotion by government, thus demonstrating that the smallholder sector can respond to the economic stimulus of attractive prices.

In the commercial agricultural sector, efforts have been made to correct serious management deficiencies in the government-owned WSTEC. Losses and waste have been reduced, and there is some prospect that the corporation may break even before too long. However, there is no prospect of servicing the debt burden of some T1.5 million a year that is a legacy of past extravagant spending. The corporation may therefore be forced into a sale of assets if it is to attain overall financial viability.

There have been divergent movements in the currencies of two of the most important trading partners, the United States and New Zealand. The low rate of inflation achieved in recent months raises the possibility that the management of the exchange rate may have erred too much on the side of containing cost increases for imports paid for mostly in New Zealand dollars, to the disadvantage of exporters who generally are paid in US dollars. In other words, the currency may now be slightly overvalued against the US dollar.

Despite a small annual growth of real GDP between 1984 and 1987, export volumes fell. By 1987 the value of commodity imports was almost six times that of exports. Remittances and aid flows, which by 1987 had reached T77 million and T38 million respectively (3.1 and 1.5 times merchandise exports), sustained the balance of payments. Moreover, there is little evidence of any structural transformation of the economy that might herald sustained growth of exports in the future.

[7] See Fleming and Hardaker, 'Agricultural supply response in the South Pacific', PEB, July 1986.

Investment is currently low. It is confined mainly to the construction of hotels and a number of modest aid-funded development projects. The Central Bank has recently been making efforts to stimulate economic growth by encouraging savings and investment while restraining the rate of credit expansion to be consistent with a stable external and internal position. It has required the commercial banks to tie the level of loans to genuine long-term savings. In addition, interest rates on longer-term time deposits have been deregulated and the commercial banks have been instructed to reduce their loans to the retail sector by at least five percentage points by the end of 1988.

Performance of the industrial sector has been little better than that of agriculture. Growth in the volume of industrial production in 1987 was estimated at less than 1 per cent, although the average between 1984 and 1986 was rather better at over 6 per cent per annum. Plans for industrial development in DP6 relate, among other things, to diversification of production and encouragement of local entrepreneurship and indigenous technology. It is proposed to set up a Small Industries Centre, review the Enterprise Incentive and Joint Venture Schemes, as well as to conduct pre-investment and feasibility studies of identified industrial opportunities.

On a more optimistic note, the performance of the tourism sector continues to be moderately encouraging. Visitor arrivals and net travel earnings continue to grow. Travel earnings in 1987 were estimated to be more than two and a half times the value in 1984. Moreover, prospects for further growth are good. Renovation and improvement works are in hand at two main hotels, and there are plans for a new, large hotel. The airport upgrading to wide-bodied jet standard has been completed, creating a capacity to handle increased passenger loads in the future. Local prices remain competitive, making the destination reasonably attractive to tourists from the main sources of American Samoa, New Zealand and Australia.

Overall record surpluses in the balance of payments in 1986 and 1987 have lifted foreign exchange reserves from the equivalent of only one month of imports in early 1984 to almost six months of imports by the end of the first quarter of 1988.

Tonga

The rate of real economic growth in Tonga in recent years has also been low. The target growth rate for the entire economy in the fourth development plan (DP4) was 5.7 per cent, while the actual rate was 3.4 per cent. Agriculture, fisheries and forests recorded no growth against a target of 4.5 per cent. The rate of economic growth in 1987 slumped to almost zero. Growth in exports has been fairly sluggish, contributing to a worsening trade deficit; the balance of payments is dependent on remittances and aid flows. Investment levels and industrial growth have been disappointing. Lip service paid to the need to develop the agricultural sector has not been matched by deeds.

The fifth development plan (DP5) was published early in 1988 - almost half way into the plan period of 1986-90. It contains little that is likely to improve agricultural performance. Policy initiatives elsewhere in the economy, such as the promotion of urban-based, import-competing manufacturing, are also unlikely to enhance development. One-half of the funds allocated to agricultural development programs during DP5 are to go to extension and banana development. Without any change in the operations of the extension service it is unlikely that agricultural performance will improve markedly. The banana development program is forecast to account for 40 per cent of total agricultural development expenditure. This is an extraordinarily high proportion given the severe doubts regarding the long-term success of this program.

Export volumes generally rose during 1987. Coconut oil exports reached 5.39 million litres, the highest level achieved since milling began in 1979. Desiccated coconut exports also increased after four years of very low production. Banana and vanilla exports showed benefits from development projects and high export prices. Because of continuing denial of access to the New Zealand market caused by quarantine problems, watermelon exports were negligible. Only three years before they were second only in value to coconut oil exports.

Exports of 17.85 tonnes of vanilla beans were almost 40 per cent higher than the previous highest level in 1984. The current situation in the world vanilla market is rather difficult to determine. There is a strong chance that high stocks and a good harvest in the major producing country, Madagascar, could greatly reduce the market power of the vanilla cartel, Univanille, and lead to a substantial fall in world prices. As the producers are highly price responsive, lower prices brought about by the removal of the price subsidy could reduce banana exports.

Two disturbing trends in the economy are the widening trade deficit and the rate of inflation. The ratio of the value of commodity imports to commodity exports in July 1987 was 10.8. Even allowing for unusually large imports of capital goods during the month, the figures reveal underlying structural weaknesses in the external position. As in Western Samoa, this condition is made possible by continuing high remittance and aid flows that have kept the balance of payments in a reasonably healthy position. A provisional record balance of trade deficit in 1986/87 of over 41 million pa'anga was offset by inflows of almost 9 million pa'anga from tourism and almost 31 million pa'anga from remittances. A balance of payments surplus is expected for 1986/87, the first since 1981/82.

The latest consumer price index figures (first quarter 1988) show that inflation is almost 16 per cent per annum compared to 10 per cent in the fourth quarter of 1987.

Tuvalu

The A$27 million Tuvalu Trust Fund has made its first contribution to the government's recurrent budget deficit. The Japanese government is to contribute US$500,000 to the Fund through the UNDP.

With Tuvalu declared a 'least developed country' by the United Nations, work is well underway on a A$1 million water program to improve household water supplies on all islands of the Tuvalu group. A team of Japanese officials have been in Tuvalu recently studying a large community fisheries project.