



Current economic trends in the South Pacific

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Fiji

The Fiji economy has in the past three years run into severe difficulties stemming from problems in consolidating the initial burst of economic growth and structural change that followed the 1987 coups. Diminishing foreign exchange reserves, capital flight and accelerating unemployment after the coups led to an effective devaluation of 50 per cent, controlled wages and the introduction of a system of tax free factories. These factories, concentrated principally in the garment industry, were mainly owned by local interests or operated with Australian / New Zealand joint ventures.

The post-coup period saw perhaps the most impressive spurt of economic growth since independence. Real GDP grew by 12

per cent in 1989 and by 4.8 per cent in 1990 and employment in the manufacturing sector rose sharply from 14,000 in 1989 to nearly 20,000 in 1990.

However, this growth has been short-lived. Since 1991 new manufacturing investments in Fiji have been slow and a continual flow of applications to the Fiji Trade and Investment Board has not resulted in an equivalent number of new projects.

The declining competitiveness of Fiji's economy has been compounded by a further appreciation of the real effective exchange rate index by over 15 per cent since 1988 and an inflation rate above its major trading partners. The estimated inflation rate for 1993 is 5.6 per cent, up from 4.9 per cent in 1992, partly the result

of the VAT introduced in 1992 and the effects of cyclone Kina in 1993.

Since 1975, the largest export, sugar (which in 1993 accounts for almost 40 per cent of Fiji's estimated exports), has mainly been exported to the United Kingdom at between two to three times the world price. Over the last 8 years the ECU price of sugar from countries covered by the Lomé agreement, the African, Caribbean and Pacific (ACP) countries, has been decreasing. The steady fall of the British pound against the ECU and the decline of the Fiji dollar against the British pound has led to an increase in the dollar denominated value of Fiji exports to the United Kingdom. Over the last year the depreciation of the Fiji unit against the ECU has slowed and as a result the value of sugar exports to the United Kingdom has stagnated. Unit values of sugar peaked in 1991 at F\$617 per tonne decreasing to an estimated F\$556 in 1993 and a projected price of F\$590 per tonne in 1994. Producer prices for sugar cane peaked in 1992 at F\$55 per tonne and decreased to F\$39 per tonne in 1993.

With the closure of the Uruguay Round, European Community prices to ACP sugar producers are expected to decline by at least 20 per cent, though the sugar industry predicts a 35 per cent decrease by the end of the century. What is more problematic for the future Fiji's sugar industry is that with the common agricultural policy, the EC has become a major net exporter of sugar. While the Lomé Convention's sugar protocol is not subject to revision it is highly probable that the European Community will attempt to reopen the issue when negotiations for Lomé V begin towards the end of the century.

The tourism sector has continued to expand, with 1992 arrivals increasing by 7.5 per cent to 278,500 and earnings up 15 per cent on the previous year to F\$328.5 million. Official government estimates indicate that by the end of 1993, tourist

arrivals will reach 290,000, and climb to 295,000 by 1994. 1993 earnings from tourism are expected to reach F\$355.1 million. Recently the industry has complained of relatively low occupancy rates in hotels. This follows a decline in its traditional markets of Australia and New Zealand although tourist numbers from Japan and the United States have increased. The lack of direction in government policy is of concern to operators in the industry.

The 1994 Budget, tabled in Parliament in early November, resulted in a storm of protest forcing the government to revise its Appropriation Bill. The political stability of the present government has been in question since the publication of the Kermode enquiry indicating *prima facie* evidence of wrongdoing by the Prime Minister in an out-of-court settlement for the wrongful arrest of a Fijian businessman. The report has been sent for judicial review, which is expected early in 1994.

When the 1994 Budget was put to the vote in the House of Representatives at the end of November, the Appropriation Bill was defeated. In accord with convention, the Prime Minister offered his resignation to the President.

In the apparent absence of an alternative leader who could command a majority of elected representatives in the House, the President agreed to a dissolution of Parliament to take effect 19 January 1994.

The Constitution provides that in the event of the defeat of an Appropriation Bill, the Minister of Finance may draw on the Consolidated Fund for a period of four months to meet costs associated with the operations of government. This section has been invoked and by implication a fresh budget should be presented to a newly elected parliament by the end of April (within four months of the new financial year).

An election can be expected to take

place by the end of February which will allow a new Minister of Finance some two months to prepare a budget. Given that approximately 90 per cent of the budget relates to non-discretionary expenditure (public service salaries and operating costs), the next government cannot expect to introduce too many innovations in its first appropriation bill.

The 1994 Budget proposed a near doubling of the projected 1993 deficit from 2.5 per cent of GDP to an estimated 4.8 per cent or F\$105 million. In reality the deficit is likely to be closer to 5.5 per cent of GDP as a result of a massive unbudgeted increase in spending by the Fiji Military Forces (which overspent by F\$10 million in 1993), the effects of cyclone Kina and VAT under collecting of some 13 per cent. A wage increase in the public sector of 5 per cent (rather than the 4 per cent projected in the 1993 Budget) has also contributed to the 1994 deficit, projected to be 3.7 per cent of GDP. Estimated total debt as a percentage of GDP will be 45 per cent (F\$1.031 million) by 1994.

The budget was accompanied by several revenue raising measures, including an increase in basic import duty rates from 7.5 per cent to 10 per cent. Import licences on rice, canned fish and skimmed milk have been replaced by tariffs, in line with government policy to deregulate these industries in advance of GATT membership which has now been formalised. The government also increased import duties on fuel.

The government is proceeding with its policy of deregulation and privatisation of the economy at a mixed pace. While moving to deregulate rice, dairy and canned fish sectors the government has also moved to lower tariffs on many of the goods that were protected in the pre-1987 era: tariffs on clinker and cement have been reduced from 35 to 30 per cent, toothpaste from 30 to 25 per cent and tyres from 35 to 30 per cent.

Exchange control regulations have been

relaxed. Exporting firms may retain 10 per cent of export earnings in foreign exchange accounts, travel allowances have been increased to F\$6,000 per applicant, individual off-shore portfolio investments of F\$5,000 are possible and companies may remit F\$5 million profits per annum.

While the budget clearly reiterated the government's intention to privatise several state-owned enterprises, practice has tended to differ substantially from policy pronouncements, for example the recent failure to privatise the Ports Authority of Fiji.

While international trade liberalisation is affecting the value of Fiji's two main exports, sugar and garments, development of mineral extraction may alter the development path of Fiji in the early part of the next century. Placer Pacific, the developer of the Porgera and Misima gold mines in Papua New Guinea, has expressed an intention to develop the Namosi copper deposit, located some 35 kilometres from Suva. If the mine comes into production late this century it will be the largest copper mine in the Asia-Pacific region. The value of exports from the mine is expected to be in the vicinity of F\$500 million per annum and the creation of 1000 jobs is anticipated.

The mine is expected to earn 50 per cent of Fiji's exports prompting debate as to what taxation regime will be employed. The Minister of Finance in his budget speech suggested that an appropriate taxation regime should be based on two principles

- the country must be compensated for the loss of an irreplaceable asset and
- the country (as well as the company) should benefit from windfall profits through cyclical high mineral prices.

More significantly, the Minister mooted the possibility of sterilisation of the revenue from the mine, possibly by setting up an overseas investment fund into which the majority (if not all) of direct revenues are

paid. The benefits of such a fund should, in the Minister's view, flow to future generations.

The mine also presents the Government of Fiji with its most serious environmental problem: the disposal of tailings waste from the concentrators. Placer is proposing to dispose of approximately 100,000 tonnes of tailings per day in the Beqa Passage at depths of between 100 and 200 metres. What damage this may cause to the marine environment is unknown. The company has ruled out the possibility of land disposal. Other environmental problems, such as acid rain, may be a threat if the company goes ahead with electricity generation from Indonesian coal.

Papua New Guinea

Papua New Guinea continued to exhibit impressive growth rates in 1993 with real GDP expected to increase by 14.4 per cent. However, the petroleum-led boom of the last two years has in effect come to an end with oil production peaking at the Kutubu oil fields in 1993 with exports of 47 million barrels. Production in 1994 is expected to be 42 million barrels resulting in a projected 0.6 per cent decrease in real GDP. The negative projected growth rate is a result of contractions in the mining and petroleum sectors of 6.1 per cent and 24.7 per cent respectively. It is expected that there will be low real GDP growth rates in 1995 and 1996 (0.8 per cent and 1.1 per cent respectively) until the Lihir gold mine comes on stream in 1997 when growth is expected to rise.

The government is projecting rapid growth rates of non-mining GDP in 1994 and 1995 of 7.1 per cent and 6.6 per cent in real terms. However this growth stems in large measure from the construction sector which is expected to increase by 41.5 per cent and 35.8 per cent respectively for 1994 and 1995. This rapid growth is postulated on the commencement of the three-year construction phase of the Lihir project in

the second quarter of 1994. Clearly, the main factor likely to generate real growth in the coming years remains the rate of development of the petroleum and mining sectors.

The balance of payments situation reflects developments in the mining and petroleum sector. Papua New Guinea's substantial merchandise trade surplus of 876 million kina in 1992 is expected to rise to 1,258 million kina in 1993. The actual merchandise trade results for the first half of 1993 confirm the government's projection. However, despite an overall merchandise trade surplus in 1992, there was a substantial deficit on services and the beginnings of a capital account deficit which peaked in 1993 as oil and mining companies paid off their debts from the Porgera and Kutubu projects. The 1992 capital account deficit of 38 million kina is expected to rise in 1993 to 306 million kina, largely the result of a minerals-related outflow of 586.4 million kina. The capital account is expected to return to a surplus by 1995.

The overall foreign exchange reserves declined by 81 million kina in 1991 and 68 million kina in 1992. As a result, Papua New Guinea's foreign exchange reserves have declined steadily despite the minerals boom. Government officials point to the liberalisation of exchange control regulations in 1992—under which firms are able to move 500,000 kina without reference to the Bank of Papua New Guinea—as partially responsible for the decrease in reserves. Moreover, commercial banks have been allowed to hold foreign exchange, resulting in a movement from public to private foreign exchange holdings.

At the end of 1985 the country had enough foreign exchange to cover nine months of non-mineral imports of goods and services. Since then there has been a sustained decline in foreign exchange holdings so that by the end of the second quarter of 1993, the last date for which

information is available, non-mining foreign exchange reserves stood at only 1.8 months cover. Government officials indicate that this is expected to be the low point of reserves and project a recovery to 2.6 months cover by the end of 1993. The government projects a steady increase in foreign exchange holdings over the next few years to reach 6.1 months cover when the Lihir mine begins operating in 1997. These projections are predicated on the assumption that there is no disruption of production at any of the mines or oil fields in the coming year and that budget projections on government spending are accurate.

The country continues to maintain a policy of pegging the kina against other currencies. Following the 10 per cent devaluation in 1991 after the Bougainville crisis and the ensuing structural adjustment program, there have been no major adjustments to the currency. Papua New Guinea does not compile a real effective exchange rate index which would give some indication whether the kina has appreciated in real terms.

Oil production and export are of major importance to Papua New Guinea but still take second place to minerals. Even in 1993, the value of oil exports was still below the value of mineral exports. Together, oil and minerals now constitute 79 per cent of Papua New Guinea's total exports. Developments in mining are encouraging despite a year in which a major confrontation occurred between the mining companies and the government. The most important development is the intention of Rio Tinto Zinc to proceed with the development of the 600 million kina Lihir project. In 1992 total exports of gold were at an all time high of 71 tonnes, up from 61 the previous year. The huge and unexpected increase in gold production from the Porgera mine, which produced 46 tonnes of gold in 1992, prompted the Government of Papua New Guinea to demand a reopening of negotiations with the Porgera joint venture. The

renegotiation resulted in a temporary devaluation of all Papua New Guinea stocks on the stock market. The government finally renegotiated an agreement in which its stake in the mine was increased to 25 per cent from the previous equity stake of 10 per cent. Gold production at Porgera for the first 9 months of 1993 had decreased to 27 tonnes. The Wingti government has indicated its intention to continue to seek the maximum possible equity in future mining projects. Under the terms of the Mining Act this is set at 30 per cent. The Act permits the Papua New Guinea government to purchase equity at sunk cost rather than at market value, resulting in the equity position being taken at a discount to the market valuation.

Due to decreasing head grade at the Porgera mine, gold production has effectively peaked and gold exports from Papua New Guinea will decline until the Lihir mine begins production. Gold output is expected to decrease to 60 tonnes in 1993 and continue to decrease to 50 tonnes per annum by 1997. Lihir, with a minimum expected mine life of 30 years and what may ultimately be 50 years, will assure that Papua New Guinea continues to be a major gold producer well into the next century. The Misima gold and silver mine continues to produce, with an expected further life of 7 years. Estimated copper production from the Ok Tedi mine increased sharply in 1993 to around 200 thousand tonnes from 193.4 thousand tonnes in 1992: production is expected to stabilise at approximately 180,000 tonnes until 1997.

While mineral production from known and viable deposits is continuing, several companies are re-examining important deposits that had previously not been considered to be economic. Most significantly Highlands Gold is re-examining the copper/gold deposits on the Frieda River, a tributary of the Sepik. In recent drilling the company recorded intersections at 4 per cent copper and 4 grams/tonne gold. This has raised the

expectation that this deposit may be developed in the future. Of potentially equal importance is the fact that Highlands Gold is also re-examining the Ramu nickel/chromium deposit which has never been developed because, like the Frieda River deposit, it was considered to be too low grade for development purposes. There are number of small gold deposits that are likely to be developed. The most significant is the Tolukuma deposit in Central Province along with prospects at Wild Dog, Wapolu, Woodlark, Tabar Island, Kaihantu and Laloki, any of which may be developed before the end of the century.

While mining has been the engine of the Papua New Guinea economy's growth for the past two decades, exploration for new deposits has decreased dramatically over the last few years. The peak of over 200 active exploration licences has decreased to an estimated 70 licences in 1993. This is mirrored in a decrease in exploration expenditure. However, given the massive exploration boom of the 1980s it was doubtful that such levels could be continued indefinitely.

The second most important export sector for 1993 has been petroleum. Petroleum production from the Kutubu field peaked in 1993, just six months after production commenced. While production from the field is likely to continue for 12-15 years it is expected to decline by approximately 20 per cent in 1994. Oil production in 1993 peaked at 47 million barrels with an expected export revenue of 848 million kina, up from 21 million barrels in the first year of production with an export revenue of 301 million kina. Oil production is scheduled to decrease gradually to 30 million barrels by 1997. What may ease the transition of the economy is the continued exploration of minor fields in the Southern Highlands. The most significant of these is the SE Gobi field—a small field with proven reserves of between 30 and 50 million barrels of oil. Given its relative proximity to the existing pipeline this otherwise sub-economic

deposit is likely to come on stream in 1996. One other prospect that is likely to reach the development stage before the end of the century is the SE Menanda structure, only recently drilled but already quite promising.

Despite a significant oil field being developed in Papua New Guinea there has been a substantial decrease in exploration expenditure and in the number of wells drilled in the last few years. In 1989 when exploration peaked there were 27 exploration wells drilled. In 1992 this declined to 7 wells and to 4 in 1993. Expenditure on exploration paralleled this decline with a decrease from 225 million kina in 1990 to an estimated 60 million kina in 1993. With Papua New Guinea actually losing its share of world exploration expenditure this decline is not simply a cyclical phenomenon. Given that the continuation of the current level of GDP per capita is reliant upon the continuation of oil developments, this decrease in exploration, in a province that is geologically promising, should be of concern to the government. It is widely felt by industry sources that drilling will increase in 1994 though it is likely to remain well below the levels of the exploration boom of the 1980s.

Several developments in Papua New Guinea's huge gas potential have occurred recently. At present, possible reserves of gas are in the vicinity of 20 trillion cubic feet for the country as a whole. The most significant development has been the entry into the BP led consortium on the Hides structure of the Japanese company Marubeni and Esso. Both have substantial interest in liquid natural gas (LNG) and there is every likelihood that a major development of LNG will occur. However, based on the experience of other countries this is unlikely to begin before the early part of the next century. The other significant development has been the entry into the exploration arena of another large Japanese firm, Nissho Iwai. Nissho has joined Mobil in the huge Gulf of Papua

field at Pandora reef indicating that with time Papua New Guinea is very likely to become an exporter of LNG to the Asian market. This will mean that exports in the vicinity of over 500 million kina per annum can be expected from a field of 7 trillion cubic feet, considered minimal for the development of an LNG facility. Total known reserves at Pandora are presently 2 trillion cubic feet but this is expected to increase dramatically with further exploration of the various reef structures in the area. This gas field has the 'advantage' of being offshore. In most countries this is viewed as a disadvantage as it substantially raises costs. However, in the case of Papua New Guinea, this lowers the risk attendant to such developments from disruptions by landowners.

It will be necessary for the government to enact new legislation to deal with gas development as the existing taxation and fiscal regime is considered to be inappropriate to give the necessary incentives to develop a project which will require an investment in the vicinity of US\$10 billion. Should the project proceed it will give Papua New Guinea the long-term financial stability it requires as such projects are normally of 20-25 years duration. The government has engaged consultants to prepare a White Paper on gas policy in 1994.

Without doubt the most important and difficult problem confronting the Papua New Guinea government is how to use non-renewable financial flows to the benefit of the renewable sectors of the economy. Three sectors in particular may need to draw upon the revenues from the minerals boom to provide subsidies to accelerate development. The sector with the most immediate revenue implications is currently the tree crop sector which the government of Papua New Guinea has been subsidising through agricultural stabilisation funds. Under the present scheme the government has guaranteed a producer price from 1992 until 1997. The price is set at 2,300 kina per tonne for

Y grade coffee, 1,300 kina per tonne for cocoa (delivered at store), 250 kina per tonne for copra (main depot) and 26 kina per tonne for palm oil (fresh fruit bunch). Actual export prices received in June 1993, the last month for which such data is available, are 1,387 kina for coffee, 257 kina for copra and 805 kina / tonne for cocoa.

As a result of these differences between export prices and the price paid to farmers, the cost of subsidies to copra, coffee, cocoa and palm oil were budgeted to be 30 million kina in 1993. Actual expenditure is expected to be approximately 50 million kina because of the very low commodity prices experienced in 1993. The government has budgeted an extra 55 million kina for 1994 in price support for the tree crop sector. The government remains committed to the use of mineral revenues to support agricultural exports and production during the current period of low prices. The difficulty with this strategy is that the World Bank has projected that commodity prices will increase only slightly over the rest of the decade and an adherence to this policy may necessitate ongoing subsidies once oil revenues have been depleted.

The government is also endeavouring to develop food production for import substitution. While market gardening has been encouraged with mixed success there is still the possibility that the government will proceed with domestic rice production despite strong criticism of the policy from international aid agencies and development banks. The establishment of a grain and rice development authority is being considered, with a view to substituting 50 per cent of imported grains with locally produced substitutes. In the livestock sector the government is actively considering the re-introduction of a system of import quotas on beef to stimulate the development of the nation's livestock industry. Under the plan the government is proposing to permit imports of beef products on a 3:1 basis. Papua New Guinea has no obvious commercial

advantage in either livestock production or rice growing. A recently signed trade agreement with Vanuatu permitting the duty free export of beef to Papua New Guinea poses further problems for the beef quota.

Regrettably, malfeasance in the logging industry appears to continue with government officials indicating that log theft, along with the more common forms of trade malpractice, appears to be becoming common. In response to the failure of regulation in the industry the government has decided to contract the Swiss company Société Général de Surveillance to monitor the logging industry in the country. The company will be paid US\$2 million.

The government announced recently that it has granted monopoly rights to can mackerel in Papua New Guinea to the Malaysian company FIMA which is proposing to establish a mackerel cannery in Lae. The company has been granted a market monopoly. There are other proposals for the development of mackerel canneries in the country as part of an import substitution policy. One of the more encouraging developments has been a joint venture between Z Fisheries, a major US purse-seining company, the IFC and the CDC. This 55 million kina facility in Alexishafen in Madang Province expects to export tuna worth 80 million kina to the United States and the European Community markets under the terms of the Lomé Convention. This is without doubt the single most important manufacturing development in Papua New Guinea for the last ten years and reflects the country's natural advantage in tuna. In normal fishing years 40 per cent of the region's tuna is caught in the Papua New Guinea exclusive economic zone. Papua New Guinea also has the advantage of abundant supplies of fresh water, essential to the development of a cannery.

In 1992 the government budgeted for a

deficit of 51 million kina: the actual deficit was 233 million kina (5.6 per cent of GDP). In 1993 the situation was also serious with a budgeted deficit of 162 million kina, now estimated at 235 million kina (4.7 per cent of GDP). The 1993 actual deficit is forecast to be as high as 315 million kina. In 1994 the projected budget deficit is estimated to be 242.8 million kina (4.7 per cent of GDP).

Moreover, the Minerals Resource Stabilisation Fund (MRSF), originally intended to buffer the economy and the budget from revenue fluctuations occurring as a result of the oil and minerals boom of the last two years, has been effectively destroyed due to changes to legislation that occurred in the late 1980s under the previous Wingti/Chan government. The government is now virtually able to draw down as much of the MRSF as it sees fit. In 1993 with injections into the MRSF of 264.1 million kina the government drew down 248.6 million kina to cover revenue shortfalls caused by the tax decrease. In 1994 the projected injections will peak due to lagged payment of dividends and taxes from 1993 at 318.6 million kina and the government will draw down 193.8 million kina. By the end of 1993 the MRSF, after two years of peak oil and gold production, has a balance below that of 1989—the last year of operation of the Bougainville mine.

Budget expenditure has increased by 9.4 per cent for 1994 and is projected to total 1,633 million kina. Expenditure as a proportion of GDP is expected to rise from 30 per cent in 1993 to 31 per cent in 1994. Expenditure by national departments will increase from 564 million kina in 1993 to 684 million kina in 1994. At the same time provincial government spending will be drastically cut from 160 million kina to 125.8 million kina. What is perhaps the most disturbing trend in government expenditure patterns is the decline in the proportion of capital expenditure to total expenditure. In 1992 projected capital spending was expected to be 16.6 per cent

of total expenditure or 196 million kina but the actual expenditure was 165 million kina or 12.1 per cent of total expenditure. Thus, in a year where the deficit blew out to 5.6 per cent of GDP, the government could not manage its capital expenditure program to reach budgeted levels. The government has also instituted a free school subsidy which will cost 33 million kina in 1994; this is funded in part by a 9 million kina reduction in existing school programs.

Capital expenditure is projected to decline as a percentage of total government spending to 13.1 per cent in 1994 from a 1993 budgeted level of 15.3 per cent.

Tax revenues are expected to rise by approximately 10 per cent in 1994 to 1,023 million kina. This rather substantial increase is a result of the delayed and secondary impact of the mining boom on tax revenues. Direct budgetary support from Australia is declining and is estimated to constitute 11 per cent of total revenues and grants in 1994. It is expected to drop to 95 million kina by 1997, representing 6 per cent of total revenue and grants. The government has introduced several tax measures in the 1994 Budget including a 3 per cent increase in the export tax on logs. The system of forestry taxation is scheduled to change to a stumpage basis from 1994. The government has also repealed the gold export tax and has relaxed duties on the import of mining exploration equipment. This is designed to give encouragement to mining exploration which has been in decline over the last few years. The government has raised excise on locally produced spirits to eventually bring it into line with the beer excise. The government also eliminated the specific gains tax on large share transactions.

On the environmental front there is concern by the government in a number of areas. The Department of Environment and Conservation has recently taken over the monitoring of the Ok Tedi project which in 1993 attracted heavy criticism from Australian conservation groups for its

dumping of tailings into the Ok Tedi and Fly Rivers. What will be important is whether the government will permit the riverine disposal of tailings and waste at the Frieda River project in the Sepik Basin. The Sepik River does not have the water volumes of the Fly and the potential impact on the environment of this method of disposal is far more damaging.

The Department has established a mine monitoring unit and has also expressed concern over such areas of the environment as the use of explosives in fisheries and the rapid rate of soil degradation in areas of high population density. In forestry the government's ability to monitor the activities of logging companies has been enhanced by the National Forestry Conservation Action Plan.

Solomon Islands

The Solomon Islands economy continues on an unsustainable growth path despite an impressive growth rate in 1992. Solomon Islands, with its heavy reliance on logging, is one of the few countries in the Pacific conducting an economic policy that is clearly and indisputably unsustainable even in the medium term. The current policy of permitting rates of log harvesting well over maximum sustainable yield is both environmentally and economically unsustainable.

In 1992 declared log exports at 553,000 cubic metres were almost double the maximum sustainable yield. Few firms in Solomon Islands have been operating at anywhere near their legal quota and are in a position to substantially increase volumes from their existing licences if they so choose. Under licences issued before 1991 it is possible for logging firms to increase output to 1.3 million cubic metres per annum. Partly in response to the perceived widespread abuse of the forest industry the government has raised taxes, a measure which encourages firms to understate their log export volumes.

Assuming the government makes no change to current logging practices the forest resource is likely to be exhausted in ten to fifteen years—an expansion to levels permitted by existing licences will deplete the resource within eight years. Despite an official moratorium on further log permits business community sources suggest that three logging permits to village-based producers have been issued recently.

There can be no doubt that the rate of logging in the Solomon Islands represents the nation's most serious environmental and economic problem. It is also arguably the region's most serious short-term environmental problem and deserves urgent attention from the aid donor community.

The recently elected government appears to have recognised the need for structural adjustment and appears likely to introduce a much needed International Monetary Fund structural adjustment package in the next year. At present, foreign exchange reserves are sufficient to cover 1.1 months of imports (September 1993) and while this is up from the lows of two weeks import cover in the June 1992 quarter, it is clearly inadequate.

Growth rates in 1992 were exceptionally high at 8.2 per cent in real terms, mainly due to an almost doubling in the value of log exports as well as a substantial increase in agricultural exports. While log prices on Asian markets appear to have peaked in the second quarter of 1993, a continuation of the expansion in the volume and value of log exports is expected.

Real GDP growth rates in 1992 and 1990 were 3.2 per cent and 2.3 per cent respectively and below the 3.5 per cent rate of population growth. Even with the rapid growth of 1992, the real GDP per capita (SI\$762) is only slightly higher than the 1981 level.

The Solomon Islands dollar appears to

have stopped its rapid appreciation in real effective terms over the last three years. The real effective exchange rate index stood at 156.2 at the end of 1992 (1985 = 100) increasing by only 3 points since 1990. The terms of trade in the Solomon Islands have improved slightly in the last year but the 1992 terms of trade index stands at slightly over half the 1985 level.

The principal export from Solomon Islands was for many years tuna from the state-owned joint venture with Taiyo Gaigyo. Fish exports are now secondary to log exports. In 1992 the total catch was 33,767 tonnes down from 43,082 tonnes the previous year. Tuna prices increased in the beginning of 1993, and rose sharply by the third quarter to their highest level since 1989. Solomon Taiyo expects the total catch for 1993 to be approximately the same as in 1992. The company underwent major restructuring in 1993 and with the consolidation of its debts, the firm is expecting to make an operating profit in 1994. The company is also expanding its existing canning facilities at Noro in Western Province with employment likely to rise to 2,600 from the existing level of 2,000.

The agricultural sector in Solomon Islands exhibited considerable growth in 1993 despite the continuing drastic decline in copra production volume of 22,890 tonnes, almost half the 1985 peak of 43,557 tonnes. In part the decrease in copra production in the last three years has been caused by coconut oil crushing which has seen a rise in production to 2,499 tonnes in 1992. Production of palm oil expanded from 21,735 tonnes in 1991 to 30,540 tonnes in 1992. Palm kernel production and cocoa production have remained stagnant. Levers has expressed its intention to sell its 60 per cent interest in its Unilevers copra plantations in the Solomon Islands. It is expected that a portion of the land (which lies between Honiara and Henderson Field airport) will be used for residential and

commercial subdivision.

The tourism sector in Solomon Islands has been declining for almost a decade with no growth in visitor arrivals except for a spurt in 1992 when arrivals rose to 17,000, to celebrate the 50th anniversary of the battle of Guadalcanal. While the government prepared a tourism master plan in 1989 and planned for 72,000 visitor arrivals by the year 2000 there has been no serious effort to implement the plan through foreign investment.

Perhaps as spectacular as the increase in growth led by logging has been the parallel increase in imports over the same period. In the first three quarters of 1993 imports rose by 57 per cent, as opposed to 43 per cent for exports. There are several reasons offered for the growth in imports. The logging boom has led to a massive increase in imports of machinery and equipment. The decline in the value of the Australian dollar, the low rate of inflation and the removal of the import levy has led to a positive price effect.

Manufacturing remains a minuscule portion of the economy though wages are low by regional standards—the wage for an unskilled factory worker is in the vicinity of SI\$200 per month. A new Korean garment factory is exporting to the United States under quota. Manufacturing around Honiara has increased marginally with the recent opening of a brewery: furniture manufacture and light metal fabrication is beginning.

Inflation eased substantially in 1993 with rates down to 5.4 per cent in the third quarter, the lowest rate since 1977. Despite the dramatic decrease in inflation, interest rates remain high. The weighted average lending rate at 16.23 per cent is down only 2 per cent since the beginning of the year. As a result, real interest rates are now at their highest level since the mid-1980s. While the spread between nominal deposit and nominal lending rates has decreased, it

remains large at approximately 9 per cent. In the banking sector there have been few changes though the Bank of Hawaii is negotiating with the National Bank of Solomon Islands to replace the Australian Commonwealth Bank as associate bank. The Commonwealth Bank has no other operations or affiliations in the South Pacific.

The government of Solomon Islands maintained a policy of running substantial budgetary deficits. In 1992 the estimated deficit was 12 per cent of expenditure. In 1991, the last year for which actual figures were available, the deficit was 28 per cent of actual expenditure. Overruns in current spending totalled 4.5 per cent of GDP in 1990 and 4.2 per cent in 1991. In large measure the deficit has been caused by substantial increases in wages in the public sector of 17.5 per cent in 1989 and 16.5 per cent in 1991. Between 1987 and 1990 there was a 25 per cent increase in real private consumption outlays. This was caused in no small measure by the increase in real wages in the public sector. Overall government deficits were generally not as large as expected because of underspending on the capital budget. Since 1987 there has been a shift in government policy with an increased emphasis on domestic borrowing to finance the deficit. Virtually the entire deficit in 1991 and 1992 was financed domestically.

Tonga

The Tongan economy experienced a drop in output of 3.9 per cent over the years 1991/93 as a result of drought, but is expected to grow by around 4.85 per cent in 1993/94 largely due to increased levels of activity in agriculture, construction and tourism. The economy is dominated by the primary sector with agriculture, forestry and fishing generating around 40 per cent of GDP in 1992. The manufacturing and construction industries are relatively small contributing

4 per cent and 5 per cent, respectively, to GDP in the same year, while public administration accounted for 10 per cent of GDP. Merchandise imports were equivalent in value to 45 per cent of GDP in 1992, but exports were much smaller at only 9 per cent. Both visible and invisible trade have been in deficit in recent years. Net private inward transfers (remittances) usually cover the larger part of this deficit (78 per cent in 1992/93), the balance being covered by net official transfers. Gross inward remittances alone were equivalent to 38 per cent of GDP in 1992/93, while total (gross) unrequited transfers were equivalent to just over 50 per cent of GDP. These figures in large measure explain the high 'Human Development Index' value achieved by Tonga despite its relatively modest per capita GNP.

As is usually the case with very small countries, economic progress in Tonga is fragile and hinges on changes in the values of a small number of items. Specifically, the export sector is dominated by sales of squash, of which 10,000 tonnes were sold in 1992. An increase to 13,000 tonnes is projected for 1993 and will be largely responsible for a 30 per cent expansion of exports (at 1992 prices). Conversely, in manufacturing, the continued decline in international competitiveness, coupled with problems experienced by exporters in adapting to supply the domestic market, is expected to lead to a fall in export sales. The decline in exports of manufactures may just be offset by increases in domestic sales, but this is by no means a certainty. Construction is moving ahead strongly on the basis of a number of major projects (the new Reserve Bank Building, the Neiafu airport terminal, the Eua High School, the Queen Salote Memorial Hall) and an expansion of 12.7 per cent is predicted for 1993/94. Further growth of tourism is expected at approximately 5.4 per cent over the year. Finally, spending on public administration is expected to be static, or very close to it.

The 50 per cent increase in remuneration of public sector employees in 1989/90 triggered rapid inflation. The rise in the consumer price index peaked at 13.3 per cent in 1990/91, the local component of the index rising by 17.6 per cent in that year. Expenditure restraint eventually brought the situation under control, but the severe and prolonged drought of 1992 led, for a time, to a return to rates of inflation in excess of 10 per cent per annum. With aggregate supply and demand now in approximate balance, a rate of inflation of around 3 per cent is forecast for 1992/93, roughly in line with rates in Australia and New Zealand.

Following the sharp increase in inflationary pressures released by the 50 per cent public sector pay rise and the drought, restrictive fiscal and monetary policies have enjoyed considerable success. Indeed, the consolidated (recurrent plus development) budget recorded an overall surplus of 2 million tala in 1992/93 rather than the anticipated deficit of 2.2 million tala. This was the result of a cut in 'current' (non-development) spending (which fell by 8 per cent in real terms in that year and was lower than the planned level) and by effective action to improve revenue performance (revenue rising by some 20 per cent over the year and exceeding the budget target by 2.4 per cent, this being entirely due to better than expected tax revenues). Government deposits in the banking system increased and the inflation rate was actually zero over the twelve months ending October 1993. Partly in response to this, the economy rebounded, with an increase of around 3.7 per cent in real GDP, an improvement in the balance of payments and significant expansion of international reserves.

At the same time, only very limited progress has been made with the longer term budget aim of deregulation of the economy. Some price controls and state monopolies have been eliminated, and the performance of certain public sector

enterprises has improved—but much remains to be done in this respect.

Despite these achievements, there is still cause for concern over the immediate future of the Tongan economy. The third quarter of 1993 saw rapid deterioration in the external reserve position by nearly 10 per cent to only 6 months import cover and a sharp rise in the rate of inflation. Moreover, it is now apparent that serious problems are being experienced in reaching budget targets. Revenue performance was poor in the first quarter of 1993 and this, together with recently approved supplementary expenditure, means that a substantial deficit is expected in 1993/94 in contrast to the surplus of 1992/93. One direct consequence of these developments is that the government is turning to the banking system for finance, thus increasing the risk that private sector investment will be crowded out and the program of privatisation adversely affected. The five-yearly public sector wage review is due in 1994/95, and given the increasing numbers of public servants, lack of restraint over the review could have very serious consequences.

In the immediate future, the anticipated shift from surplus to deficit, with its attendant adverse implications for growth, may be moderated by adoption of a vigorous policy of expenditure cutting. One approach is to decrease public sector employment, which has expanded considerably in recent years. While cutting current expenditure, this would also release human resources to the private sector.

Lastly, it is understood that it is important that monetary policy reinforce the aims and achievements of budgetary policy. Specifically, current monetary conditions in Tonga require that interest rates be sufficiently high to yield positive real rates in order to avoid loss of funds to neighbouring countries. At the same time, while ensuring that adequate credit is

available to permit rapid expansion of the private sector, excessive liquidity should not be allowed to lead to a return to earlier inflationary conditions and the loss of international reserves.

Extensive deforestation and progressive encroachment onto fragile coastal areas for agricultural and residential purposes are not adequately dealt with at present. More effective land-use planning and management are clearly required if groundwater supplies and inshore fisheries are not to deteriorate further. Additional provision is also required for safe and effective disposal of solid and toxic waste. However, the most urgent current priority is the need for improvement of urban drinking water, which has been subject to potentially serious contamination, especially in the Nuku'alofa area.

Tuvalu

The main aim of current economic policy in Tuvalu is to promote development by reducing the dominance of the state as provider of employment and incomes while embarking on a program of privatisation and corporatisation coupled with strong support for the emergent private sector. The civil service, public sector enterprises and cooperative societies currently employ around two-thirds of the nation's formal sector labour force.

In recent years, domestic budget revenue has been insufficient to cover recurrent expenditure and shortfalls have been covered by supplementary funding from the Tuvalu Trust Fund and borrowing from the commercial banking sector. All development (capital) spending has been aid-financed, though lack of absorptive capacity for project finance (at both bureaucratic and operational levels) has prevented Tuvalu from taking full advantage of the resources available. In 1991, just over half of all committed

funding could be utilised.

Despite the authorities' firm intention to reduce the public sector and to release both financial and human resources for directly productive activity, initial steps in this direction have actually entrained an expansion of state activity—both current and development. The central policy vehicle, the Education for Life program, incorporates growth and reorientation of both school and vocational education together with some augmentation of administrative back-up. Moreover, improving government's absorptive capacity for aid funding (which involves improving the operating efficiency of certain departments and agencies, notably the Ministry of Labour, Works and Communications) has inevitably created additional labour requirements.

The net result is that recurrent budget spending rose by 21 per cent in 1992 and is programmed to grow by a further 30 per cent in 1993 with the revenue shortfall being met by further drawings on the Trust Fund.

At the same time, private sector development remains fragile, skilled labour is in very short supply, viable enterprises are tiny and few in number and expansion of exports above their present low level is proving difficult. The completion earlier this year of the new hotel in Funafuti, together with improvements to the international airport may help boost tourism, though the fragility of the atoll environment—already under severe pressure from urbanisation on Funafuti—will inevitably restrict the nature and scope of this development. Offshore fishing in Tuvalu's large exclusive economic zone is potentially the most promising enterprise prospect, but attempts to assess and exploit this resource are still at a very early stage.

An important footnote to any discussion of the country's prospects concerns the running down of mining in Nauru. This will lead to the repatriation of the bulk of the Tuvaluan labour force

(much of it skilled and semi-skilled), equivalent to around one-third of the domestic formal sector labour force. If this influx is to be turned to advantage, rather than exacerbating unemployment in Funafuti, planning for reabsorption is an urgent priority.

Vanuatu

Following a protracted period of very slow economic growth in the mid-1980s Vanuatu exhibited rapid growth over the last 2 years of the decade. In 1989 and 1990, real growth rates were 4.5 per cent and 5.2 per cent respectively. In 1991 the World Bank projected growth rates at between 2 and 4 per cent, and the recent International Monetary Fund mission has indicated that the 1992 growth rate is expected to be in the vicinity of 2 per cent. The Vanuatu economy is expected to see a higher rate of growth in 1994, due to tourism growth based on the projected recovery of the Australian economy.

Savings and investment in Vanuatu have, over the period for which data are available, grown rapidly with gross domestic investment (GDI) reaching a high of 40.8 per cent of GDP in 1990. However, gross domestic savings (GDS) constituted only 13.6 per cent of GDP. The low level of domestic saving is a result of very low levels of both non-expatriate income and general monetisation.

Perhaps one of the most disturbing developments in Vanuatu has been the labour relations situation in the public sector. Wages in the public sector in nominal terms did not rise between 1985 and 1990. The government then granted public servants a pay increase of 10 per cent and in 1992 a further 4 per cent. In May 1993, the Vanuatu Teachers' Association went on strike demanding a 20 per cent pay increase. Union members were dismissed by the government but were eventually reinstated following an

agreed increase of only 5 per cent in nominal terms. During the teachers' strike the government granted pay increases to all Members of Parliament, including the President, ranging from 40 per cent to 70 per cent of existing salaries thus creating expectations of higher salary increases for all public servants. As a result on 24 November the Vanuatu Public Service Association (PSA) began an indefinite strike to coincide with the South Pacific Mini-games. The union is demanding, among other things, a 16 per cent wage increase. As at the end of December the stalemate between the PSA and the government continued. The union has engaged in legal action to frustrate government plans to fire striking workers and overturn the government's denial of workers' access to the media.

Agricultural production declined dramatically in 1992 due to cyclones, but producer prices were maintained by subsidies from the Vanuatu Commodities Board. The Board has monopoly rights for export of cocoa and copra and has maintained producer prices well above world price levels and as a result has sustained substantial losses in the past few years. In 1993, the Board lost some 600 million vatu (up to September), largely due to the government's subsidy of copra production. In 1991 the Commodities Board operations deficit was 431 million vatu with a 23 million vatu deficit in 1992. Despite subsidies, copra exports declined to 24,143 tonnes in 1992, down from 30,878 tonnes in 1991, due to cyclones. The Finance Minister, Mr Willy Jimmy, has indicated that there will not be a continuation of the policy of subsidising farmers and beginning in 1994, prices will reflect world prices more closely.

Coffee production has begun to increase substantially, with 1992 production rising to 67 tonnes, mostly for the domestic market. In 1992 exports were 25 tonnes, increasing to 27 tonnes in the first quarter of 1993. Kava, which was widely expected to be a major export crop, has not taken off

although it has become an increasingly important crop for domestic consumption as a substitute for alcohol. Exports increased in 1992, reaching 62 tonnes, mostly destined for Germany for pharmaceutical use.

Beef production, which has potential for expansion, has stagnated since 1990 with exports of 1,228 tonnes in 1992, and figures for the first and second quarters of 1993 suggesting no growth. The problem lies partly in unstable export markets.

The instability of markets is being addressed to a degree by preferential trade agreements, signed in June, between the Melanesian spearhead countries. The treaty involves only three commodities—beef from Vanuatu, tea from Papua New Guinea and canned tuna from Solomon Islands. In general, the margins of preference afforded under the treaty for goods coming into Papua New Guinea are small or non-existent. The margin of preference for Vanuatu beef in Solomon Islands, however, is substantial and as a result, Vanuatu beef exporters have made some inroads into the Solomon Islands market. While a treaty with Fiji is expected, the margin of preference for beef is considered insufficient to assure any trade diversion. The emerging process of trade liberalisation in Melanesia, while having minimal impact at this early stage, is encouraging given the region's past lack of progress in external trade liberalisation.

Perhaps the most disturbing tendency in the Vanuatu export sector is the possibility of a return to log exports which have been prohibited for several years. Vanuatu exports of timber have increased dramatically, reaching 154 million vatu in the first half of 1993, a figure surpassing total 1992 exports. The Department of Finance indicates that the government may again begin to issue logging permits in 1994. The Vanuatu forest resource is small and incapable of meeting even long-term domestic demand. Vanuatu may follow Solomon Islands on an unsustainable path

of forest product exports.

Vanuatu's tourism sector has seen a major revival. Visitor arrivals have increased dramatically since the nadir of 1987 when tourist arrivals dropped to 14,624. In 1992 arrivals were 42,744, up 11 per cent on the previous year. In the first quarter of 1993 arrivals continued to increase, but decreased by 4 per cent in the second quarter. Hotel construction has ceased on Efate but recently several smaller lodges and hotels have been built in Santo, Tanna, Ambyn and Ambae. The Radisson Hotel (in receivership for over a year) was sold for US\$3.5 million, a price well below the government's estimate of its real market value. The sale of this hotel/casino will set an important benchmark, having an adverse impact on hotel construction in Vanuatu as well as in other parts of the Pacific. While there has been ongoing discussion with the Club Med company, which owns property in Vanuatu, no decision to build has yet been made.

The balance of payments situation in Vanuatu remains generally healthy. The trade deficit for 1992 was 5,562 million vatu, down from 1991 (6,599 million vatu) and 1990 (7,669 million vatu). Gross official reserves were US\$112 million at the end of the third quarter of 1992 (or 8.3 months import cover), continuing a trend beginning in 1990 when they represented 5.6 months import cover.

The banking system has undergone several changes in the last year or two. The most significant is the establishment of the government-owned National Bank of Vanuatu. Its creation was largely a result of the perceived lack of access of ni-Vanuatu to the traditional commercial banking sector. The French-owned Indosuez Bank was sold to the Bank of Hawaii which has recently made substantial inroads in the South Pacific.

In the past, the spread between deposit and lending rates tended to be inflexible. The weighted average lending rate in

Vanuatu stood at 12.7 per cent in the first quarter of 1993, one of the lowest rates for many years. The spread between deposit and lending rates over the last four years has been over 10 per cent. Weighted average deposit rates also rose in the first quarter of 1993, the last quarter for which such data is available, to 5.2 per cent, creating the narrowest spread in five years. The inflation rate for 1992 was approximately 2.3 per cent and prices in the first and second quarters of 1993 showed no tendency to increase.

The 1994 Budget, brought before the Vanuatu parliament in late November, contained no new revenue-raising measures though several tax changes were announced in 1993. Significantly the government has continued to change the business licence fee to a turnover tax system with 4 per cent tax on turnover for lawyers, accountants, medical practitioners and all business services. In the 1994 Budget the government mooted a major review of the taxation system and there is every indication that either a value added tax or a sales tax system will be introduced eventually. The government moved to decrease export tax on miscellaneous products from 5 to 3 per cent. This was widely seen as a strong disincentive to the diversification of exports.

Government expenditure under the 1994 Budget is expected to rise by 1.9 per cent over the 1993 Budget. A supplementary budget of 291 million vatu for 1993 was necessary to meet overexpenditure, however, this may not be the final figure. This is a worrying development because Vanuatu has normally conducted an extremely prudent recurrent budget policy with only small deficits. The budget is projected to balance in 1994 as it did in 1993. The development budget in Vanuatu, as in other Pacific countries, is funded by aid programs.

Environmental issues in Vanuatu are similar to those of other countries in the

region. Vanuatu's forest resource is small and there is ongoing pressure from Asian logging companies to increase exploitation of the forest above its maximum sustainable yield. The question is whether the government will permit the development of a rational long-term policy or develop its forests at rates beyond maximum sustainable yield. Moreover many of the logging operations in Vanuatu have poor conservation practices which result in soil erosion and slow natural regeneration.

Western Samoa

Western Samoa has for some years enjoyed a markedly higher standard of living than the domestic economy is capable of supporting. Substantial unrequited inflows of remittances from Samoans working overseas and official grant aid have permitted structural imbalances in both the external sector and the government's budget to be maintained over an extended period. Indeed, the deficits in both of these have tended to increase as a proportion of GDP. However, in the recent past a number of factors have combined to put severe pressure on the nation's economy and to raise serious doubts about the sustainability of the present structure. The increasing concern of government over the situation was reflected in the far-reaching changes incorporated in the 1993/94 Budget (published in May 1993). By November 1993, however, the situation had deteriorated further, as indicated by the supplementary budgetary provisions introduced at that point.

Current economic difficulties in Western Samoa date from the three successive cyclones which devastated the nation's infrastructure, plantations and domestic housing. Real GDP (at 1992 prices) has fallen each year since 1989: by 7.4 per cent in 1990, 1.6 per cent in 1991,

and 4.4 per cent in 1992. It now seems likely that 1993 will see a further decline. The major rehabilitation efforts undertaken over these years have depended heavily on access to external resources. Merchandise imports rose by nearly 50 per cent over the period 1989/92 to a figure of US\$111.5 million. At the same time, reduced agricultural capacity cut exports by nearly two-thirds to a mere US\$5.9 million in 1992, the lowest level for several decades. As a result, the resource balance situation deteriorated sharply from a deficit of US\$41.9 million in 1989 to over twice that figure in 1992. This process led, in 1991, to the first drawing down of foreign exchange reserves for a decade (by US\$2 million) and in 1992 to a further net outflow of US\$7.3 million. These movements reduced import cover from 8.5 to 6.3 months. Given the volatility of the foreign sector, this was viewed by the authorities as a very unwelcome development.

The consequences of the rehabilitation program for public sector finances have also been worrying. Expenditure rose from 128.6 million tala in 1989 to 223.6 million tala in 1992. Despite a 45 per cent increase in tax revenue over the same period, the underlying budget deficit (the deficit prior to allowing for external grants) rose from 36.8 million tala to 84.3 million tala. Net of external grant aid a budget surplus of 3.1 million tala in 1989 became a deficit of 49.0 million tala (equivalent to 13.4 per cent of GDP) in 1992. This was financed by expanding overseas borrowing to 27.6 million tala and domestic borrowing to 21.4 million tala. These developments seem likely to create a heavy debt servicing burden. Furthermore, given the shallow nature of the monetary sector in Western Samoa—the rise in domestic borrowing in 1992 alone was equivalent to 18 per cent of M2 (notes and coins, deposits and quasi money)—the risk of crowding out private investment is acute.

While encouraged by the rapid expansion of fixed investment from 26 per cent of GDP in 1989 to 42 per cent in 1992,

and by the success in containing the inflationary pressures generated by the effects of the cyclones and the rehabilitation program, (the year-on-year rate of inflation to April 1993 was 6.3 per cent with a downward trend), the government recognised the need for an extensive package of measures in its 1993/94 budget to address the interlocking problems.

The key aims of the budget were to facilitate immediate improvement in the economic situation by achieving 4 per cent real growth in GDP in 1993/94 and closing the external payments gap while at the same time laying the foundation for solid long-run progress. This was to be achieved by a combination of policies. Short-run targets were to be met by applying appropriate demand management measures (to reduce the import bill), expanding the credit available to private sector producers (to encourage output growth) and, as a prerequisite for the latter, cutting the public sector deficit. Specific budgetary initiatives included pruning public sector spending by freezing civil service salary increments and restricting regrading of posts, and improving the revenue collection system.

Longer term measures included

- a reorientation of the fiscal system to encourage income and employment generation, involving reduced reliance on income taxation (personal and corporate income tax rates are to be cut) and the introduction on 1 January 1994 of a value added tax (the VAGST)
- renewed emphasis on privatisation of public sector enterprises and / or increased reliance by public sector enterprises on raising funds by issuing debt instruments rather than depending on budgetary resources
- the introduction of, or increases in, user charges for a wide range of services provided by the public sector including agriculture, education, transportation, and post and telecommunications

- encouragement of diversification by improving access to land for commercial purposes to be achieved by government leasing of land from traditional owners and sub-leasing to domestic and foreign investors

- promotion of tourism by increased spending on roads, continued support for Polynesian Airlines and facilitation of expansion of hotel accommodation (primarily by encouraging foreign investment in this sector)

- establishment of a Trade and Marketing Board to promote exports of agricultural and manufactured output.

The projected overall impact of the various budget measures was an immediate cut in the underlying deficit from 90 to 58.3 million tala, and in the actual deficit from 53.0 to 24.1 million tala.

The latest information (November 1993) on economic developments in Western Samoa suggests a deepening crisis. Despite success in containing the money supply (M2 has changed little over 1993) and inflation, the growth in net output and exports of the new manufacturer, Yasaki, from 6 million tala in 1992 to a projected 8 million tala in 1993, and the imminent prospect of investment by Australian garment manufacturers, it now seems likely that the recovery program in the 1993/94 Budget will be blown off course by important developments, some unforeseen, some predictable.

In particular, private remittance flows have contracted sharply, and a figure of 50 million tala is projected for 1993. (There is some evidence of reverse flows of remittances to Samoans in difficult financial circumstances overseas.) At the same time, the sudden appearance of taro leaf blight has led to a complete cessation of exports of taro (from early September) and the possibility of a limited amount of importing. In 1992 taro accounted for 33 per cent of total merchandise exports, and a prolonged disease problem (which seems a

definite possibility) would have very serious consequences for both exports and domestic food prices. Furthermore, prospects for exports of coconut cream, which accounted for just over one-third of export revenue in 1992, have deteriorated sharply because of competition from low-cost producers in Thailand and the Philippines. These foreign sector problems have been exacerbated by a surge in imports aimed at beating the imposition of VAGST. Lastly, the attempts to free up credit for private sector expansion have so far had little effect. A major lender—the National Provident Fund—is experiencing difficulty in significantly expanding lending to new borrowers because of its commitments to Polynesian Airlines, while many of the loans made for rehabilitation purposes have yet to be repaid. This has led to very tight credit conditions for both producers and consumers.

In addition to these difficulties serious doubts exist as to the outcome of the switch from primary reliance on direct taxation to the VAGST. Experience elsewhere suggests that problems are likely to be encountered in achieving revenue targets in the transition phase. This difficulty is likely to be compounded by escalating costs of under-writing the expansion of Polynesian Airlines and the introduction of TV Samoa which is now to receive cash injections totalling 2.35 million tala in its first year.

It is not possible to estimate the overall impact of these changes with confidence, but it seems likely that the fall in remittances alone could be large enough to nullify all attempts to improve the balance of payments situation, while shortfalls in tax revenues could undermine prospects for a reduction in the overall budget deficit.

Western Samoa is affected by a range of environmental and resource problems common to Pacific island countries. In particular, rapid and extensive deforestation (accelerated by recent cyclones) together with extension of cultivation to steeply sloping land, expanding use of herbicides and generally inadequate watershed management, are causing problems of erosion and impairment of the water supply. Given these considerations, and the government's intention to accelerate leasing, it is clear that action on a long-term program of integrated reforestation and agricultural activity is essential. Action is also needed to head off further deterioration of Apia lagoon through inadequate treatment of domestic and industrial waste and to arrest the speedy decline of inshore fish stocks in Upolu waters. Given the importance of fisheries in terms of both employment and diet in Western Samoa, effective official action to preserve inshore stocks while facilitating increased exploitation of offshore fisheries is an important priority.