Current economic trends in selected South Pacific countries

Rodney V. Cole, Paul Cotterell, Graeme S. Dorrance, Ethan Weisman

The rescue operation orchestrated by the World Bank to meet Papua New Guinea's crisis resulting from the long-term closure of the Bougainville mine in the early part of the year and the depression of international commodity prices was the most dramatic economic event in the South Pacific during 1990.

International economic conditions provided little stimulus to the area, and are unlikely to be more propitious in the immediate future.

The cessation of driftnet fishing in the South Pacific was one of the few favourable developments. However, if it continues in the North Pacific, there may be unfavourable South Pacific repercussions.

Demand in the industrial countries continued to rise but at a decelerating rate. Consequently commodity prices tended to decline, and as Pacific island import prices remained stable, there was a slight worsening in the islands' barter terms of trade.[1] Until the Iraqi crisis, inflation expectations were diminishing, thus putting future downward pressure on primary product prices. Events in the Middle East have caused unexpected increases in government outlays in several industrial countries (notably the United States, United Kingdom, Australia, France and Canada). This will lead to careful examination of other government expenditures. Foreign assistance could well be a target for budget saving. The Papua New Guinea rescue was organized in May. There is no reason to be certain that the bilateral contributions would have been as generous if the Consultative Group had met in September. Aid and capital exports to other developing areas are being examined rigorously in light of the increased demands from Eastern Europe and the continued misery in Africa. It is not impossible that small countries, such as the islands, will suffer rather large proportionate declines in their receipts. Fortunately, Australian aid, other than assistance to Papua New Guinea, appears likely to be unaffected. Increasing Japanese interest in the area appears likely to be matched by rising transfers of resources.[2]

Papua New Guinea

Fifteen years after Independence, the economic prospects for Papua New Guinea are uncertain. Many of the problems facing the country, such as its inadequate education system, are a heritage of the weak administrative and social structure bequeathed to it by the colonial power and of incompetent technical advice. The weak educational system means that there are few nationals able to fulfil the rapid localization program to which the government is committed. Consequently the administration has difficulty in implementing many of the policies that are proposed. Through 1989, the government failed to recognize the effects of the outbreak of terrorism on Bougainville island on the economic situation by assuming that the violence would subside and the mine would re-open shortly. With the indefinite (possibly permanent) closure of the mine at the beginning of 1990 and the decline in the prices of the country's major exports in the first half of the year, it became apparent that the country faced a crisis. The World Bank convened a meeting of the Consultative Group for Papua New Guinea in Singapore in May and at this meeting a 1990 program was agreed upon.

1 See 'Pacific Island Commodity Prices' in this issue.

2 See 'Japan's cooperation with the South Pacific Region' in this issue.

The Bank acknowledged the need for 'structural reforms to accelerate the development of the non-mining economy' but gave pre-eminent attention in its announcement to 'adverse effects on incomes and employment of the recent developments'. The program should provide an opportunity to correct the underlying causes of the crisis and not be an anaesthetic to disguise the severity of the long-term economic malaise.

The program provides a very large increase in total foreign assistance. Almost two-thirds of it is general budget and balance of payments support for the government's general adjustment program, with no specific project allocation. That is, the country is receiving assistance from overseas to provide resources equal to approximately one-tenth of its gross domestic product (GDP). Further, almost half of these funds are grants. However, the program is limited to 1990 (presumably through mid 1991). The next Consultative Group discussions will be held next May. Even if the government's program is successful, it is unlikely that aid can be continued at anything like its present level. International Monetary Fund (IMF) support is limited. As noted above, aid programs for developing countries are likely to be under pressure in 1991. If the 1990 program is not successful in changing the economic outlook, further requests for assistance will, no doubt, be subject to close scrutiny and more effective conditionality. In any event, a continuation of foreign aid is contrary to the government's expressed desires to end dependence on aid by the end of the century. The economy cannot accommodate a rapid decline in aid. A start must be made at the beginning of the decade if the government is to achieve its avowed target. The Singapore program must be regarded as an opportunity for the implementation of essential policy and administrative changes rather than an opportunity for relaxation.

It is difficult to overestimate the severity of the problems facing Papua New Guinea. The law and order problem continues to be a severe barrier to any economic or social progress. The inadequacies of its education system resulting in a severe shortage of competent administrators has already been mentioned. Most of the senior members of the public service are very competent; but they are a thin crust on the top of the pie. Melanesian customs, particularly land ownership traditions, have many desirable aspects (for example, they have prevented the emergence of a land-owning oligarchy), but they impose a barrier to the changes in resource uses that are an essential part of economic development. The proposed Land Mobilization Program deals with only a minor aspect of this problem. The 'pay-back' warfare in the Highlands destroys productive resources.

Even the major source of growth and balance of payments viability over the last decade—the development of minerals—has its costs. As an enclave activity, mining has little direct impact on the domestic economy. Its major effect is on the balance of payments. Capital imports to develop mines and exports of their output create demands for domestic currency on the exchange markets. Unless the authorities intervene by purchasing foreign currencies, the exchange rate will appreciate, or, alternatively these receipts will support an overvalued currency, depressing exports, encouraging imports, and, thereby reducing domestic output. Enclave activity has little direct influence on such important economic variables as the volume of employment and the level of wages (the mid 1970s decision of the Minimum Wages Board to accept Bougainville wage rates as a standard for the rest of the economy was a bureaucratic rather than an economic decision that had disastrous results). Nevertheless, a rapid reduction of mineral production by established mines has drastic consequences. With export production and import substitution repressed by the previously overvalued exchange rate, the economy has difficulty adjusting to the decline in exports and any devaluation is likely to be excessive (in 1990, the Papua New Guinea authorities limited the devaluation). It also imposes a severe strain on government finances forcing rapid adjustments to expenditure (Bougainville Copper Limited (BCL) provided almost one-tenth of government non-grant revenue). It will be some years before the other mineral developments will earn enough to satisfy their depreciation allowances and have taxable earnings. Mineral developments such as Bougainville have other indirect effects. For example, the prospect of high mining wages attracted labour from the Highlands. Many of those who were not employed by the mine remained to work in the cocoa plantations in the hope of eventual BCL employment. Consequently, when the mine closed the supply of labour for North Solomons plantations was reduced (an effect quite separate from the impact of terrorism).

The decline in gold and copper exports resulting from the closure of Bougainville, partly offset by the expansion of production at Misima and Porgera, but accentuated by the decline in Mt Kare alluvial production, prevented the economy from obtaining the full advantage of the last half of 1990 increases in the prices of these commodities.

Coffee exports have not declined as yet, but prices continued to be depressed and coffee rust has re-emerged. Forestry product prices also continued to be low. Over the year as a whole, the barter terms of trade were below 1989 levels, even if not as depressed as seemed to be the prospect at the time of the Singapore meeting.

In January, immediately after the announcement of the indefinite closure of the mine, and well before the Singapore meeting, Papua New Guinea announced a 10 per cent devaluation of the kina and a severe limitation on increases in bank credit.[3] The first of these measures marked an abandonment of the government's policy of regarding the exchange rate as primarily an anti-inflation weapon and a recognition of its role as a balance of payments regulator and stimulator of import substitution and export promotion. The credit squeeze was relaxed in June so that credit expansion during the year would be equal to the 1990 target. This represented a nominal easing of monetary policy that may encourage private investment in support of structural adjustment. The inflationary potential in the present situation should not be ignored. However, effective monetary policy continues to be relatively restrictive in light of the increased demands for commercial finance consequent on the devaluation.

The 1991 budget approved on 7 November projected a 9 per cent decline in taxes and other domestic revenues (largely reflecting a decline in mineral revenues[4] and customs duties—reflecting the decline in tariffs) and a 4 per cent increase in expenditures (less than the probable rate of inflation (Table 1)). The consequent shortfall will be covered by the expected increase in grants (covering all of 1991 compared to part of 1990) and borrowing (including loans negotiated under the Singapore program). It removed a few import bans and replaced them with 50 per cent tariffs. It provided that most import bans would be replaced by 50 per cent tariffs at the beginning of 1992 and that sugar would follow later in 1992 (this should lead to a 25 per cent reduction in the domestic price) and canned meat in 1994. Decreases in tariff rates have been offset by a change in the calculated value of imports from fob (free on board) to a cif (cost, insurance and freight) basis. However, tariffs on many imports for manufacturing, tourist, agriculture and fisheries industries have been abolished. The size of the public service is being reduced.

Table 1 **Papua New Guinea government accounts** (kina million)

	1990 estimate	1990 budget	1991 budget
Internal revenue	923	863	836
Grants etc.	183	183	244
Total receipts	1106	1046	1080
Expenditure	1250	1082	1310
Foreign borrowing	138	37	185
Domestic borrowing	6	−1	45
Total borrowing	144	36	229

A change in attitude towards foreign investment is indicated by the replacement of the National Investment and Development Authority (NIDA) and the Industries Assistance Board by the Investment Promotion Authority that is instructed to promote foreign investment. Companies with more than one-half non-resident ownership, rather than the previous one-quarter are now regarded as foreign owned and their establishment made subject to approval. The training and localization requirements that foreign firms had to satisfy have been replaced by a training levy of 2 per cent of payrolls against which training expenditures may be offset. Work permit fees have been reduced from kina 500 to kina 10 and the procedures for their issue simplified. Many of the changes will require legislative approval which will not be possible before Parliament reassembles next July.

The negotiations with the trade unions to limit wage increases have, as yet, been reasonably successful, but wage pressures show signs of increasing.

Fiji

1990 has been a mixed year for Fiji. After declines in real GDP in 1987 and 1988, the Reserve Bank of Fiji reported a 12.5 per cent rise in 1989 and it expects further growth of 5.5 per cent in 1990. Much of this growth was in the output of firms benefiting from the Tax

3 PEB 5(1), June 1990.

4 1990 mineral revenues were largely derived from Bougainville profits earned in 1989. 1991 receipts reflect the decline in profits in 1990.

Free Factory Scheme. On the other hand, there has been a deterioration in the balance of payments, and increasing inflation.

Contrary to expectations reported in the December 1989 issue of this Bulletin, the balance of payments deteriorated during 1989. This was largely because of a F$300 million (or 46 per cent) increase in imports that more than offset the expected increases in merchandise exports, and tourist receipts. The main increases in imports were for machinery and equipment (F$105 million), mineral fuels (F$75 million) and other manufactures (F$60 million). Overall there was a balance of payments deficit of F$18 million in 1989, compared to a surplus of F$155 million in 1988.

The balance of payments picture for 1990 is similar to that of 1989. Except that while imports have continued to increase, exports measured in foreign currencies have tended to stagnate (in Fiji dollar terms they were 9 per cent higher in the first six months of 1990 than in the same period of 1989). Tourism earnings are also higher, but not sufficient to prevent the current account deficit from increasing by F$90 million compared with the first half of 1989. There has also been increased capital inflow, but an overall deficit is again expected.

The Fiji dollar has depreciated against most major currencies in the twelve months to September 1990, viz. Pound Sterling (12.7 per cent), Deutsche mark (15.5 per cent), and the French franc (16.2 per cent). In contrast, it appreciated against the US dollar (6.8 per cent) and the Japanese yen (0.6 per cent).

The Tax Free Factory Scheme was discussed in some detail in the December 1989 issue of this Bulletin. By the end of June 1990, there were 98 tax free factories in operation, producing exports totalling F$75 million. However, not all of these sales represented additional exports as many of the firms were already exporting prior to the introduction of the scheme. When the new factories are established and providing additional employment they require relatively large imports (for example, Japanese sewing machines). As yet, on balance, the tax free factory scheme has probably increased the balance of payments deficit. In future, it should make a marked net contribution to Fiji's foreign accounts. The exports of finished clothing (approximately half the output of the tax free factories) have a very high import content of fabric and finishings. The net value added in Fiji is some 10–15 per cent of gross exports.

The foreign reserves of teh Reserve Bank of Fiji (RBF) were practically unchanged when measured in foreign currencies, rising only to an amount equivalent to four and a half months imports, compared with four months at the end of 1989 and over six months in 1988.

In support of the government's policy to generate economic growth through the expansion of exports, the RBF is considering relaxing the restrictions on investment abroad. Consideration will be given to proposals on a case by case basis and companies need to demonstrate that the proposed investment abroad will increase the volume and value of its exports. Also, the companies will be required to borrow the initial funds they require from local sources.

The inflation rate, as measured by the consumer price index, has increased during 1990 by an estimated 8 per cent per year. This compares with a fall in the annual rate of increase from a high of 11.9 per cent in 1988 to 6.1 per cent in 1989. The most important increases in the twelve months to August 1990 have been recorded in food (9.1 per cent) and transport (8.3 per cent). The recent rise in oil prices may be expected to put further upward pressure on the consumer price index.

Solomon Islands

Real per capita GDP increased in the Solomon Islands in 1988 and 1989. However, projections of total GDP growth of 2.7 per cent in 1990, if realized, would mean a decline of 0.8 per cent in income per capita.

Tight monetary policy has been the only response to inflationary pressures fuelled by rapidly expanding government expenditures. This is the main cause of the slowed growth. Government expenditure increased by 12 per cent in 1989. The 1990 budget estimate of SI$177.8 million represents an increase of over 23 per cent. Wages and salaries, capital expenditures and acquisition of fixed capital assets (both almost doubled) are the major sources of the increased deficits. Meanwhile, government revenues are budgeted to increase by 6.6 per cent in 1990. If the budgeted figures are realized, the government plans to finance the deficit by borrowing SI$19.9 million domestically (primarily from the banks) and the rest from external sources. This expansive government fiscal policy will tend to 'crowd out' the private sector and add to inflationary pressure.

However, inflation is being contained by strict monetary contraction. Domestic credit continues to increase slowly, but a drastic fall in net foreign assets has meant a drop in the money supply (M3). As of June 1990 annual inflation was running at only 8.8 per cent compared to 14.6 per cent a year earlier. The lack of liquidity has made it difficult for the private sector.

At the same time, the trade balance and current account deficit continued to widen between 1986 and 1989.[5] Although a current account deficit is not necessarily detrimental to the Solomon Islands economy, the sustainability of these deficits is becoming questionable. The deficits continued in the first half of 1990, even though imports of goods and services have declined. Improvement in the trade balance will probably continue as the relative depreciation of the Solomon Islands dollar tends to strengthen the country's international competitiveness. In the first half of 1990, the Solomon Islands dollar depreciated against the pound Sterling, Australian and US dollars, and only appreciated slightly against the Japanese yen.

On the other hand, if one uses the change in external reserves as an indicator of the strength of the economy, recent experience casts a shadow on the Solomon Islands economic future. In the last quarter of 1989, reserves dropped by SI$11.5 million and by another SI$21.6 million the following quarter. By June 1990 the level of external reserves was equivalent to just over one months payments for imports of goods and non-factor services. The level of reserves in July 1990 was SI$44 million, approximately half of which is represented by STABEX (European Community Stabilization of Exports Scheme) funds. A belief in 'self-reliance' and the corresponding disregard for the uses of external reserves seems to exist in the government. If this is the case, the development of Solomon Islands will be increasingly difficult. Fiscal responsibility and coordination with monetary authorities is needed to realize the political benefits from the rich natural resources for the majority of the population.

Western Samoa

The economy of Western Samoa is slowly recovering from the devastation of Cyclone Ofa in February 1990. Real GDP is expected to have fallen by 3 per cent in 1990.

Local food supplies were destroyed by the cyclone and it has taken until October 1990 to recover to 80 per cent of capacity, with taro and bananas again being harvested. Breadfruit is not expected to recover for a number of years. A ban has been placed on the export of taro, that will be relaxed through the use of a quota system as domestic supplies improve.

The annual average inflation rate, fuelled by domestic food shortages, is expected to be 12 to 14 per cent in 1990, compared with 6.5 per cent in 1989.

Notwithstanding the effects of the cyclone, the government has continued to pursue the policy changes announced in the 1990 Budget Statement. These include:

- reduction of import duties on raw materials from 42 per cent to 35 per cent from 1 July 1990;
- elimination of import duties on fertilizers, chemicals and agricultural machinery from 1 July 1990;
- elimination of export taxes on cocoa, copra, coconuts, copra meal, fruits, taro and logs from mid February 1990.

Falls in world prices for agricultural products, combined with the effects of the cyclone, are expected to result in a decline in export receipts of 40 per cent over the levels achieved in 1989, to about tala 18 million. At the same time, imports have increased to help overcome the shortages. However, the worsening trade deficit is being offset by increased inflows of private remittances (partly in response to rebuilding requirements) and direct cyclone aid. As a result, international reserves are expected to remain high (of the order of nine months coverage of imports).

Vanuatu

There was a marked improvement during 1990 in the availability of statistics in Vanuatu. The publication of the first National Accounts (for 1983–87) was perhaps the most important step. Now that the technical problems associated with the compilation of these data have been overcome, it is to be hoped that the 1988/89 estimates will be published soon, to be followed rather quickly by the 1989/90 estimates. Not unexpectedly, with hurricanes and political unrest in the middle of the decade, overall growth has been slow. Even at the end of the period for which data are available (1986/87), the increase in income over the previous year was only 8.2 per cent. This is higher than the rate in preceding years. Provisional figures from the 1989 decenial census indicate that, in the ten years since Independence, the population has increased by

5 See 'Solomon Islands balance of payments' in this issue.

2.8 per cent (slightly more than the average rate for all developing countries). This suggests that, in real terms average real incomes have fallen over the decade.

Over the five year period to 1987, agriculture, including fisheries and forestry, contributed 26 per cent of GDP. As in most countries the group of service sectors was the most important source of income. Wholesale and retail trade was surprisingly large with 25 per cent of total measured output. Government, with 14 per cent of the total, accounted for only two-thirds of the average for all developing countries.

With 82 per cent of the population living in rural areas, the social importance of agriculture is much more important than would be suggested by its contribution to output. Approximately 90 per cent of domestically produced commodity exports (that is, excluding re-exports—primarily fish) are agricultural products. Therefore, changes in overseas receipts from the sale of farm products (largely arising from changes in world prices) are the important determinant of domestic incomes. Hence, the Smallholder Agricultural Survey undertaken in 1989 provides important information on which future policies may be based. Copra, cocoa and beef, in that order are the major domestic exports. These products realized approximately vatu1500 million in 1987, 1988 and 1989—a marked fall from the record level of vatu 3200 million in 1984. This decline arises mainly from a fall in the value of copra exports, reflecting an almost halving of world prices and the aging of the palms—indicating an area for agricultural development. There has been a small impetus to agricultural incomes from increasing (social as opposed to traditional) consumption and very small exports of kava.

Tourism continues to grow, partly because of improved airline services and partly because of improved accommodation facilities. Prices are still high compared to similar Australian tourist venues (most tourists come from Australia), but Vanuatu has the romanticism of a South Seas island and a people that are very pleasant and charming.

There has been an important shift of population from rural areas, even though the vast majority of people still live in them. Port Vila has reached a population of almost 20,000. This growth is probably one cause of the social tensions that are receding but could increase again, unless careful provision is made to accommodate this changing locational structure.

Tonga

The dramatic increase in the inflation rate is the most important economic issue facing Tonga in 1990–91. The consumer price index rose by 4 per cent from mid 1988 to mid 1989. This rate increased to 7 per cent from June 1989 to June 1990. There was a sharp rise of 5 per cent between June and August. This rapid acceleration was largely a one-off effect of higher commodity taxes announced in the latest budget, and the ongoing pressure on prices arising from the flow-on effects of civil service pay increases. The budget changes included an increase in duties on alcohol and tobacco products, protective tariffs on meat and the introduction of an excise duty on locally produced beer. It is possible that these changes, particularly the pay increases may continue to provide pressure on prices during the last half of 1990 and early 1991.

The government's recurrent budget in recent years has usually shown a small deficit. Although the 1989/90 Budget was forecast to be in balance there has been a substantial increase in civil service wages and salaries without any commensurate new revenue measures. Consequently, the actual 1989/90 result was a deficit of approximately pa'anga 4 million; that is larger than in previous years. The 1990/91 result, notwithstanding the additional tax revenue, is expected to be for a more substantial deficit as the full year effect of the salaries increase takes effect. These deficits are being funded primarily through domestic borrowing that will also contribute to inflationary pressures.

A recovery in agricultural production since the drought of 1987/88 led to real GDP growth in 1988/89 estimated at 3.5 per cent. Higher growth had been expected in 1989/90, but the rise in inflation casts some doubt over this forecast.

Even though the balance of trade deficit is continuing to widen, the overall balance of payments returned to a small surplus of pa'anga 1 million in 1989/90, following two years of deficit. Exports increased by 14 per cent to pa'anga 12 million while imports increased by 10 per cent to pa'anga 67 million. This deterioration has been offset by a one-third increase in services receipts to pa'anga 42 million, primarily from the sale of Protected Persons Passports (largely to Hong Kong residents) and a 13 per cent increase in private remittances to pa'anga 40 million. The passport sales will probably be a temporary phenomenon. It is likely that the balance of payments will again be in deficit in 1990/91 and that there will be a reduction in reserves.

On 1 July 1989 the National Reserve Bank of Tonga (NRBT) was created as the nation's central bank responsible for the management of the foreign reserves and monetary policies of the Kingdom. As a result, there has been greater flexibility introduced in interest rate policy, with the long standing ceiling of 10 per cent being raised to 13.5 per cent for new loans, and higher rates being offered for term savings deposits. Other developments encouraged by the NRBT include the introduction of an Export Financing Facility. It is also not impossible that the longstanding link between the pa'anga and the Australian dollar will be severed. Tonga might adopt a 'basket' system of exchange rate determination similar to those of Papua New Guinea, Fiji, the Solomon Islands, Western Samoa and Vanuatu.