Current economic trends in the South Pacific

Papua New Guinea

The 1996 Budget

Available information on the recently handed down 1996 Budget reveals that a total expenditure of 1,924 million kina has been proposed. This represents an increase of over 3.8 per cent over the 1995 Budget. Of this, 69 per cent has been earmarked for recurrent expenditure, 29 per cent on development expenditure and 10 per cent on loans and amortisation. The two significant features of this budget are the increased allocations to the provinces following the adoption of the provincial government reforms in 1995 and to the development budget to fulfil Papua New Guinea's obligations under its structural adjustment program.

The allocation to all provincial governments has been increased by 200 million kina, reflecting the cost of implementing the reforms. Recognising that delays in implementation of these reforms is inevitable, a phased approach has been agreed where only 75 per cent of all provincial development grants will be funded in 1996 while the full recurrent funding has been provided for. The development budget has been set at 410 million kina, almost double the allocation in 1995. If the past record of underutilised development funds is any indication, it is difficult to envisage how things could change so quickly that these funds can be fully utilised.

The projected growth in GDP is 1.8 per cent for the year. This would be a marked improvement over 1995 with an expected growth of -4.8 per cent. Growth in the non-mining and petroleum sectors is expected to make a positive contribution. Inflation is assumed at 6 per cent, with wage increases restricted to below 4 per cent. A budgeted deficit of 1 per cent of GDP introduced in the 1995 Budget has been retained. Net external financing has been set at 146.7 million kina, including a new drawdown of 72 million kina from the World Bank, while domestic financing has been reduced from 83.4 million kina to 35.7 million kina.

Fiscal developments

The fiscal crisis that threw the Papua New Guinea economy into chaos in 1994 appears to have subsided, although the effects of a number of policy changes adopted as a result are still feeding through the system. The crisis was one Papua New Guinea had to have. The fiscal discipline which had been built in the years after independence

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had been abandoned in the late 1980s. Fiscal indiscipline worsened until the crisis hit. Total government expenditure in the period 1990–94 grew at a nominal rate of 11.3 per cent. Over-expenditures averaged about 9 per cent of budgeted expenditures between 1991 and 1993, increasing budget deficits well above the levels provided for in the national budgets. The actual budget deficit in 1993 was 5.9 per cent of GDP compared to a budgeted deficit of 3.3 per cent. Revenue shortfalls of about 60 million kina were also a common occurrence over this period, reflecting capacity problems in the government's revenue collection machinery.

The management of the crisis has preoccupied the current government which was forced to take some drastic measures. These included the devaluation and subsequent float of the kina, strict expenditure controls and reduced deficit targets, wage restraint, legislative protection of capital expenditures and negotiations for a structural adjustment program.

The results have been quite impressive given the magnitude of the problem. The kina has been successfully floated, stabilising at around US$0.76, although many had feared a free fall. The initial system of auctions has now been replaced with a 'screen-based system'. This is an improved system which provides instant information for purposes of trading. Expenditure controls made possible the reduction in the actual deficit from an expected 10 per cent to 2.8 per cent at the end of 1994. Under these controls, priority is given to payments relating to debt service, salaries and wages, provincial grants and constitutional offices.

The continued use of these controls in 1995 has resulted in a budget surplus of 144.7 million kina as of August. The bulk of these funds (84.4 million kina) has been used in settling government external debt while the balance is held as government reserves. The poor performance of the public investment program continues, with only 20 per cent of the budgeted 309 million kina spent as of August 1995. This raises doubts about the wisdom of the initiative in the 1996 Budget which has proposed a significant increase in this area. Some progress has been made with the establishment of Imprest and Trust Accounts with the Bank of Papua New Guinea however, which should see a much easier flow of resources to those who manage these projects. This, combined with improvements in the government's cash flow situation, should see a better implementation performance before the end of the year.

An improved revenue performance has also assisted the recovery process. Direct tax collections appear to be on target although indirect taxes, particularly excise duties and the export tax on logs, are likely to fall below projections. Persistent high commodity prices have avoided the need to utilise the allocation of 10 million kina for the crop price support program. The float of the kina has had a big impact in improving export revenue flows. Additional revenue has also been generated through the government's privatisation drive which has seen the sale of preference shares in Ramu Sugar and pre-payment by OTML on road-user charges under the 'roadco' arrangement. The privatisation program is expected to continue and will involve all public enterprises, a number of agricultural projects and state mining and petroleum interests.

The 1995 Budget financing arrangements have been slightly altered, given the loan drawdown problem which appears to be a recurring outcome. It continues to be mentioned in every national budget but there appears to be very little effort put into resolving it. Of the 111 million kina budgeted in 1995, only 20 per cent has been drawn down as of August. The budget allocation has since been revised downward to 50 million kina. Past efforts to streamline procedures appear to be slow in reversing this trend.

Similarly, given the agreements on the structural adjustment program, the extra-ordinary financing of 35 million kina in the 1995 Budget has been revised upward to 172 million kina. The World Bank, IMF and other bilateral donors agreed on details of the program in mid-1995 and funds are to be made available to Papua New Guinea in two phases. The total program has been costed at US$350 million with phase one involving US$200 in 1995 and phase two involving US$150 million in 1996. The IMF standby facility alone provides a total of 135 million kina.

The structural adjustment program has been agreed to on the basis of an undertaking by Papua New Guinea to proceed with a wide range of reforms over the next two years. These involve restoration of economic stability through sustainable budgets, liberalisation and deregulation, changed composition of government expenditure in favour of investment, public sector reform and sustainable development of the country's vast natural resources.

Macroeconomic developments

Economic growth in Papua New Guinea over the last five years has been extremely variable, with record growth rates of 11.8 per cent in 1992 and 16.6 in 1993 and a significant contraction to a modest 2.4 per cent in 1994, reflecting the impact of the crisis. This impact has continued into 1995, with the result that overall growth is expected to contract further to -4.8 per cent, with non-mining and petroleum GDP contracting by 1.2 per cent. This reflects the impact of slowdowns in both the private and public sectors. The commencement of development of the Lihir project is a major influence in the budgeted GDP growth of 1.8 per cent for 1996.

The external sector has shown some improvement in 1995, resulting from improved export prices following the devaluation in 1994. The weighted average price of all exports was 54 per cent higher in the second quarter of 1995. This compares favourably with an increase of 10 per cent in the total import bill over the same period. A trade surplus of 947 million kina was recorded but with increased invisible transfers, the surplus in the current account balance was restricted to 482 million kina. A deficit in the capital account of 538 million kina resulted from increased official and private outflows. This eroded away much of the advantage of the surplus in the current account, resulting in an overall balance of payment deficit of 24 million kina. As of October 1995, Papua New Guinea's international reserves stood at 314.7 million kina or 3.9 months of import cover. The bulk of this improvement has resulted from capital inflows under the structural adjustment program.

Tight monetary policy has been pursued through 1995. The minimum liquid asset ratio was raised from 29 per cent to 32 per cent in May 1995. This has increased liquidity in the banking system although private sector credit continues to remain weak. The Bank of Papua New Guinea has abolished the discount facility and replaced it with a Kina Auction Facility for short-term liquidity management. Both these changes have had the impact of increasing average interest rates, with the deposit rate increasing by 1.8 percentage points to 7.5 per cent and the lending rate increasing by 2.2 percentage points to 13.5 per cent by August 1995. Some easing of this tight policy is expected in the near future when inflationary pressures have subsided.

The most direct impact of the devaluation and float of the kina in 1994 has been the significant increase in domestic inflation, estimated at 14.9 per cent for the year to June 1995. Much of this impact has now filtered through the system as evidenced by declining quarterly increases in the CPI. The increase in the June quarter was 1.8 per cent. Inflation is expected to peak at 15 per cent and decline thereafter. The 1996 projection is for an increase of 6.6 per cent in the CPI.

Sectoral developments

The agricultural sector in Papua New Guinea has continued to provide for the bulk of the population. Although considerably overshadowed by developments in recent years in the resources sector, agriculture production, both of traditional and commercial export crops, remains a very important activity. A draft white paper outlining a new agricultural policy was completed in 1995 and is currently awaiting cabinet approval. The privatisation of agricultural projects and the corporatisation of commodity boards are important agenda items in this draft policy. Support for the major export commodities is expected to be maintained while some degree of diversification will also be pursued.

In forestry, a great deal of confusion has occurred with continued delays in the adoption of the National Forestry Development Guidelines. Ministerial reshuffles, with new ministers pursuing different interests, has left the Forestry Authority in a state of despair. The removal of the former Managing Director is likely to worsen this situation. Funding cuts have also affected many of its functions, particularly the surveillance project for which political support appears to have recently declined. The failure of Papua New Guinea, along with Solomon Islands, to finalise a regional forestry code of conduct before the last meeting of the South Pacific Forum was seen as a major setback for efforts aimed at promoting greater sustainability of forest resource use in the South Pacific region.

The Department of Fisheries and Marine Resources was abolished in the second half of 1995 and all functions transferred to the newly established Fisheries Authority. A Board of Management has been established to oversee and direct the functions of the new Authority—a similar arrangement to that in forestry. Given the increasing importance of commercial fisheries, the establishment of the Authority is seen as a means of increasing the effectiveness and efficiency of the management of marine resources. It is also expected to promote a degree of independence, something which has been lacking in the past with continued political interference —although the experience of the Forestry Authority is not encouraging. A concerted effort has been mounted in recent years to develop a domestic tuna fishing capacity.

Mining and petroleum development has had the greatest impact on development in Papua New Guinea. This is likely to continue with the development of Lihir, whose public float was oversubscribed, the upgrading of reserves in Kutubu and the potential of new wells in Gobe and South East Gobe and an even greater potential in gas development in the Hides region of the Southern Highlands. A draft national gas policy is expected to be approved in the November 1995 sitting of parliament. The accumulated liability for the Kutubu project was fully repaid in October 1995. This will make possible the direct ownership of 22.5 per cent of all future oil flows from Kutubu. It will also mean some direct revenue flow from oil sales to landowners and the provincial governments.

Provincial government reforms

A new provincial government system was established in July 1995 with the passing of a new Organic Law on Provincial Governments and Local-level Governments. Receiving support even from the Opposition in the Papua New Guinea parliament, the new bill has essentially changed the composition of provincial governments whereby national ministers have given themselves seats in provincial governments along with other elected representatives from the local-level governments and other community interest groups such as women. The regional member has the option of taking up the governorship of the province while the deputy governor is elected from among the local government and area authority representatives. Funding for the new provincial governments is guaranteed by law, using formulae that take into account population, land and sea areas. Certain taxation powers have also been granted by law. Unlike its predecessor, the current bill makes explicit provision for the establishment of local-level governments.

The adoption of this bill in July was carried on the understanding that certain amendments were to be incorporated. These amendments have, as of October 1995, been unanimously passed by parliament. The implementation of the reforms took effect soon after the passing of the bill with full implementation scheduled to occur after the national elections in 1997. While there was a great deal of confusion and tension in the initial stages of change, the transformation appears to have worked out well for most provinces with governors now in full control. The bigger task of public sector reform to put in place the necessary staff at the provincial and district levels has yet to be organised. This is expected to take a lot of strategic planning because very little capacity and infrastructure is currently in place, especially at the district level. In view of this, the significant increase in funding to provincial governments under the 1996 Budget raises concern about the capacity to fully utilise these funds in approved activities.

Vanuatu

Elections and budget preparation

The national elections in Vanuatu were held in November 1995. The prospect of the election affected preparations for the 1996 Budget which was to be delivered in October, but has been deferred to the first sitting of parliament in the new year. While the bureaucracy has been busy with all necessary preparations for the budget, there has been very little political involvement. The lack of direction from the Council of Ministers for development policy initiatives and the absence of preliminary budget submissions from a number of key government departments, including that of the Prime Minister, were indicative of this lack of involvement.

In the absence of any political directives, the Third National Development Plan (1992–96), was to provide the framework for the 1996 Budget. The main themes under this plan are economic self-reliance, improved quality of rural life and balanced regional development. Four specific strategies have been adopted: decentralisation of growth centres, public sector reform to reduce size and improve efficiency, infrastructure investment and vocational education. It is expected that the new government would continue with these broad themes.

Fiscal developments

Under current policy, Vanuatu has been using a balanced budget approach. This is seen to be an important safeguard against overexpenditure. Past performance, with actual surplus budgets in 1990, 1991 and 1994 and marginal deficits in 1992 attest to this. The exception was in 1993 when significant overspending gave rise to a deficit of 251 million vatu, equivalent to 1.3 per cent of GDP. While the outcome for 1995 was expected to be close to a balanced budget, the fact that it is an election year could result in a different outcome, with a much higher deficit than previously. The increasing use of supplementary budget provisions during the year make this result a strong possibility. Preliminary figures for the 1996 Budget indicate that the level of recurrent expenditure requested by all government departments and statutory organisations is 2 billion vatu more than a planned revenue of 6 billion vatu for the year. The task of the Budget Committee is now one of trying to reach a balanced budget from these figures.

Public investment in Vanuatu has been funded through its development budget. A development fund has been maintained for this purpose, where funds are secured from international donors, loans, recurrent transfers and bond issues. The revenue flows into this fund have been quite variable, reflecting the uncertainty of having a large number of funding sources. Uncertainty and declining fund balances pose a significant threat to maintaining an effective development budget. While the withdrawal of British support has been somewhat offset by increased support from France, overall reductions in foreign aid are inevitable. Moreover, other donor countries like Australia are now beginning to adopt conditionalities for the support they provide.

The Vanuatu government has recently initiated a borrowing program whereby 6 billion vatu will be borrowed from commercial sources over the next five years. A Special Project Implementation Committee was set up to oversee this program. A total of 1.3 billion vatu has already been raised and the goal of an additional 700 million vatu has been set for 1996. The bulk of these funds are expected to be spent on infrastructure projects.

The priority sectors of health and education have requested the bulk of the increase in the 1996 Budget expenditures. The establishment of provincial and local-level governments with a guaranteed funding limit is also responsible for some of the increase. Under this legislation, no less than 5 per cent of internal revenue must be transferred to lower-level governments. Concerns have been raised that such a ceiling has been determined without much reference to the type of functions expected to be performed at the provincial level. Moreover, there is the issue of taking away 5 per cent of the revenue base with no specified offsets in expenditures. The inclusion of foreign aid-funded projects presents the added danger that the burden of financing them will have to be borne by the national government if aid is withdrawn.

The Vanuatu economy has been managed to date with great discipline, resulting in macroeconomic stability since independence. Along with the balanced budget approach, an expenditure control system has been in existence which has proved to be an effective guard against departmental over-expenditures. Statutory limits for supplementary budgets, approval for which can only be obtained from the Council of Ministers, adds to the discipline. These control mechanisms have also meant that government borrowing has been limited and quite selective. Where bond financing has been used, a bond redemption fund has been established, funded by the government's recurrent expenditure. The debt situation has therefore been manageable and debt servicing has not imposed an undue burden on government financial resources. This could change over the medium term with increased borrowings from commercial sources to replenish the development fund.

Macroeconomic developments

Economic growth in Vanuatu has been moderate and variable, reflecting the difficulties which small Pacific Island countries face in today’s competitive world and the vulnerability of their economies to external economic forces. Foreign aid, which in recent years has been equivalent to 20 per cent of GDP, has had an important positive influence on this result. Preliminary figures for 1993 suggest that growth in GDP in real terms was 4 per cent. Growth was dominated by the service sector although there was also a positive contribution from other major sectors of the economy. This performance was not likely to have been repeated in 1994, with expectations of more modest growth. Subdued overall economic performance in the first quarter of 1995 would suggest the continuation of the moderate growth trend of 1994.

Vanuatu’s current account balance has been dominated by a negative trade balance which has reduced the positive impacts of services and investment income and transfers. A negative current account balance of 1,778 million vatu was recorded for 1994, representing a deterioration of 68 per cent over 1993. The capital account balance for 1994 shows a positive balance of 3,530 million vatu. However, allowing for errors and omissions, official data show a negative overall balance of payments of 1,158 million vatu for 1994. This is a complete reversal from 1993 when a positive balance of 1,844 million vatu was recorded.

The Reserve Bank of Vanuatu estimates that foreign reserves as of June 1995 are about US$40 million. If copra prices remain favourable and the government borrows at levels budgeted for 1995, this should provide comfortable cover for the rest of the year. However, with exports providing cover for only 30 per cent of imports, it is important that government domestic borrowing be undertaken with a great deal of caution.

During the first quarter of 1995, broad money supply in the Vanuatu economy has remained at about the levels recorded at the end of 1994—25 billion vatu. About 56 per cent of this is held as foreign currency deposits and the rest held as vatu deposits. This reflects the pattern of asset holding by domestic commercial banks, whose net holdings have declined by 1.6 per cent over the 12 month period from March 1994. Total domestic credit over this period increased by 1 billion vatu to 7.6 billion vatu, an increase of 14.5 per cent.

The vatu exchange rate movement against major currencies has been varied. Over the 12 month period from March 1994, the vatu appreciated by 8.8 per cent against the US dollar and by 3 per cent against the pound sterling, but depreciated against other currencies of its major trading partners. This has been one of the contributing factors to Vanuatu's subdued economic performance.

The increasing trend in domestic inflation which began in the third quarter of 1994 has continued into 1995, with an annual increase of 4.8 per cent. Changes in business licences and the 4 per cent business turnover tax introduced in January 1995, appear to have contributed to this increase. This suggests that these costs are being passed on to the domestic consumer.

The turnover tax was adopted following a report on taxation reform which assessed new taxation opportunities while protecting Vanuatu's tax-haven status. A number of other taxation measures such as income and profit tax were also recommended in the report but not adopted by the Vanuatu government. Such selective adoption raises concern that the full benefits of the reforms recommended in the report are not likely to be realised. Reductions in the tariffs of a range of imported items, ranging from food to machinery, were also introduced in the year. While these were adopted to offset the impact of the turnover tax, legislation to implement them was passed some 3 months after actual implementation of the turnover tax, imposing an extra burden on the business community as a result of this delay.

Sectoral developments

The Financial Services Commission had its first full year of operation in 1994. Set up in 1993 to regulate and monitor the activities of the Finance Centre, the Commission has improved the coordination of operations, resulting in improved revenue flow into consolidated revenue. Of the total 300 million vatu raised, some 280 million vatu was channelled directly into government revenues. As of June 1995, the operations of the Finance Centre show increased activity, with gross turnover increasing by about 14 per cent, foreign exchange earnings increasing by 24 per cent and the number of ships registered increasing by 20.

A new agricultural development strategy is under preparation—a document which will form the basis for agricultural development in Vanuatu from 1996 onwards. This follows the completion of a national agricultural census in 1993 and the report published in October 1994. This strategy is likely to maintain current levels of support for existing agricultural activities and at the same time pursue a diversification program where opportunities exist and viability is established. For copra, alternative favourable markets in terms of distance are being sought and opportunities for downstream processing are being explored. Kava seems to have great export potential, especially with emerging markets in the United States and Europe. A production potential for vanilla and pepper has already been established and a marketing drive is currently under way to assist these farmers. With quarantine requirements being the main constraint to the trade of traditional crops, new fumigation facilities in Vila and Santo and greater public awareness should see a drastic improvement in these exports.

The Vanuatu Chamber of Commerce was established in July 1995 and has attracted good membership from the business community. Efforts to draw up a comprehensive document on investment guidelines commenced in 1994 and are continuing. This is seen as an important step towards the promotion of Vanuatu as an attractive investment location. All issues that affect investment, including land acquisition, are being addressed.

The fishing industry in Vanuatu is not significant, with much of past effort spent on extension services to teach fishing skills. This approach is to be reviewed in 1996, given recent increased interest in commercial fisheries. This review will also involve assessing current government involvement in fish marketing. The Natai Fish Market in Vila is 100 per cent government owned and has been forced to change management three times already in 1995.

The Tourism Master Plan has been completed and is awaiting approval by the Council of Ministers. It addresses issues ranging from promotion, which involves opening up offices in Australia and New Zealand and targeting the US, Europe and the Japanese markets, to investing in infrastructure capable of handling increased volumes. Upgrading of the airport facilities and new hotel buildings have been identified as areas of need. The Melanesian Spearhead Group has made a commitment to promoting tourism at the sub-regional level. The promotion of ecotourism has received some support in Vanuatu. Efforts are already under way to identify areas which have some natural advantages so that they can be set aside as tourist attractions.

Solomon Islands

Development strategy

On taking office, the current government of the Solomon Islands drew up a policy document, *Development Framework: policies, strategies and program of action 1995–1998*. Regarded as a party agenda for the Solomon Islands National Unity, Reconciliation and Progressive Pati, this statement provides a program of action which relies on maximum utilisation of the country’s natural resources to generate incomes for financing essential services, create jobs, expand local processing industries and promote trade. Economic growth is also stated as an important national development objective.

Fiscal developments

Expansionary fiscal policy has characterised national budgets in Solomon Islands in the last three years. Budgeted expenditure for 1995 was 30 per cent higher than 1994, with planned spending on debt service increasing by over 50 per cent. This represents the net effect of increasing fiscal deficits over the last 4 years. Except for 1992, when Solomon Islands recorded a surprising fiscal surplus, fiscal deficits have been 112 per cent to 273 per cent higher than budgeted over this period. Persistent overexpenditure, especially in 1993 (21 per cent) and 1994 (24 per cent), has added to these deficits. Substantial increases in logging revenues, grossly underestimated in recent budgets, were responsible for cushioning the impact of overspending on fiscal deficits. It had also cushioned the impact of the shortfall in non-log revenue in 1993 and 1994.

The current government's policy on utilising natural resources to generate incomes has presented Solomon Islands with the unique situation of having greater revenues than budgeted. While some of this increase had been given over to development expenditure, indicated by higher development expenditure than budgeted, much of this advantage has been wasted. Increasing fiscal deficits, especially in the last two years when it has increased from SI$22 million to SI$79 million, is an indication of this. The Central Bank of Solomon Islands in its 1994 annual report indicates the strong possibility that the actual deficit for 1995 will be well above this amount. The actual deficits for 1993 and 1994 were 273 per cent and 197 per cent higher, respectively, than budgeted. With current indications for declining log revenues during 1995, the Central Bank's assessment could well have been realised before the end of 1995.

In August 1995, however, the Central Bank took a hard line against the government by announcing that it would no longer service any treasury bills. While this action was prompted by government moves to borrow beyond its statutory provisions, there was also a genuine concern, at least on the part of the Central Bank, that the gross deficit was reaching dangerous levels at SI$755 million. The domestic component had exceeded the foreign component in 1994, raising concerns of 'crowding out' the private sector. Assessing the gravity of this situation, the commercial banks restrained lending to the government such that by September 1995, the government was successful in borrowing only SI$17 million of the SI$79 million it required for the year. Much of this represented financing from the Central Bank and the National Provident Fund of the Solomon Islands.

While such difficulties should force any government to change course, this does not appear to have happened in Solomon Islands. Indications are that the government is currently accumulating debts with its domestic and external suppliers of goods and services. This has undermined the tough stance of the Central Bank, hence its perception that the deficit in 1995 is likely to exceed the budgeted level. This is likely to eventuate only so long as private suppliers are willing to carry government debt. The true extent of deficit in this case will not be known immediately so that there is no sense of crisis, even if the threat is real.

The lack of concern for the growing deficit is also reflected in recent changes to levies which have given substantial exemptions and concessions to the private sector. Under the circumstances prevailing at the end of 1994, these measures were seen to be counterproductive, especially in view of increasing budget deficits. There was also concern that the groups targeted by such exemptions were the least deserving. Logging companies have been exempt from the timber levy so that their effective rate of levy is only half the required 7.5 per cent. The total effective log export tax has also declined from over 35 per cent in 1994 to about 20 per cent in 1995. Given problems of government borrowing, it is likely that a number of these exemptions will be reversed before the end of the year. The Central Bank estimates that these exemptions represent about SI$60 million worth of revenue.

In the last two years, overexpenditure has reached levels never before reached by any government in Solomon Islands. In 1994, the government overspent by 24 per cent, all of which was in its recurrent budget. This has raised concerns regarding government resolve for genuine controls. A Public Expenditure Screening Committee which existed up to 1993 became essentially an expenditure stamping system with virtually no controlling powers. This was dismantled and replaced with a Budget Management Committee but the new government, in taking up office, set up its own Public Expenditure Control Unit within the Ministry of Finance. It is staffed by only one senior public servant, and does not appear to be functional or have any real authority. Its routine functions appear to duplicate those already performed by the Budget Unit. The expenditure control system is also affected by the lack of timely expenditure information. Under these circumstances, it makes sense to promote greater accountability and control at the departmental level.

Macroeconomic developments

Economic growth in Solomon Islands has, in recent years, been driven largely by increased exploitation of its rich forestry resources. The current estimate for growth in real GDP in 1992 is 8.2 per cent. Such a rate could be expected for 1993 as well, given increased government spending and the doubling of log export values for the year. The Central Bank estimates an average growth of about 3–4 per cent over the last three years, with similar growth expected for 1995. While such rates are impressive under normal circumstances, high population growth rates during this period have meant that per capita incomes have declined. In addition, a great deal of concern currently exists, both internally and externally, with regard to rates of log extraction. The current levels of log output, at 6–700,000 cubic metres, are estimated to be two or three times higher than sustainable levels. This raises the critical issue of the sustainability of the moderate levels of growth achieved to date.

For the first time in many years, a positive trade balance was recorded in 1994, reflecting a strong performance from the export sector, especially fish and palm oil. Large service outflows and declining transfers continued to dominate, however, resulting in only a marginal improvement in the current account balance for the year. While the capital account has recorded significant net inflows, especially in the form of direct investment in the resource sectors, this changed in 1994 with a significant decline in direct investment, resulting in a small net outflow of SI$1.9 million. A positive net balance of payments of SI$6.6 million was reported for the year as a result of adjustments relating to errors and omissions. Notwithstanding this, the level of gross reserves in the second quarter of 1995 stood at SI$56.5 million, providing only sufficient cover for one month's imports. This is the lowest figure since 1992, raising concern that it may not be sufficient to counter any shock to the system. Increased government consumption in recent years could lead to further deterioration in this situation, in which case a crisis similar to that faced by Papua New Guinea in 1994 would be imminent.

Slow growth in money supply over the year to June 1995 is a surprising result given heavy borrowing by the government during this period. The Central Bank appears to have successfully sterilised much of this through sales of treasury bills as well as the government's own action of non-payment of creditors.

The high levels of liquidity in 1994 continued into 1995, although there was a reduction in the last quarter to June 1995, reflecting the effects of liquidity tightening and changes to the liquid asset ratio from 30 per cent to 40 per cent. The bulk of this liquidity has, until recently (that is, 1994), been held as Bokolo Bills. They are now held mostly as deposits with the Central Bank. Increasing the treasury bill rates by 2 per cent and the early redemption penalty rate by 5 per cent has done little to revive interest in the Bokolo Bills. With the actual liquidity level well above the required rate and given the stance taken by the Central Bank with regard to treasury bills, this trend is expected to continue.

The growth in domestic credit over the past year has slowed due to declining credit to government. Private sector credit, on the other hand, has been on the increase, reversing the trend over the previous 5 years. Increases in private sector credit have been distributed across all sectors, but with the service sectors attracting the bulk of funds.

The Solomon Island dollar has continued to depreciate against all major currencies. The steady depreciation against the US dollar reflects the active nature of exchange rate policy currently being pursued in Solomon Islands. Constant depreciations have been used to protect against a balance of payments crisis. A slight appreciation against the Australian dollar was recorded in the second quarter of 1995.

The high levels of inflation recorded in early 1994 have tapered off, declining to about 9 per cent in the second half of 1995. Much of this early inflation was driven by price increases of local items. With these increases now entrenched, the rate of inflation is expected to remain at its current level, around the average for the past 7 years.

Sectoral developments

The adoption of an agricultural sectoral plan in 1994 has provided a new framework for the development of agriculture in Solomon Islands. Important strategies under this plan include export diversification through downstream processing for the traditional exports of copra, cocoa and palm oil, revitalisation of extension and support services, better land use management, proper coordination of projects between the national and provincial governments and proper planning, implementation and monitoring of agricultural activities. A Farmer Support Program, with a 5 year funding of SI$11 million, was established in

1994 to promote agricultural productivity. Opportunities for diversification have been identified in chilli production, dairy farming, bee keeping, rice and vegetables. The Public Sector Investment Program will be utilised to develop some basic infrastructure to support these programs. In 1994, agricultural exports represented about 15 per cent of the total value of exports from Solomon Islands. Production of these commodities continued to increase in the first half of 1995.

The importance of the fishing industry in Solomon Islands has been overshadowed in recent years by developments in forestry. The fishing industry accounts for some 20 per cent of total export earnings, providing a strong base for the economy. Production rebounded in 1994, increasing by 20 per cent to 30,005 tons, after poor performances in the two previous years. Solomon Tayo Ltd dominates processing, producing over two-thirds of the industry output while the National Fisheries Development Ltd contributes the balance. This level of production is expected to be repeated in 1995, providing the opportunity for the Solomon Tayo cannery to operate at full capacity to produce a record 1 million cases of canned tuna. Extra production capacity is also expected given the approval in 1995 to a Taiwanese company to catch tuna for the sashimi market. A total of 19 longline boats have since been engaged. While there has been a great deal of interest in the industry by foreign investors, a number of problems have been encountered with operators not following guidelines, resulting in the withdrawal of licences. New areas of interest such as clam farming and aquarium fish production have also emerged in recent years.

A number of bilateral fishing agreements have been utilised by Solomon Islands to market its fisheries resources in the 200 mile economic zone. Some 120 foreign boats were allowed to fish in this zone in 1994, generating SI$6 million in licence fees. The current fee rate of 4 per cent of the value of total catch is to be reviewed with a view to increasing it to 5 per cent.

The tourism sector in Solomon Islands is largely undeveloped although the potential is large. In recognising this potential, the government plans to revitalise the Tourism Authority by turning it into a Visitors Bureau, supported with all necessary funding. Along with the Tourism Division of the Ministry of Tourism, Culture and Aviation, both organisations will oversee tourism development in the country. The problem of limited tourism infrastructure has long been recognised as a constraint to foreign investment. Under the public sector investment program, this sector is likely to receive priority. Activities targeted under this program include airport expansion and upgrading work, new hotel developments through government organised land leasing arrangements and a special fund of SI$0.5 million to assist the development of local culture and nature-based attractions for tourists.

With highly concentrated manufacturing industries, the government has pursued an active policy of developing small to medium-scale industries, providing assistance with credit and the actual set up of the activity. About 21 such industries were established in 1994 and another 29 are scheduled for establishment in 1995. The government has also established an industrial estates program where all necessary infrastructure will be provided to support small industrial activities. Recently announced duty free zones are expected to include all activities under the industrial estate program.

The forestry sector continues to attract the greatest attention. A draft forestry policy document has been prepared with emphasis on issues of forest revenues and taxation system. It emphasises the need for equitable distribution of logging rents among all interested parties, the importance of promoting a stable investment environment, the need for sustainable development of the resource and the need for an effective monitoring and enforcement system. Logs continue to dominate export revenues, generating about 56 per cent of total export revenues. Export duties on logs were amended several times in 1994, with the new government reducing them from 35 per cent to 32 per cent for logs valued at up to SI$250 f.o.b. per cubic metre and from 55 per cent to 35 per cent for the amount in excess of this f.o.b. price. The National Forestry Inventory has been completed but has received little political support as indicated by the delay in its adoption. The Timber Control Unit continues to function, performing a monitoring role under trying conditions.

Foreign investment in Solomon Islands has been promoted through the Foreign Investment Board. A total of 35 new applications worth SI$762 million were approved in 1994. However, investment data from the Central Bank suggest that only SI$28 million worth of investment had been implemented in the year. While this may well reflect the difficulties of implementing investment plans, it also reflects the scope of needed improvements in administrative processes that enhance implementation. This is particularly true for resource development proposals that require provincial government and landowner approval. Some provincial governments opposed to the idea of foreign investment have used their powers to impose high licensing fees to discourage foreign investors. These issues need to be resolved urgently if investment is to be promoted in Solomon Islands.

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Fiji

Compared with most other Pacific island countries, Fiji is blessed with abundant natural resources and has achieved a high level of human resource development. Its social and economic development give it a lower middle-income country ranking.

The political turmoil in Fiji in 1987 wiped out the income gains of the previous decade. The government lessened the economic effects of the military coups by adopting fiscal, monetary and exchange rate policies that stimulated growth. Despite the devaluations and a plethora of investment and tax incentives, however, the Fiji economy has performed unevenly since 1991. In particular, private investment in the manufacturing and construction industries, crucial in generating much-needed employment opportunities, has been on a downward trend since 1988, with no upturn in sight. Data provided by the Reserve Bank of Fiji clearly show a recent sharp fall in the rate of provision of private sector credit. Even though a financial and management crisis overtook the government-owned Bank of Fiji during 1995, shortage of credit has not been the cause of the lack of investment.

Issues of governance and political uncertainty appear to be the most powerful deterrents to private investors. Under the 1990 constitution, Indo-Fijians are held to a minority in the parliament and access to senior government positions is limited. Another factor contributing to uncertainty is the cloud over the future of sugar cane leases, held mainly by Indo-Fijians, on land predominantly in Fijian ownership. One costly manifestation of the racial disharmony is the yearly outmigration of 5,000 skilled workers; annual population growth has been reduced to 1 per cent as a result.

Government investment is also low. The very large and comparatively well-paid public service competes for government funds and labour market flexibility is confined to the private sector. Loss-making public enterprises place an additional drain on the public purse. An improved fiscal performance has involved the introduction of a value-added tax to replace customs duty, sales tax, hotel turnover tax and excise tax. However, compliance has been low, except at ports, and exemptions are significant. There has been a lack of investment in physical and human infrastructure such as roads, schools, primary health care and hospitals, as well as underexpenditure on their operation and maintenance. This trend seems to reflect the priorities of government rather than a lack of where-withal, given that government revenues have increased sharply as a result of the new tax arrangements.

Another inhibiting factor to investment appears to be the lack of economic policy direction. Instead of clear signals being given that the human and physical resources of the country are being freed up, many of the rigidities, restraints and distortions in the economy remain in place. For example, trade protection is still significant—raising production costs—while domestic price controls inhibit incentives for domestic production. At the same time, the requirement for multiple permits and the application of administrative criteria by the Fiji Trade and Investment Bureau can be restrictive. Another performance-inhibiting factor is the constant interference by government in the running of statutory organisations.

While there are still generous tax incentives to exporters, the upward drift in the real exchange rate has already eroded most of the benefits of the currency devaluations of 1987, according to the World Bank (1995). Even though the Fijian exchange rate is pegged against a basket of currencies of its major trading partners, high relative domestic inflation rates over the last few years mean that generators of exports and of import-competing goods face a steadily increasing disincentive to invest and expand. And while there is no longer a danger of capital flight, foreign exchange controls are still in place. The fundamental long-run competitiveness of the textile industry—now a major employer, particularly of women—is being questioned, given Fiji's comparatively high wages and the fact that raw materials must be imported.

A clear policy directive is all the more necessary in the light of a changing global trade environment. The erosion of tariff preference—into Australia and New Zealand, and of import quotas to other destinations for Fijian manufactures—herald profound changes to trade patterns in train under GATT / WTO, NAFTA and APEC.

Major industry trends: the manufacturing sector

The manufacturing sector has been given a key position in the new development strategy of Fiji. It is now seen as a leading sector, rather than simply as a complement to the two earlier pillars of the economy: agriculture and tourism. Ministers of Finance now regularly compare Fiji's economic performance with the Asian 'tigers' and, more recently with Mauritius, implicitly identifying the key position of manufacturing in the country's new development strategy.

In the last eight years, the Fiji government has undertaken many measures designed to reorient the economy towards export production, encourage savings and investment, promote internal competition, increase foreign (and local) investment, and encourage greater participation of indigenous Fijians in commerce and industry.

In recent years, the manufacturing sector has performed well. Manufacturing

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value-added growth has averaged 5 per cent per annum over the 1988–94 period, being particularly strong in 1994, when it increased by 8 per cent. With strong garment exports already evident in the first six months of 1995, and annual exports expected to top F$200 million, manufacturing value-added is expected to be even higher in 1995.

The manufacturing sector's performance has been especially strong in employment growth. Not only has the earlier decline in absolute terms in the manufacturing sector labour force been arrested, but there has been a high rate of employment generation. Manufacturing employment increased from just under 14,000 in 1986 to almost 23,677 in 1994. In fact, for most of this period, the manufacturing sector has provided the bulk of the new jobs created in the economy as a whole.

There has been a significant increase in the number of females in the sector. In 1986, women represented only about 24 per cent of the manufacturing labour force, but this is estimated to have increased to 54 per cent by 1994 (almost 13,000).

The manufacturing sector has performed equally well in exports. Manufactured exports (basic and miscellaneous manufactures) grew from just F$1.8 million in 1976 to F$205 million in 1994. Manufactured exports grew by an average of 52 per cent per annum between 1988–94, a very high rate of growth by international standards.

Most of the increase has been in garment exports which now stand at F$140 million, having increased from only F$4.9 million in 1986. The first six months of 1995 show an increase of 48 per cent in garment exports over the same period in 1994, suggesting that the 1995 total will exceed F$200 million.

Footwear exports have also increased dramatically, increasing from around F$420,000 in 1991 to F$3.6 million in 1994.

Reduction in government protection, from extremely high and variable rates to a standard rate of 22.5 per cent in 1995, has resulted in increased competition for domestic producers. Consumers have benefited through reduced costs, increased range and better quality. One indication of the positive response of manufacturers to the new competitive environment is the increasing number of International Standards Organisation certifications being obtained by Fiji manufacturers. There are, however, continuing problems in the manufacturing sector. Investment in the tax free factories sector has been declining recently (the number of approvals declined by 57 per cent between 1991–93) along with new employment creation and investment. There are also problems of skill shortages, with inadequate linkage of market demand for skills with their supply.

In addition, the manufacturing sector is becoming more and more dependent on garment production, which increased its employment share of tax free factories from 75 per cent in 1989 to 87 per cent in 1993. Its share of manufactured exports of Fiji (basic manufactures and miscellaneous exports) in 1994 was 84 per cent. The garment industry is a sunset industry and in the case of Fiji, given the peculiarities of the local value-added requirements under SPARTECA, is more footloose than might normally be the case. There are worrying signs that initial sales in Europe and Asia are not being sustained. For instance, Fiji exported garments worth F$2.3 million to Singapore in 1993, but this fell back to only F$18,000 a year later.

The government is committed to a further reduction of tariff rates. There are, however, some concerns that detailed information on the impact of deregulation, particularly on the investment decisions and long-range capacity plans of manufacturers, need to be considered. In addition, it is vital that the government ensures infrastructure costs become internationally competitive; these costs are currently very high compared with those in neighbouring Australia and New Zealand. For instance, the cost of electricity to industries in Fiji is almost three times that in Australia. Moreover, the report of the Sub-committee on Private Sector Development (1995), a government appointed group, is scathing in its evaluation of the Ports Authority of Fiji which has monopoly control of another key service for the manufacturing sector—ports. There has been political interference at the highest levels in the operation of ports.

The Fiji economy as a whole must be seen in the light of the country's abundant and accessible natural resource base. This confers on Fiji comparative advantages in agriculture, tourism and fishing.

The natural resource sectors

The importance of subsistence production is highlighted by the engagement of more than two-thirds of households in agriculture, and it is from surpluses in this sector that an abundant supply of produce reaches the growing urban population.

Sugar. Sugar comprises 30 per cent of total commodity exports, maintaining a value of about F$350m over the last six years. Its social importance is underlined by the fact that it employs a quarter of the economically active population. The long-term future of the industry is uncertain, however. A price subsidy is guaranteed by the European Union until 2001 when a new pricing arrangement will be negotiated. Given the need for the European community to meet its GATT obligations, it is likely that the price after 2001 will be lower than the present price.

Price subsidies have caused Fiji to become a high-cost producer. The price to the grower, and the price signal, is an average of the subsidised and the free market price which is around US$0.18 per pound, compared to the world market price of around US$0.12 per pound. The price to the grower at the margin should be US$0.12, not US$0.18. The distortion caused by price averaging encourages sugar producers to crop marginal land which would be unprofitable at the world price. It also prevents growers from diversifying into other niche markets. The expansion of area under sugar stimulated by subsidised prices has been accompanied by a decline in the amount of sugar extracted per tonne of cane. But price signals to growers that favoured quality sugar cane production and resulted in processing efficiency are also lacking.

Steep hillsides are being brought into production with consequent severe soil erosion. The need for soil conservation work is ignored and the agricultural potential of the marginal land is destroyed. The long-term costs are a loss of land productivity and river and inshore water sedimentation leading to reduced coral reef productivity, but there is also a significant short-term cost in the dredging of rivers to keep them navigable, and an increased incidence of flooding.

An underlying cause of the failure to implement soil conservation works is the uncertainty of property rights in agriculture. A high proportion of leases are due for renegotiation in 2000–01, but only 60 per cent of landowners have indicated that they will renew leases, opting to grow sugar themselves. The social costs of the displacement of a high number of the Indo-Fijian community could be exacerbated by any price adjustments to sugar that take place at the same time. The twin imperatives required to secure the future of the sugar industry are ensuring that correct price signals are sent to the growers of sugar, and securing the property rights of growers.

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Tourism. The structure of arrivals in the tourism industry has been changing, with an increase in arrivals from Asia and New Zealand but a decrease from elsewhere, including Australia. These trends are a result of new air links as well as changes in the economies of country of origin. While the tourism industry will remain a significant contributor to the Fiji economy, its further expansion is problematic, given the economic trends affecting tourism demand. Due to an expansion of capacity faster than visitor numbers, the occupancy rate of existing hotels is well below the levels that the industry regards as necessary to trigger a new round of investment. An underlying problem, affecting not only the expansion of the tourism industry but also of primary and manufactured goods, is the steady rise in the real value of the Fijian currency. Other destinations in the region now offer cheaper holidays. Possible uncertainties with respect to tenure over property is also a negative factor in investment decisions. Another possible impediment to the expansion of tourism is the rundown of essential services resulting from the lack of maintenance expenditure on water and electricity supply, and sewerage.

Fish. The export of chilled and fresh tuna has grown rapidly over the last few years. It is worth about F$16 million, and promises to be a major future contributor to export income. Canned tuna, with exports over F$30 million, is the main contributor to an export industry which is worth about F$60 million, comprising 12 per cent of the country's commodity exports. The future of exports of canned tuna to Europe is clouded given the changes in trade arrangements.

There are several contributory factors to the growth of the fresh fish market. Most importantly, private sector entrepreneurs have been able to deliver high quality products to the high-priced Japanese and US west coast markets. Shipments are made possible by three direct flights to Japan and access to the west coast via Honolulu. However, the availability of air freight may become a restraint on the growth of the industry.

The number of domestic long-lining vessels licensed to fish Fijian waters, has increased from 10 in 1990 to 40 in 1995. Stocks of the main tuna species being targeted (albercore, yellowfin and bigeye) are plentiful. The maximum sustainable yield, according to the South Pacific Commission, is considerably greater than present catches. Limitations on further expansion of this lucrative fishery are the provision of port facilities and infrastructure. In contrast to private enterprise, the government-owned cannery and fishing fleet face financial difficulties. The preferred role for government in fisheries is to regulate catch and manage stocks.

Summary

Contributing to Fiji's poor economic outlook are continuing political uncertainty, the price of labour and the high value of the Fiji dollar. While trade liberalisation, public enterprise reform (three enterprises were put on the market in 1995) and public service reform are underway, there are still significant structural inhibitions to development. An improving standard of living and quality of life would appear to be contingent on resolving political conflicts and adopting policies that allow efficient resource deployment. Clear policy directives are necessary in the light of a changing global trade environment.

The manufacturing sector has responded well to the new policy environment, helped by the provisions of SPARTECA, and by the systematic deregulation of the Australian and New Zealand markets. Employment and exports have grown substantially and even dramatically. The manufacturing sector faces serious problems, however, some evident and some incipient, and government, industry and labour will need to cooperate to ensure continued industrial growth. To do this, the government needs to resolve critical national problems, such as the adoption of a constitution acceptable to the majority of the people in Fiji, resolution of land tenure problems (which have the potential to wipe out employment gains and cause significant social and political upheaval), a commitment to a reduction in the size of government, privatisation of government assets, and the creation of a powerful and a unifying national sense of purpose. Without these, Fiji will probably continue to grow, but it will not perform to its potential, nor will it be able to satisfy the rapidly increasing aspirations of the majority of the people.

Distortions in prices and lack of clear property rights in Fiji are major challenges in the agriculture sector. In contrast, the fish export industry is an area where rapid, apparently sustainable, growth is taking place.

A continuation of low levels of investment in public infrastructure is likely to affect not only the level of human resource development, but also the ability to maintain the quality of local environments and, through them, the health of the population. At the same time, there is an increased requirement for families to adjust to new economic circumstances. Urban poverty is a serious problem and social costs are tending to erode the benefits of economic reforms. Urban drift, the ageing of the population and the slow rate of job creation, have increased the need for poverty alleviation.

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Tonga

While there was a steady performance by most key economic indicators in 1994/95, there was an alarming deterioration in others. GDP in real terms grew 2.2 per cent, the budget recorded a surplus, prices were stable as were interest rates and the real exchange rate, while private sector savings were buoyant.

In contrast foreign reserves fell drastically due to a severe deterioration in the balance of payments. The growth in private credit fuelled imports, and at the same time there was a decline in exports. Consequently, reserves fell by 24 per cent to reach an all-time low in import cover. The government has noted that the trends in credit, balance of payments and reserves cannot continue without prejudicing performance.

Growth occurred mainly in agriculture, forestry and fisheries, and electricity and water, while shrinkages took place in manufacturing, construction and tourism.

The balance of payments

There has been a depreciation of the real effective exchange rate, signifying an improvement in competitiveness. Major factors contributing to the depreciation were the steep appreciation of the yen and, to a lesser extent, the New Zealand dollar during the latter half of the year, combined with a low rate of domestic inflation. Government statistics for 1994/95 reveal a total value of exports of T$18 million, a decline of 18 per cent (T$4 million) on the year before. Almost all the decline is attributable to a fall in receipts from squash, an agricultural export crop with a niche market in Japan. Nevertheless, squash exports still represented over half of the total, with vanilla and fish exports also important. Another factor contributing to the fall in export income is the long-term decline in manufacturing from 31 per cent of exports in 1989/90 to an insignificant level last year. The virtual disappearance of manufacturing has left Tonga even more dependent on a narrow primary production base. The substantial increase in imports together with the fall in exports resulted in a trade deficit of T$77.5 million, up T$11 million on the year before.

As a result of trends in the values of exports and imports, foreign reserves at the end of fiscal 1995 were T$33 million. As recently as November 1993, however, they had totalled T$53.5 million. The import coverage represented by foreign reserves had declined from 7.3 months to a level of a little over 4 months at the end of fiscal 1994/95.

Trends in primary industries

Land and marine resources are the backbone of the subsistence economy in which the majority of the population participates. In the absence of significant tourism and manufacturing there are significant efforts being made to generate export income from natural resources.

For example, the rise of the export squash industry over the last eight years has been dramatic. The industry is not only a major contributor to export earnings, but it is a major employer, with production spread among 2,000 growers supplying 14 licensed exporters. Export rejects of squash contribute significantly to local food supplies.

A price fall in the Japanese market for the 1994 crop led to the decline in export income from squash. The fall impacted heavily on Tonga's foreign reserves. There were several causative factors, one being the fact that shipping was not coordinated with the requirements of the market or the production of the crop. Consequently there was an oversupply of poor quality squash on an already depressed Japanese market.

While the future of the squash industry rests on timely delivery of a quality product, there are other production factors which should also be monitored closely. Information from the Tonga Development Bank and the Ministry of Agriculture and Forestry indicates a decline in soil fertility, and the emergence of plant disease and human health and environmental problems associated with the use of pesticides and chemicals. As a consequence, production has shifted to new lands in the west of Tongatapu from the east, and there is now a great deal of emphasis by the extension services of the Ministry on organic squash production which uses less, and less-harmful chemicals. Early indications are that organic squash is of superior quality and yields just as well as chemically grown squash.

The relatively poor returns in 1994 resulted in a high default rate by growers on development bank loan repayments. A combination of a dry season and poor 1994 returns has resulted in a fall in the area of 1995 plantings to only half those of 1994. A reduced area and lower yields could easily depress production to well below the 1994 export quota level of 14,000 tonnes set by the Tongan government. Lower export earnings from squash could have a significant negative impact on the balance of payments in 1995–96.

The considerable fish resources of Tonga are presently harvested mainly by subsistence and artisanal fishers. Research indicates that there are considerable offshore tuna stocks that could be profitably harvested. It has already been confirmed that catches from longline vessels will fetch high prices on international markets. This would provide a much-needed diversification in the country's sources of income. An increase in catch from the unexploited resources would also relieve the pressure on the heavily exploited snapper fishery.

At present there are a handful of vessels actively engaged in catching, chilling and exporting. The degree of quality control and marketing expertise necessary to succeed in the chilled fish export industry is considerable and valuable experience is being built up by the few private operators. There is also a three-vessel fleet of Tongan-owned vessels that targets tuna for the canning market, delivering supplies to the Seakist cannery in Pago Pago. The government is presently reviewing policy with a view to the introduction of licensing and management arrangements to ensure that Tonga captures the benefits from marine resource exploitation and that catch levels are sustainable. Additional investment in infrastructure to allow efficient operation and processing will be necessary.

Western Samoa

Western Samoa's economy is characterised by substantial inflows of both remittances, from expatriate Western Samoans, and aid. The annual rate of flow of remittances in the first quarter of 1995 was 88 million tala (A$150 million) and the flow is increasing with growth in the New Zealand economy. The flow of aid in the same period was at an annual rate of 72 million tala. The volumes of these flows allow very high rates of both private and government consumption. They also meet a substantial part of the significant balance of payments deficit. The size of these flows notwithstanding, drawdowns of foreign reserves have resulted in a reserve of 110 million tala at the end of the first quarter of 1995, or the equivalent of 4.9 months of imports.

Subsistence agriculture and fishing still support the majority of the *in situ* population, the export base being narrow. While the country has a comparative advantage in the region in fertile agricultural lands and has a competitive exchange rate, there are strong inhibitions to development in the high flows of income from other sources and a lack of technical skills in the population.

In recent times cyclones have had a devastating effect on development and national income. In addition, the taro virus has caused receipts from the export of taro to be reduced to insignificant levels. These difficulties in the Western Samoan economy have been increased by the recent financial crisis of Polynesian Airlines.

Economic management and trends

Substantial aid flows to repair damage and replace infrastructure and a drawdown of international reserves to fund a high requirement for imports were necessary as a result of two cyclones, one in early 1990, the other in late 1991. Aid flows and remittances have continued at very high levels inducing high consumption in the government sector and high consumption relative to savings in the private sector. The government is responsible for most of the investment yet savings deposits offer only 3 per cent while the average lending rate of banks is 12 per cent.

While trends in GDP tend to be of much less significance in subsistence economies of the Pacific islands, compared to industrialised economies, this indicator nevertheless reflects the effect of lower primary product prices and cyclones: the trend in Western Samoan GDP per head has been downwards since 1989 and now stands at about 1,000 tala.

The demise of the staple food crop taro, plus the introduction of a goods and services tax in the beginning of 1994, resulted in high inflation in that year. The CPI peaked at 18.4 per cent in December 1994 (average over the previous 12 months). The effect of the tax has worked its way through the economy and inflation is now below 10 per cent.

An historically high rate of inflation has not produced an upward trend in the real exchange rate. Devaluations in the 1980s, and a managed exchange rate since, have steadily depreciated the tala against the currencies of Western Samoa's major trading partners. While the recent high inflation will probably have strengthened the tala's real value temporarily, the country remains one of the most competitive in the South Pacific.

While the low wage rates in Western Samoa are attractive to investors they encourage emigration and have induced a shortage of skilled and agricultural labour. The net departure rate of over 6,500 Western Samoans in the first quarter of 1994 (the latest period for which figures are available) was the highest for any quarter since 1989.

High fiscal deficits have been a feature of the last few years. Total government expenditure more than doubled over the period 1989 to 1993. While the completion of the major cyclone rehabilitation has seen total capital expenditure fall substantially, recurrent expenditure is still rising, due mainly to the government's wage and salary bill. The net result has been a further increase in external debt and drawdowns in international reserves during 1994 and the first quarter of fiscal 1995. The failure of Polynesian Airlines necessitated a draw-down of reserves of 23 million tala in 1994—financial restructuring arrangements for the airline will require similar drawdowns in 1995 and 1996. While the international reserve situation may provide cause for concern, the loan structure reflects an increasing trend to soft loans; as a consequence debt servicing rates and costs have steadily fallen since 1989.

Development prospects

The underlying decline in the terms of trade for agricultural products does not conjure a rosy picture for raw exports in general. One prospect for agriculture would, however, appear to be in the development of vegetable, fruit and other horticultural exports. The root crop taro, for example, was formerly a major contributor to foreign exchange, constituting 64 per cent of exports and worth over 9 million tala in 1993, but this crop will probably take several years to recover from disease. (Meanwhile, the substitution by growers of other root crops has filled the gap in the domestic food market.) Niche market development for horticultural products requires quality control, marketing skills, transport availability and, in the case of fruit and vegetables, special treatment of produce to overcome the quarantine restrictions of importers.

The export volumes of coconut cream and coconut oil, traditional coconut-derived products badly affected by the cyclones, have taken some time to recover but are now undergoing a resurgence. The expansion of processing of agricultural products for export presents one of the most attractive areas for private investment.

A Japanese plant (Yasaki), manufacturing automobile wiring components, established in 1991, has since expanded to become the largest single employer in the private sector. Yasaki now has 1,700 Western Samoans, mostly women, on its payroll. The country's relatively low wage rates will continue to be an attraction to industrial assemblers.

Large, continuous flows of remittances

and aid tend to obscure the fact that the lands, forests, and near and offshore waters of Western Samoa are the productive bases upon which most of the population will continue to rely for subsistence and that will generate the bulk of export earnings. But much development has already been environmentally damaging to the productive base. Deforestation for agriculture not only threatens several plant and animal species with extinction but has also diminished the limited surface water resources. Production figures do not reflect the increase in area brought into agriculture, probably because of a decline in fertility of existing lands. Given the dominance of customary ownership of land, the stimulation of community action for land and watershed management is the key to prevent further irreversible losses of natural capital.

Inshore marine resources have been seriously overexploited. Dynamiting of the reef and fish poisoning continue. Nevertheless, the fish resources of the deeper waters offer prospects for sustainable development—to meet both domestic needs and to generate export income. The development of offshore fisheries for the domestic market is receiving attention, assisted by AusAID. In addition, there are two Western Samoa-based exporters already supplying lucrative exports markets in New Zealand, the United States and Japan with chilled fish.

The regular air services of Polynesian Airlines to New Zealand and of Air New Zealand to Auckland and Honolulu are allowing the growth of tourism and the export of the high-value chilled fish. The lack of freight space may, however, be limiting expansion.

The natural attractions, history, culture and ambience of Western Samoa are appreciated by a growing number of tourists. But there is inadequate disposal of sewage effluent and other wastes, particularly in Apia. The resulting pollution of valuable ground and inshore waters not only threatens the expansion of the tourism industry but also poses human health risks and destroys local environments.

Due to its high literacy and life expectancy levels, the UNDP ranks Western Samoa about half way up the human resource development index of countries. This ranking tends to mask deficiencies in education—the lack of technical and managerial training limits employment opportunities—and in the participation of women in the economy.

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