



# Strategy and Program Assessment

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## Republic of the Fiji Islands: Macroeconomic Assessment

# Fiji Islands

## Macroeconomic

### Assessment

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Abbreviations

ADB	Asian Development Bank
COLA	Cost of living adjustments
FIRCA	Fiji Islands Revenue and Customs Authority
FNPF	Fiji National Provident Fund
GDP	Gross domestic product
GoF	Government of the Fiji Islands
IMF	International Monetary Fund
MoFNP	Ministry of Finance and National Planning
RBF	Reserve Bank of Fiji
VAT	Value-added tax

## Executive Summary

In 2005, the Asian Development Bank (ADB) approved a new policy covering cost sharing and expenditure eligibility for bank financing. Central to the implementation of the new policy is the determination of country cost sharing ceilings based on a macroeconomic assessment. This paper presents the findings of such an assessment.

The fiscal stance is and has been expansionary

The period following the 2000 coup is the most expansionary 5 year period since independence. The budget deficit was 6% or more of GDP from 2001 to 2003 and has remained high subsequently. A trend deficit of the order of 4% of GDP is expected over the foreseeable future. As general government debt has reached 52% of GDP and the Government's contingent liabilities are a further 22% of GDP, such an expansionary fiscal stance is of concern.

This puts pressure on the macro-economy

Fiji's budget deficits are largely funded domestically and support a high wage and salary bill. Such deficits fuel domestic demand and ultimately impose pressure on the balance of payments. Likely outcomes are ever tighter monetary policy and exchange rate adjustment (and/or the tightening of Fiji's foreign exchange controls). Fiscal correction is required if such macroeconomic instability is to be avoided.

Fiscal correction is over-due

The recent experience suggests that acceptable overall fiscal outcomes can now only be achieved by undesirable cuts in government investment, maintenance and expenditure on goods and services. Key sources of the fiscal pressure are the large and growing wage and salary bill and weak revenue collections. There has been little recent success in correcting these problems.

There are a range of options for achieving this

Sensible options for fiscal correction include lifting compliance with the tax system, cutting-back on the use of tax concessions, improving the recovery of Government charges, making cost savings through efficiency gains within Ministries, linking civil servant pays to productivity and lifting the financial returns from public enterprises. Such options would need to be backed-up by the ongoing efforts of the Government to improve public administration including raising transparency and accountability.

A sustainable position is a deficit of 2.5% of GDP or less

Projections based on an extrapolation of trends suggest the current fiscal position is unsustainable. A sustainable debt position could be achieved if the budget deficit is reduced to no more than 2.5% of GDP. Such deficits could see the ratio of general government debt to GDP plateau at 55% by 2015. A deficit of no more than 2.5% of GDP achieved through wage restraint would see a reasonable share of the public investment program funded by internal revenue.

Evidence has been sought in support of the view that the fiscal position is sustainable. The strongest argument in favor of this view is that debt has been used to fund capital expenditure. In broad terms the level of borrowing has matched capital expenditure. But the investments are unlikely to generate the Government revenue required to service the debt and instead are adding to the fiscal burden. It is preferable that internal revenue make a greater contribution to capital expenditure.

External financing could be used

Restraining the debt to GDP ratio to 55% of GDP implies an annual financing requirement of F\$120 million to F\$250 million over the medium term (ie US\$85m to US\$140 million at current exchange rates). It would be reasonable for external financing to meet all or part of this financing requirement. External general government debt is low at less than 5% of GDP and there is considerable room to borrow externally.

It would offer a number of broader benefits

A greater reliance on external financing offers the opportunity to strengthen the financial sector. The financial sector is reported as relatively sound. But it is heavily weighted towards investment in government securities, notably via the Fiji National Provident Fund (FNPF). It is relatively easy for the Government to finance its deficits via the FNPF, and this situation inevitably undermines fiscal discipline. It also provides the FNPF too much influence over the setting of monetary policy and has resulted in the FNPF bearing a high exposure to the fiscal position and the domestic economy. A greater use of external financing offers the opportunity for FNPF to diversify its portfolio offshore and also to normalize fiscal and monetary management.

If matched by Fiji-led reform

It would be important for external financing to be complemented by Fiji-led and owned economic and fiscal reform. In the absence of such reforms, there is a risk that external financing could aggravate rather than alleviate economic weaknesses. Arrangements would also need to be made, and could be made, to avoid an injection of liquidity to the monetary system through external financing and to manage exchange rate risk arising from external financing.

Debt should be limited to 55% to 60% of GDP

This suggests an annual cost ceiling for the ADB of the order of US\$100 million on average, provided the setting of economic policy and fiscal management is appropriate. A general government debt to GDP ratio of 55% to 60% would probably be manageable provided substantive action is taken to revise the fiscal fundamentals and cap debt in this range.

# 1. Introduction

A new cost sharing policy guides ADB lending

In 2005, the Asian Development Bank (ADB) approved a new policy covering cost sharing and expenditure eligibility for Bank financing. The new policy follows three basic principles: (i) expenditures financed by ADB should promote development and underpin poverty reduction efforts (ii) operations funded under a more flexible cost sharing framework should not unduly burden the country's fiscal, debt and sustainability base and (iii) effective fiduciary and other oversight arrangements should be in place at all stages of the business cycle - at the country, executing agency and project level.

Country cost sharing ceilings are central to implementation of the new policy framework. They are to be based on a detailed macroeconomic assessment covering:

Country ceilings are to be prepared, based on economic factors

- the past, present, and projected fiscal policy stance;
- the revenue collection systems;
- the quality of the public expenditure program and its financing plan.
- the public financial management system and mechanisms for budget preparation, implementation, and control;
- the integration of the ADB portfolio and the member country's budget process;
- the foreign exchange regime and balance of payments situation;
- trade and financial policies; and
- debt sustainability.<sup>1</sup>

This report discusses an appropriate country ceiling

This report discusses an appropriate country cost sharing ceiling for the Fiji Islands drawing on an assessment of these economic variables. It is to be used as a basis for discussion between the Government and ADB on the country's debt strategy and the Bank's potential role in implementing such a strategy.

Against a background of a need for economic adjustment

The assessment is against a background of an expansionary fiscal stance that has now being in place since the 2000 coup. General government debt was the equivalent of 38% of gross domestic product (GDP) prior to the coup, but has now risen to 52%.<sup>2</sup> The expansionary fiscal stance has had the positive effect of supporting economic growth, and price and exchange rate stability have been maintained. But the Government has recognized the need for adjustment and has set a medium term strategy of fiscal consolidation. The ability to implement this strategy is unclear. The budget faces cost pressures from a rising wage bill and the 2006 national election and there are substantial economic risks from pressure on the key sugar and garment industries.

The next section presents the findings of the macroeconomic assessment. The concluding section discusses implications for the country cost sharing ceiling and the potential role of the ADB.

<sup>1</sup> ADB (2005a), p. 5

<sup>2</sup> Ratios to GDP are ratios to GDP at market prices.

## 2. Macroeconomic Assessment

### 2.1 The fiscal stance

Large deficits have been recorded since 2000

Following the coup of May 2000, the Government adopted an expansionary fiscal stance in order to support economic activity and social stability. Additional operating grants and capital expenditure combined with weak revenue outcomes to produce budget deficits of 6% or more of GDP from 2001 to 2003.<sup>3</sup> Expenditure restraint, good economic growth and an increase in the value-added tax (VAT) rate then reduced the deficit over 2004 and 2005, but it remained around 3% of GDP.

A fiscal consolidation is now planned

The 2006 Budget projected a further high deficit for 2006 of 4.6% of GDP before moving to a surplus of 0.6% of GDP by 2008.<sup>4</sup> This projection was made before a new wage agreement was settled with leading public sector unions. The agreement is to provide a 16% across-the-board (partly backdated) increase in wages and salaries for the period 2003 to 2007. If this increase extends across the public sector, and other budget projections are met, the estimated budget deficit for 2008 is 2.1% of GDP (see Figure 2.1). The feature of the budgeted reduction in the deficit from 2006 to 2008 is its source, which is primarily a reduction in capital expenditure. A reduction in the real level of spending on operating grants, goods and services, maintenance and pensions is also budgeted.

The period following the 2000 coup is the most expansionary 5 year period since independence. The deficit had trended up over the 1970s, but this trend was reversed over the 1980s. In contrast to the recent experience, the first coup in 1987 was met by expenditure restraint and the deficit was low over the late 1980s. Fiscal policy was progressively relaxed over the 1990s and relaxed even further following 2000. Projections based on an extrapolation of trends, as presented at Figure 2.1, point to continuing high deficits.

Revenue and grants have fallen to around 24% of GDP

Revenue and grants had risen from a low of 18% of GDP in 1974 to reach 27% by the early 1990s, and averaged 26% of GDP over the 1990s. They stepped-down in 2001 to below 24% of GDP, the main contributor being a fall in non-tax revenue. The VAT rate was increased from 10% to 12.5% in 2003 and a 5% import excise duty was introduced in 2006 on goods deemed as luxuries, health-adverse and/or sin goods (to recover revenue lost from a VAT exemption granted on essential food items). The average ratio of revenue and grants to GDP projected for 2001 to 2008 is 23.4%.

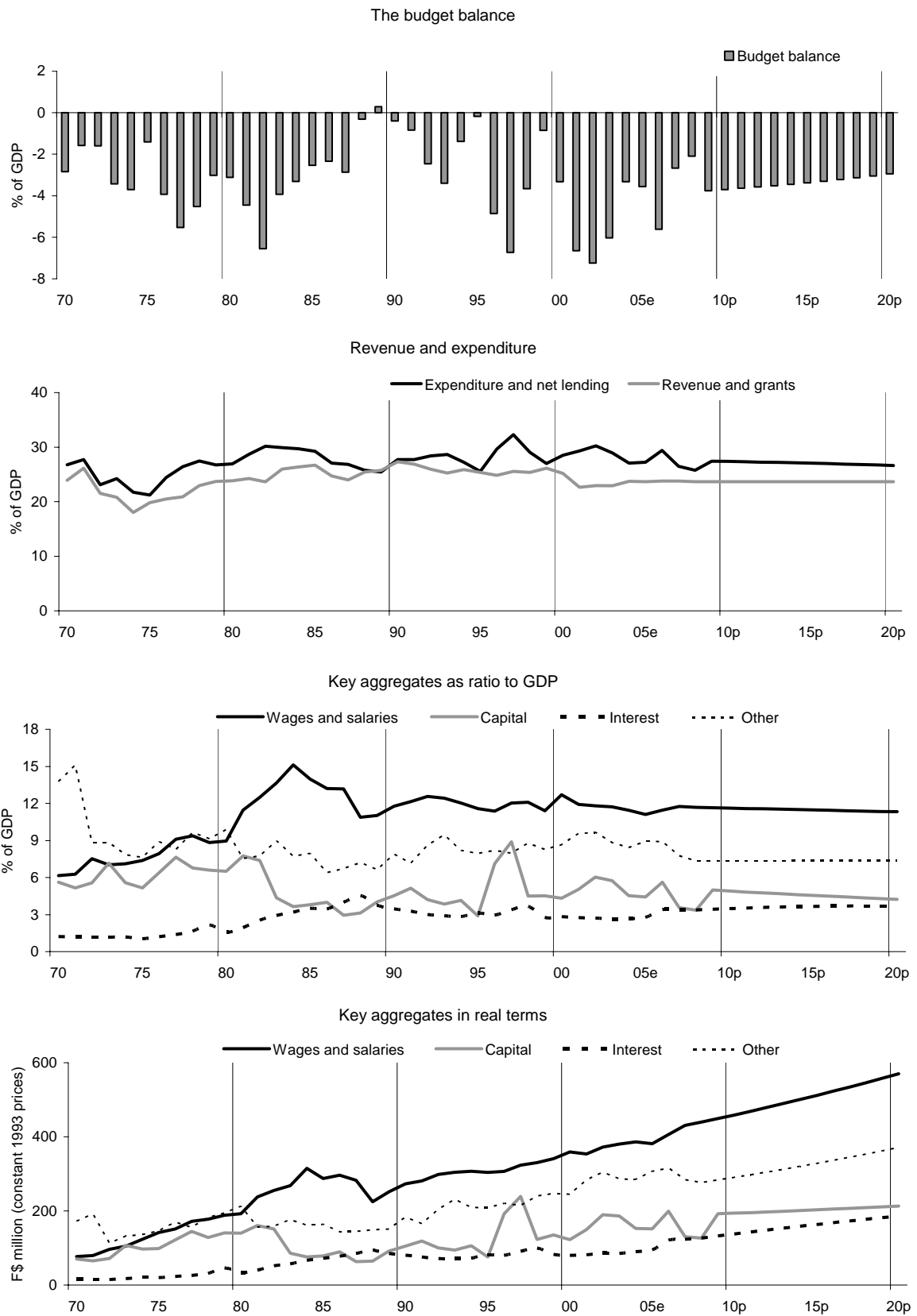
Real staff and interest costs are rising

There is a clear upward trend in the real value of wages and salaries. This is associated with an expanding number of civil servants, a widespread practice of providing regular staff pay increments and periodic cost of living adjustments (COLA) either negotiated with public sector unions or awarded through arbitration. Interest costs are now on an upward trend given the annual increase in the stock of debt and recent increases in official interest rates.

<sup>3</sup> The financial year is 1 January to 31 December.

<sup>4</sup> MoFNP (2005), pp. 49-50

Figure 2.1 The past, present and projected fiscal stance



Note: Central projections are presented. Data are exclusive of asset sales and VAT paid by government.  
 Source: Derived from Table A.1

The projections assume 'normal' growth in expenditure

Projections prepared to explore the likely future fiscal stance assume a reversal in 2009 of the contraction in capital expenditure and non-staff operating costs budgeted for 2007 and 2008. It is difficult to determine the optimal level of capital expenditure, but it is likely that the projected level for 2007 and 2008 of less than 4% of GDP is too low to meet reasonable needs. The projections assume that the real level of capital expenditure per head is returned to its long run average. The projections assume that from 2008 staff costs and most non-staff operating costs grow at their real long growth rate, while operating grants and transfers are assumed to grow in line with total expenditure and net lending.

The projection is for high budget deficits

Based on these assumptions, and a constant ratio of revenue and grants to GDP, the projection is for a trend deficit over the long run of approximately 4% of GDP. This is somewhat above the annual average deficit from 1970 to 2005 of 3.2%. The projection of a trend deficit slightly higher the long run average is considered to be consistent with the rising stock of public debt and an apparent weakening in fiscal discipline in recent years.

The main risk to these projections is the rate of economic growth. This is assumed to equal 2.5% in real terms, the average annual growth rate over the 10 years to 2005. If growth is below this rate, the revenue projection would be lower than shown and the budget deficit would be higher.

## 2.2 The revenue system

Revenue performance stepped-down in 2001

As noted, the revenue-raising performance of the revenue system stepped-down in 2001. There is room to lift revenue by filling some gaps in the tax system, such as the absence of capital gains and fringe benefits taxes. But the more important opportunities for improvement are in relation to compliance, the widespread use of tax concessions and the financial performance of public enterprises.

There are substantial compliance problems

A large stock of revenue arrears is one indicator of the magnitude of the compliance problem. Arrears were estimated to have accumulated to F\$187 million by the end of 2004, 17.5% of the year's revenue and grants. Most of these arrears are tax payments owing to the Fiji Islands Revenue and Customs Authority (FIRCA). Substantial arrears are also owed to the Department of Works and Infrastructure for water and sewerage rates, to the Judiciary, for land rent and for meteorological services.<sup>5</sup> A further compliance issue has been the recent absence of audits of FIRCA's collections (there is a dispute between FIRCA and the Auditor-General over the need for auditors to sign an Oath of Secrecy).<sup>6</sup>

Tax compliance is being addressed

Strengthening compliance is a focus of Government efforts in regards to direct taxes.<sup>7</sup> FIRCA was established (among other reasons) to help improve compliance and is the subject of a major capacity building program. There has been recent success and arrears declined over 2004.<sup>8</sup> A range of other initiatives are being implemented to improve tax administration.<sup>9</sup> They include mandatory reporting, the adoption of tax identification numbers and the simplification of tax administration processes and procedures.

<sup>5</sup> Auditor-General (2005), pp. 38-41

<sup>6</sup> Auditor-General (2005), pp. 30-31

<sup>7</sup> See for example MoFNP (2005), p.37 and IMF (2004a) p. 9

<sup>8</sup> Auditor-General (2005), pp. 38-41

<sup>9</sup> See ADB (2005b), Section 4.2.4 and IMF (2004a) p.9

Despite these efforts, compliance problems can be expected to continue. A large number of indirect tax rates, frequent changes to tax rates and rules, the wide variety of tax concessions available and the discretionary authority held to grant concessions (as reinstated in 2003) provide ongoing administration problems.

Tax concessions are widespread and impose a heavy fiscal cost

Tax concessions also impose a substantial cost in terms of forgone revenue. The Ministry of Finance and National Planning (MoFNP) estimated that in 2002 direct tax concessions cost F\$93 million while indirect tax concessions cost F\$48 million (excluding those associated with duty-free stores). This is equivalent to an annual cost of 15.5% of revenue and grants.<sup>10</sup>

There are sound arguments against such concessions

Tax concessions include income tax exemptions, company tax holidays, accelerated depreciation, deductions of 100% to 200% for donations to approved organizations, investment allowances and duty-free imports. Many concessions are provided to targeted sectors (eg tourism, agriculture, ICT) or certain business structures (eg small and medium sized enterprises). Internationally it is widely accepted that a broadly-based tax system applied uniformly at low rates and supported by a sensible expenditure program will generate better revenue, growth and equity outcomes than a system offering extensive, targeted tax concessions.<sup>11</sup> The downside of such extensive concessions has been recognized within Fiji. Targeted tax concessions are acknowledged as difficult to administer, are costly in terms of revenue forgone, distort market prices and investment decisions and can lead to inappropriate behavior by market participants.<sup>12</sup>

The Government established a Fiscal Review Committee in 2004 to identify, among other matters, potential improvements to the tax regime. The Committee recommended a number of actions that would improve the design and administration of the system, while retaining a preference to provide targeted incentives for some key emerging sectors.<sup>13</sup>

Public enterprises could do much to lift revenue

The reasons for the recent decline in non-tax revenue are unclear. But what is clear is that there is room to improve the recovery-rate of Government charges and that public enterprises could contribute more revenue. The Government has set a target of achieving a 10% return on the more than F\$1 billion invested in Government Commercial Companies (GCCs) and Government Statutory Authorities (GSAs). The actual return on assets is typically less than 1% p.a.<sup>14</sup> This low rate of profitability reflects the partial completion of a reform effort that commenced in the 1980s.<sup>15</sup>

<sup>10</sup> Data from MoFNP. Note that some of these 'concessions' may be normally allowed as deductions in other jurisdictions.

<sup>11</sup> See for example the discussion in ADB (2000) pp.99-100, 108-115, ADB (2005b), Section 4.2.4 and IMF (2004a) pp. 8-9.

<sup>12</sup> See for example the Prime Minister's speech of 1999 and the result of a 1997 MoFNP review, as quoted in ADB (2000) pp. 99, 108.

<sup>13</sup> See ADB (2005b), Section 4.2.4

<sup>14</sup> MoFNP (2005), pp. 75-76 and Ministry of Public Enterprises and Public Sector Reform, personal communication.

<sup>15</sup> See ADB (2005b), Section 5.3.2

### 2.3 The quality of public expenditure

Important considerations in assessing the quality of public expenditure are its allocation across expenditure items and between activities, and the efficiency in use.

Operating expenditure is rising above 85% of total expenditure

Recognizing the importance to growth and development of public investment, the Government had previously targeted a 70:30 mix of operating:capital expenditure.<sup>16</sup> The 2005 Budget statement noted that this target is now unachievable, and projected a 82:18 mix for the year.<sup>17</sup> Operating expenses will exceed 85% of expenditure and net lending by 2008 if the budgeted reduction in capital expenditure is implemented and the recent wage and salary agreement is extended to the whole civil service. Operating expenditure is thus displacing capital expenditure and undermining growth and development prospects.

Steps have been taken to control wages and salaries

The Government has taken steps to reform the civil service and reduce the growth in the wage and salary bill. A key initiative is the introduction of a performance-based pay system. Head of Ministries have been established as performance-orientated chief executive officers and performance appraisals have commenced at less senior levels. The initiative is critical to addressing fiscal imbalance and the erosion of the quality of expenditure.

But success is not guaranteed

Initial proposals for performance-based pay were built on sensible principles. But as formulated, they carried significant fiscal risk as there was a potential for performance-based pay increases to be made in addition to cost-of-living adjustments. Furthermore, there have been problems in the past controlling the provision of annual increments and the engagement of new staff by Ministries, and there is some risk that the proposed controls may prove insufficient. This is against a background of some uncertainty as to whether the Government has identified an appropriate structure and role of government to reform towards.<sup>18</sup>

Expenditure has been shifted to education and health

The latest National Strategic Plan established an objective of targeting expenditure on key areas that have a positive impact on the economy or provide essential services. The performance indicator was established of an increased ratio of expenditure on infrastructure, health and education. Although expenditure on infrastructure is being compressed, there has been some success in terms of the sectoral allocations. Approximately 25% of operating expenditure is allocated to health and education. This share is slightly above the average for the 1990s. Public order and safety has also received a slightly higher allocation in recent years. The main reductions have been in economic affairs, general public services and defense.<sup>19</sup>

Poverty remains high

Early results from the 2002/2003 Household Income and Expenditure Survey point to a slight rise in the extent of poverty since 1990-91. Although further analysis of this preliminary result is required, it casts doubt on the extent to which public programs are assisting the disadvantaged.<sup>20</sup>

<sup>16</sup> For example, the Strategic Development Plan 2003-2005 targeted a 70:30 ratio by 2005 (GoF(2002) p. 32).

<sup>17</sup> MoFNP (2004) p. 35

<sup>18</sup> See ADB (2005b), Sections 4.2.3, 5.3.1 and 5.3.3.

<sup>19</sup> Fiji Islands Bureau of Statistics (2006b) Central Government Finance sheet

<sup>20</sup> MoFNP (2005), pp. 31-32

## 2.4 Public financial management and budgeting

The legal framework is adequate

Fiji has in place an adequate legal framework for public financial management and budgeting. Most activities of government are reported publicly, and budget documents, government accounts and audit reports provide an informative appraisal of the economic and financial position. There are however weaknesses in the application of the legal framework, notably in terms of compliance with legislative provisions (see Box 2.1).

Weaknesses in implementation have spurred reform

Weaknesses in public financial management have been recognized and are the subject of an ongoing reform effort. In early 2004 a financial management reform was initiated that centered on a new Finance Management Act, an improved financial management information system, the phased implementation of performance budgeting, improved budget reporting and a major communication and training program.<sup>21</sup> Audits of the public accounts are now up-to-date (albeit qualified) as are the audits of most public enterprises.<sup>22</sup> And the long in-active Public Accounts Committee is now working (backwards) through a backlog public accounts.

The link between the national plan and budgets is not strong

There are concerns that the national planning process is not linked strongly to the budget process. The current planning processes originated with a National Summit held in 2002. The key performance indicators are a mix of desirable outcomes, outputs, activities and milestones. They are not easy to monitor, many are not measurable, and there are indications that in practice monitoring has been inadequate.<sup>23</sup> And the approach to planning is now inconsistent with the architecture of the new Finance Management Act as adopted in 2004.

The Act requires broader outcomes only to be specified in the high-level plans, with the detailed outputs and activities to instead be addressed by individual departments in preparing their annual corporate plans and budget. In the 2005 Budget process, the annual corporate plans of departments (which are the basis of budget bids for inputs) were not aligned with the objectives and desired outcomes specified in the high-level plans. Without a workable strategic focus, there is a risk that government activities will be fragmented, uncoordinated and fail to achieve an adequate effectiveness.<sup>24</sup>

These concerns regarding the link between national plans and the budget extend to the independently prepared Public Sector Investment Program. Furthermore, there are concerns that the link between capital and recurrent expenditure is weakened by a poor integration of the Public Sector Investment Program and the budget process.<sup>25</sup>

Donor assistance is reported in detail

Donor expenditure is recorded on-budget. The accounting system records cash grants from external donors and aid-in-kind is reported in the budget statements. Individual overseas loans and the overall sector allocation of overseas loans are reported in detail in the budget documents.

<sup>21</sup> The detailed initiatives are outlined in MoFNP (2005), Chapter 6.

<sup>22</sup> Auditor-General (2005), pp. 20

<sup>23</sup> For example, a 2004 review concluded that almost three-quarters of the Key Performance Indicators had been inadequately monitored (see Chung (2004) p. 1).

<sup>24</sup> See ADB (2005b) Section 5.2.1

<sup>25</sup> See IMF (2004a) p. 8

Box 2.1 The IMF’s assessment of fiscal transparency

Fiji meets the requirements of the fiscal transparency code in a number of respects, and in recent years has expanded the range of information presented with the annual budget. Despite the suspension of the PFMA 1999, Fiji has a reasonably sound legal framework for the conduct of fiscal management. Basic provisions are in place such as the requirement for Parliament to authorize all taxation and spending and controls on the issue of guarantees. The RBF enjoys effective independence in the conduct of monetary policy. Public enterprises are legally required to operate in a commercial manner, and to be funded from the budget for any CSOs they undertake. The Auditor General is independent of the executive, and reports directly to Parliament. Fiji has also made improvements in recent years in the range of information presented to the legislature with the annual budget. For example, the budget documents now present information on government guarantees, aid in kind, and revenue arrears, and a number of CSOs are funded from the budget.....

There are longer-standing and serious weaknesses in the implementation of the existing legal framework for fiscal management that need to be addressed urgently. Chief amongst these is a serious and widespread breakdown of internal controls in budget implementation, as evidenced by a series of reports by the Auditor General that point to extensive irregularities and practices in breach of laws and regulations. These breaches include: entering into commitments or expenditure in breach of appropriations; fraud; failure to account correctly for commitments and expenditure; failure to recover advances to staff, or to impose disciplinary action when indicated; inadequate reconciliation practices; abuse of trust accounts; ex post regularization of illegal expenditures; abuse of office in government procurement; and continual ignoring of regulations. In this regard, the Auditor General qualified the 2001 Accounts and Finances of Government to the effect that he could not verify that they had been fully kept in accordance with section 167 of the Constitution.

More seriously, a widespread tolerance of this lack of compliance with the rule of law in financial management appears to have developed at all levels of the system. For instance, central agencies fail to comply with their own Instructions, and there has been no discussion in the legislature of the last three annual reports of the Auditor General. The government has acknowledged the seriousness of the problems. In the Strategic Development Plan (SDP), it has announced its intention to emphasize accountability for the management and use of public funds, and compliance with laws and regulations. It also indicated a need to strengthen the capability of Parliament to exercise its oversight role.

Reasserting financial accountability in government will require strong action in a number of areas, focusing on basic financial management systems and deferring consideration of advanced reforms. The systemic nature of the breakdown in control is such that reasserting control will not be achieved by ad hoc or isolated initiatives. Many of the problems are inter-related, and need to be addressed in tandem; others require sequencing. Until these basic steps are taken attempts to introduce more advanced techniques of budgeting are likely to reduce rather than increase accountability.

Source: IMF (2004) pp.19-21

**2.5 Foreign exchange and balance of payments considerations**

Domestically financed deficits can put pressure on the exchange rate

Fiji’s budget deficits have been almost entirely domestically funded. Deficits arising from a large and growing public sector wage bill fuel consumption and raise imports, without a matching rise in export receipts. There is a risk that foreign reserves will be eroded over time, with the resulting pressure on the balance of payments flowing through to a depreciation/devaluation of the exchange rate and hence macroeconomic instability. Fiji is currently facing this scenario.

Capital controls are in place

In Fiji's case, controls on capital flows are used to avoid or minimize the need for exchange rate adjustment. Fiji operates a range of exchange rate approvals, some requiring the approval of the International Monetary Fund (IMF) under Article VIII.<sup>26</sup> Although these controls have been relaxed over recent years, their presence and the prospect that they will be tightened in difficult economic conditions is a deterrent to foreign investment. The use of such controls also shields the domestic economy from the need to generate internationally competitive investments, where this will tend to have an adverse effect on growth over time. The result is that Fiji can still bear dynamic efficiency losses even if exchange rate adjustment is avoided.

The expansionary fiscal policy is supporting consumption

The initial response to the 2000 coup was the adoption of expansionary fiscal and monetary policy. Monetary policy has been tightened in recent years through increases in official interest rates and reserve requirements and the fiscal deficit has been reduced. Nonetheless, the fiscal stance remains expansionary and has probably contributed to the recent high levels of consumption growth.<sup>27</sup>

Investment has increased since the 2000 coup. The investment ratio is estimated to have reached 17% in 2005, up from the 12% to 14% ratio estimated over 1999 to 2001.<sup>28</sup> But the investment response is probably insufficient to provide the export receipts required to relieve growing pressure on the balance of payments. Furthermore, the budgeted reduction in capital expenditure and imminent rise in the wage and salary bill will tend to exacerbate the situation.

And contributing to the erosion of foreign reserves

The pressure created by an overly expansive policy setting is evident in a downward trend in Fiji's reserves. Foreign reserves held by the Reserve Bank of Fiji (RBF) improved over 2004 for the first time since 2000 but subsequently declined by approximately 20% over 2005. They are now at their lowest level since 1997.<sup>29</sup> Total official foreign reserve levels stood at \$850.1 million as at February 2006, sufficient to cover 4.0 months of imports of goods.<sup>30</sup>

At a time of weak merchandise exports

A weak performance in merchandise exports is contributing to the downward pressure on reserves. Garments have provided the single largest source of merchandise exports in recent years, but almost halved over 2005 following the loss of preferential access to the US market. The sugar industry, the second largest source of merchandise exports, also faces substantial adjustment over the medium term as it loses EU preferences. Tourism and related industries have continued to expand since the coup and their earnings, combined with remittances that have grown to high levels and the prospect of substantial (plantation) mahogany-based exports, provide the main prospect for supporting the balance of payments.

<sup>26</sup> The latter arise from the monetary limit imposed on the transferability by nonresidents of dividends abroad, the requirements for tax clearance certificates for the transfer of profits and dividends and the proceeds of airline ticket sales, and on the making of maintenance payments (IMF (2003) p. 15 and RBF (2005)).

<sup>27</sup> It has been argued that an expansionary fiscal stance is still required to support social stability.

<sup>28</sup> RBF (2006a), pp. 15, A43

<sup>29</sup> RBF (2006a), p. A1

<sup>30</sup> RBF (2006b)

## 2.6 Trade and financial policies

Protectionism has increased since 2000

The Fiji economy was opened over the 1990s through a reduction in protection and supporting structural reform. However, since 2000 there has been a progressive increase in the level of protection granted to domestic manufacturers and/or producers (albeit perhaps unwittingly). The incentives provided through a complex system of tariffs, price controls, import licenses and the economic aspects of an affirmative action program for indigenous Fijians encourage the development of low value-added activities. They are biased against higher added value activities, such as in the agricultural sector, and encourage socially unproductive rent-seeking activities.<sup>31</sup>

And there are extensive controls over the private sector

At the same, a high degree of policy intervention and control is exercised by government agencies (at either national or local level or both) over private sector activities. A “command and control” approach has, in practice, created a network of veto points over private sector activities. In many cases, the veto points are operated by officials or Ministers who enjoy a large measure of discretion in deciding whether to approve or reject applications for licenses, permits, or investment approvals. Even if approvals, licenses and permits are freely and promptly granted, the compliance costs imposed on the private sector are considerable. This interventionist approach, combined with a trade policy that is increasingly inward looking, will tend to suppress growth prospects.<sup>32</sup>

The financial sector is relatively sound

The financial sector is subject to prudential regulation by the independent RBF. The regulatory environment has been strengthened including a progressive extension of prudential oversight to the compulsory superannuation scheme, the Fiji National Provident Fund (FNPF). The IMF reported that in 2004 the financial sector was relatively sound.<sup>33</sup> A Financial Sector Assessment Program with the IMF is underway and is to be completed in 2006.

The FNPF is the main source of deficit financing

A feature of the finance sector is the role of the FNPF in financing budget deficits. The growing and ‘young’ formal workforce generates net cash inflows to the FNPF. Tight limits on the fund’s ability to invest overseas means that the FNPF must find substantial investment opportunities onshore. As of the mid 2005 the FNPF held 71.3% of the central Government’s domestic debt (66.3% of total central government debt), and Government securities and loans accounted for 78.8% of the scheme’s assets.<sup>34</sup>

This offers budget savings

These arrangements probably offer budget savings. Under the current policy setting the FNPF needs the Government to run budget deficits to provide investment opportunities, and is an eager buyer of Government securities. The result is the Government probably pays less for its debt than it would in a normal, open market.

But imposes broader costs

But the arrangements also impose broader costs. The ease of accessing deficit financing will inevitable undermine fiscal discipline. Because the FNPF dominates the bond market, it has too much influence over the setting of monetary policy, which should be the sole responsibility of the RBF. Furthermore, the FNPF is now highly exposed to the fiscal position and the domestic economy. Responsibility for funding future superannuation payments largely rests with the Government.

<sup>31</sup> See ADB (2005b) Sections 4.8 and 4.9

<sup>32</sup> See ADB (2005b) Section 4.8 and ADB (2005c)

<sup>33</sup> IMF (2004)

<sup>34</sup> RBF (2006), pp A.16, A.48-50

## 2.7 Other considerations

Decentralization and central government financing of local government can be important dimensions of the fiscal setting. However little is known of these matters, in part because of the relatively minor role of local government. Sub-national expenditure has been reported as less than 5% of general government spending, with only around 10% of sub-national government spending financed from central government transfers.<sup>35</sup>

Fiji released the IMF's Staff Report on the 2002 Article IV Consultation but declined to release the 2004 Staff Report. As the main external assessment of macroeconomic management, release of such reports is important to transparency and accountability. The next Article IV Consultation is scheduled for 2006.

## 2.8 The sustainability of public debt

Public debt has risen to 52% of GDP

Total general government debt is estimated as 51.8% of GDP as of the end of 2005. Almost all debt is held domestically. The ratio of general government domestic debt to GDP is estimated as 47.9% and the ratio of general government external debt to GDP is estimated as 3.8%. Government is also guarantor to extensive loans held by agencies such as the FNPF, the Fiji Development Bank, the Housing Authority and the Fiji Electricity Authority. These contingent liabilities are equivalent to 22.0% of GDP.<sup>36</sup>

Debt is sustainable if its costs can be met readily

Debt accumulation can be thought of as sustainable if interest and principal repayments can be readily met (see Box 2.2). This would normally be the case if debt is self servicing. That is, if debt generates an income stream sufficient to meet debt servicing costs and mechanisms are in place to ensure the additional income earned is secured to meet these costs. Debt used to fund consumption carries greater fiscal risk as it normally offers little if any additional revenue to service the debt. In which case the sustainability of the debt depends on whether the fiscal position can accommodate additional debt servicing costs.

### Box 2.2 A definition of sustainability

It is useful to start with a definition of debt *sustainability* as a situation in which a borrower is expected to be able to continue servicing its debts without an unrealistically large future correction to the balance of income and expenditure. Sustainability rules out any of the following: a situation in which a debt restructuring is already needed (or expected to be needed); a situation where the borrower keeps on indefinitely accumulating debt faster than its capacity to service these debts is growing (a Ponzi game); or a situation in which the borrower lives beyond its means by accumulating debt in the knowledge that a major retrenchment will be needed to service these debts (even if nothing in the external environment changes). The cost of financing is a key factor influencing debt accumulation (i.e., the present value budget constraint), and thus sustainability. Sustainability thus incorporates the concepts of solvency and of liquidity, without making a sharp demarcation between them. Moreover, the assumption of no expectation of major corrections in income or expenditure captures the notion that there are social and political limits to adjustment that determine willingness (as opposed to ability) to pay, which may be especially important in a sovereign context.

Source: IMF (2002) pp.4-7

<sup>35</sup> IMF (2004b), p. 6

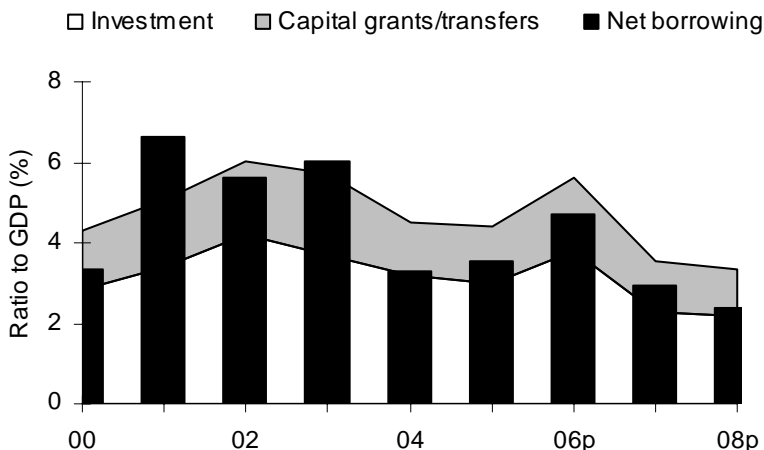
<sup>36</sup> Gross contingent liabilities less government debt held by the FNPF (which is recorded in general government debt) as of the end of 2004 (Auditor General (2005) p. 16).

Net borrowing is broadly matched by capital expenditure

Net borrowing has broadly matched total capital expenditure in recent years and is projected to continue to do so (see Figure 2.2).<sup>37</sup> Thus it can potentially be argued that a form of inter-generational equity has been achieved. That is, in broad terms long-lived assets can be thought of as being paid for by future generations. Fiscal sustainability is a more stringent requirement as it requires mechanisms to be in place to ensure additional revenue is both generated and collected to meet the additional debt servicing costs.

Figure 2.2 Net borrowing and capital expenditure

Net borrowing equals the annual increase in debt



Source: Derived from Table A.1

Capital expenditure is not self funding and raises the fiscal burden

Some capital grants/transfers can be expected to generate additional revenue, such as those provided to the Fiji Visitors Marketing Bureau and FIRCA, but most would not. A similar situation probably applies to investments in equipment and building and construction. Funding for some sewerage and water supply projects would generate additional revenue, but these projects would generally fall short of full cost recovery (which is one reason why they are undertaken by government and not the private sector). Transport projects can be expected to generate some additional revenue through their boost to economic activity, but it is unlikely that the additional revenue could fully meet the capital costs. In broad terms other investments are even less likely to generate sufficient revenue to meet their debt servicing costs.<sup>38</sup> It is concluded that recent borrowings will impose a net fiscal burden (although the magnitude of this fiscal burden is unclear). Hence, fiscal correction is warranted so that more capital expenditure is funded from revenue and grants.

There are a number of options for fiscal correction

From a technical perspective there are a number of sensible options for correcting the fiscal position. These include efforts to lift compliance with the tax system, cut-back on the use of tax concessions, improve recovery of Government charges, generate cost savings through efficiency gains within Ministries, to link civil servant pays to productivity and improved financial returns from public enterprises.

<sup>37</sup> Capital expenditure substantially exceeded net borrowing from 1984 to 1999, meaning much of the capital expenditure over the period can be thought of as funded from internal revenue. But this situation has changed since 2000 as internal revenue collections have stepped-down, as capital expenditure has increased and as the wage and salary bill has continued to grow.

<sup>38</sup> A sample of typical capital purchases are listed at MoFNP (2005) pp. 62-63.

The issue at hand is the practicality of achieving such corrections. Correction may be technically possible, but there may be social and/or political barriers to their implementation. A way to test what is practical is to examine actual performance.

For example, consider an interpretation of the data based on ratios to GDP. Revenue and grants appear to have stabilized as a ratio to GDP. This suggests it is unlikely there will be a willingness to correct the fiscal position through an increased revenue effort. There has been more variability on the expenditure side. If the fiscal correction is to be achieved by expenditure restraint, what sort of restraint would be required?

Current fiscal trends are unsustainable

Under the central projection presented in Figure 2.1, which is based on the extrapolation of trends, the ratio of debt to GDP is projected to rise to 62% by 2020. Annual interest costs are projected to increase by the order of 0.1% of GDP per annum. In the projection, this rising cost is largely met by restraining growth in capital expenditure. This is considered an unsustainable fiscal position as it implies the indefinite accumulation of debt without a matching growth in the capacity to service the debt. Recent experience has suggested that acceptable overall fiscal outcomes can now only be achieved by cutting back investment, maintenance and expenditure on goods and services. This is a reflection of fiscal stress and an early warning of the need for corrective action.<sup>39</sup>

Debt sustainability requires a stable ratio of debt to GDP

Debt sustainability would be achieved if the ratio of debt to GDP leveled off. Cutting maintenance, other goods and services and capital expenditure is an inappropriate way of reducing expenditure. The remaining options are to cut the wage bill and grants and transfers. As a ratio to GDP, expenditure on these items has been fairly stable over time. This stability over time suggests that it is probably impractical to expect sustained cuts in these items. But assume that instead such cuts are practical.

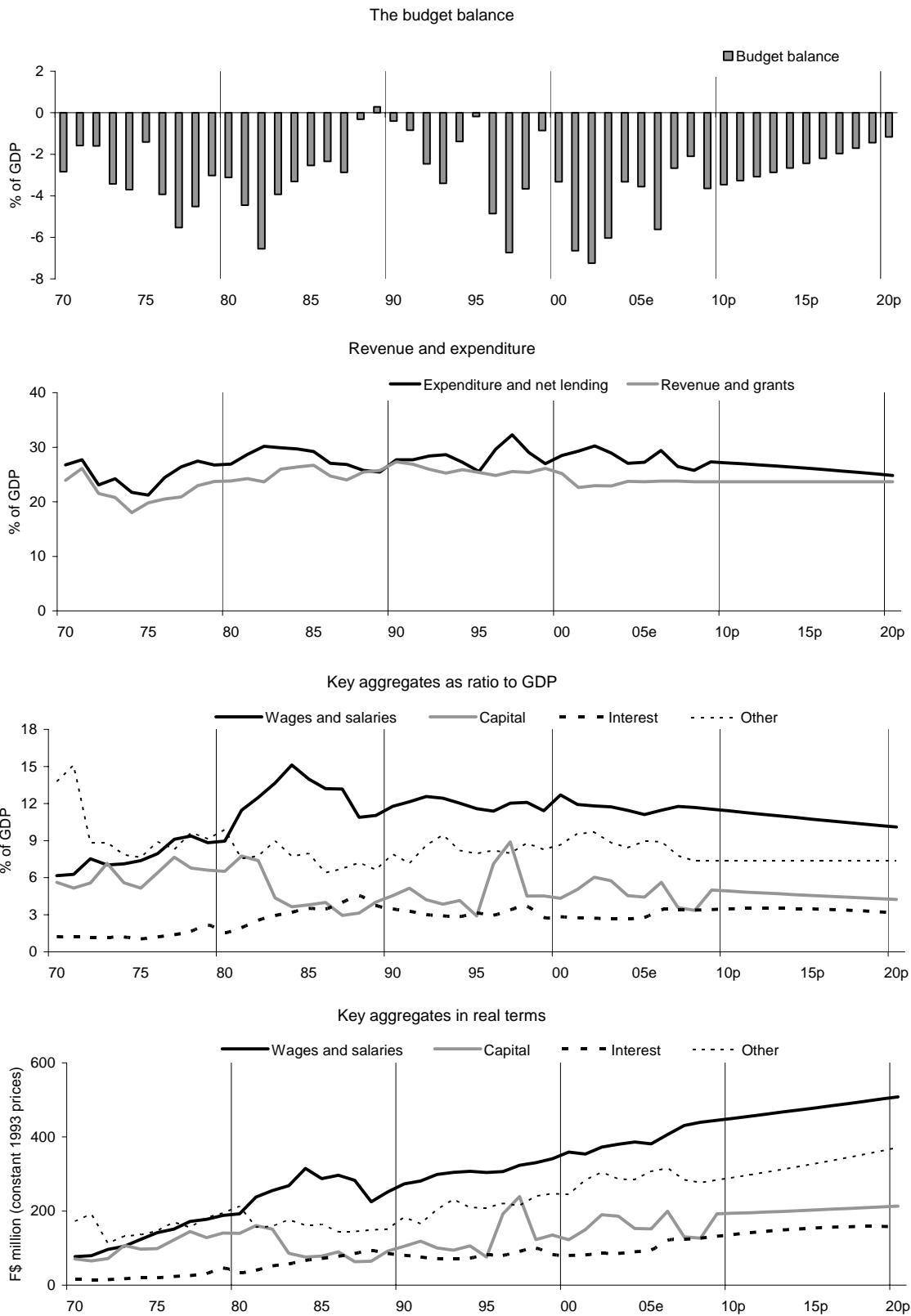
Good expenditure restraint could see debt plateau at 55% of GDP

Figure 2.3 presents a projection that assumes real wages and salaries grow at 1.3% p.a. from 2008, one percentage point below the long run growth rate of 2.3% p.a. This correction would be sufficient to see the debt to GDP ratio level off at 55% by 2015. It would see wages and salaries fall from 44.9% of expenditure and net lending in 2008 or 11.7% of GDP to 40.5% and 10.7% by 2015. This projection provides for debt sustainability. It provides a guide to the magnitude of expenditure cuts required to achieve debt sustainability. It highlights that even under overly optimistic assumptions of expenditure restraint, the debt to GDP ratio will grow above current levels. The ultimate height of the debt to GDP ratio is a function of how quickly any fiscal corrections are made.

Concerns in the sustainability of public debt often arise from high levels of external debt. Fiji does not yet face this issue. Total external debt is low and the economy could support external borrowings if made in a sound policy environment. As of late 2005, statutory bodies owed external debt equivalent to 0.4 % of GDP and the private sector held external debt equivalent to 7.1% of GDP, giving a ratio of total external debt to GDP of approximately 11.3%. Total public and private external debt servicing is of the order of 4% of goods exports or less than 2% of exports of goods and services.

<sup>39</sup> The finding that the fiscal position is unsustainable is consistent with the results of a recent econometric analysis. Reddy (2006) applied co-integration analysis to data for 1970 to 2004 and concluded that Fiji's public debt borders on unsustainable limits.

Figure 2.3 A projected fiscal stance that stabilises debt



Note: Based on the central projections but with real wages and salaries growing at one percentage point below trend from 2008. Data are exclusive of asset sales and VAT paid by government.

Source: Derived from Table A.1

### 3. Conclusion

In response to its first coup, Fiji restrained government expenditure and adopted structural reforms to open the economy and raise its productivity. The response to the 2000 coup has been markedly different. The fiscal stance has been highly expansionary and there has been slow progress in implementing the structural reforms required for sustained, broad-based growth. Important gains have been made in public administration in recent years, but these changes alone cannot ensure fiscal sustainability. The current policy setting is poorly suited to achieving debt sustainability.

While there are some arguments in favor of current policy

Evidence has been sought in support of the view that the fiscal position is sustainable. The strongest argument in favor of this view is that debt has been used to fund capital expenditure. In broad terms the level of borrowing has matched capital expenditure. But the investments are unlikely to generate the Government revenue required to service the debt and instead are adding to the fiscal burden. It is preferable that internal revenue make a greater contribution to capital expenditure, as it did prior to 2000.

The current fiscal setting is unsustainable

Projections based on long run trends suggest the fiscal position is unsustainable. Public debt levels are rising and there is little evidence of a willingness to achieve the required corrective action, on either the revenue or expenditure side. It appears that acceptable overall fiscal outcomes can now only be achieved by undesirable cuts in government investment, maintenance and expenditure on goods and services. This is against a background of a recent unsustainable surge in private consumption and slow progress in preparing for looming economic shocks. It is concluded that the current fiscal setting is unsustainable.

Although Fiji is not yet facing a fiscal crisis

Fiji does not yet appear to face fiscal crisis (although this cannot be ruled out over the medium term) and can still avert such a situation. But the current direction is an unhealthy one and if continued can ultimately be expected to result in economic difficulties. This is most likely to manifest itself in pressure on the balance of payments that will require ever tighter monetary policy and potentially exchange rate adjustment (and/or the tightening of foreign exchange controls).

An improved revenue effort and spending cuts are needed

The situation could be corrected through an improved revenue performance and/or expenditure restraint. Options include lifting compliance with the tax system, cutting-back on the use of tax concessions, improving the recovery of Government charges, making cost savings through efficiency gains within Ministries, linking civil servant pays to productivity and improving the financial returns from public enterprises. Such options would need to be backed-up by the ongoing efforts of the Government to improve public administration including enhancing transparency and accountability.

To cap the growth in public debt

It is estimated that a sustainable debt position could be achieved by reducing the budget deficit to no more than 2.5% of GDP. The projection based on trends is for a deficit of the order of 4.0% of GDP. Under optimistic assumptions of the willingness to make fiscal correction, the ratio of general government debt to GDP could plateau at 55% by 2015. A deficit of no more than 2.5% of GDP achieved

through wage restraint would see a reasonable share of the public investment program funded by internal revenue.

Deficits are acceptable, but they should be smaller

Restraining the debt to GDP ratio to 55% of GDP implies an annual financing requirement of F\$120 million to F\$250 million over the medium term (ie US\$70m to US\$140 million at current exchange rates). These are broad estimates only, with actual requirements subject to variations in economic conditions, rigidities in expenditure and any new expenditure needs.

External financing could help fund the deficits

It would be reasonable for external financing to meet all or part of this financing requirement. External general government debt is low at less than 5% of GDP and this provides considerable room to borrow externally. Doing so would reduce the Government's reliance on the FNPF. This would allow the FNPF to diversify its portfolio by investing more in overseas growth assets. And fiscal and monetary management could be normalized if the reliance on the FNPF was reduced.

The foreign exchange risk arising from external financing could be managed. In principle any external borrowings by the Government could be matched by offshore investments by the FNPF. This would mean that for the country as-a-whole there would be little if any exchange rate risk. And financial instruments could be created so that both the Government and FNPF could individually avoid or minimize exchange rate risk. Allowing the FNPF to invest offshore an amount equal to any inflow of external financing would also avoid an injection of liquidity to the monetary system at a time when tighter monetary policy is required.

If matched by Fiji-led reform

It would be important for external financing to be complemented by an appropriate setting of economic policy and fiscal management. In the absence of reform, there is a risk that external financing could aggravate rather than alleviate economic weaknesses. This is because the ready availability of external financing could ease the need to pursue over-due reform. Reform prospects will of course be maximized if change is led and owned by Fiji.

Debt should be limited to 55% to 60% of GDP

This suggests an annual cost ceiling for the ADB of the order of US\$100 million on average, provided the setting of economic policy and fiscal management is appropriate. A general government debt to GDP ratio of 55% to 60% would probably be manageable provided substantive action is taken to revise the fiscal fundamentals and cap debt in this range.

Appropriate actions by the Government would include:

- continuing to strengthen the independent role of the RBF, including its responsibilities for prudential regulation of the financial sector;
- improving the enabling environment for the private sector, such as through revisions to the regulatory regime including for foreign investment and an improved performance from infrastructure;
- an improved internal revenue effort, notably through improved compliance and a better financial performance of public enterprises;
- control of the overall level of expenditure, backed up by ongoing improvement to the financial management system and information disclosure;
- a shift in the composition of expenditure away from wages and salaries; and
- an emphasis on the needs of the disadvantaged.

Table A.1 Summary of the central projection

	Revenue and grants (F\$m, current prices)				Expenditure and net lending (F\$m, current prices)										GDP (F\$m, current prices)		Inflation rate (annual change in the CPI, %)
	Direct taxes	Indirect taxes	Non-tax revenue	Total	Capital	Interest	Wages and salaries	Other operating expenses					Total	At market prices (estimate)	At factor cost		
								Travel and comm.	Special expenses	Maintenance nec	Other goods and services	Grants and transfers					
70	n.a.	n.a.	n.a.	44	10	2	11	n.a.	n.a.	n.a.	n.a.	n.a.	25	50	185	169	4.1
71	n.a.	n.a.	n.a.	53	11	2	13	n.a.	n.a.	n.a.	n.a.	n.a.	31	57	204	185	9.1
72	n.a.	n.a.	n.a.	54	14	3	19	n.a.	n.a.	n.a.	n.a.	n.a.	22	58	252	231	22.0
73	n.a.	n.a.	n.a.	68	23	4	23	n.a.	n.a.	n.a.	n.a.	n.a.	29	79	326	301	11.1
74	n.a.	n.a.	n.a.	78	24	5	31	n.a.	n.a.	n.a.	n.a.	n.a.	34	94	434	411	14.5
75	n.a.	n.a.	n.a.	107	28	6	40	n.a.	n.a.	n.a.	n.a.	n.a.	41	115	542	515	13.1
76	n.a.	n.a.	n.a.	123	38	7	48	n.a.	n.a.	n.a.	n.a.	n.a.	53	147	601	571	11.4
77	n.a.	n.a.	n.a.	133	49	9	58	n.a.	n.a.	n.a.	n.a.	n.a.	53	168	636	606	7.0
78	n.a.	n.a.	n.a.	155	46	11	63	n.a.	n.a.	n.a.	n.a.	n.a.	65	186	677	643	6.1
79	n.a.	n.a.	n.a.	195	54	18	73	n.a.	n.a.	n.a.	n.a.	n.a.	75	220	822	779	7.8
80	n.a.	n.a.	n.a.	226	62	15	85	n.a.	n.a.	n.a.	n.a.	n.a.	94	255	948	901	14.5
81	n.a.	n.a.	n.a.	247	79	20	117	n.a.	n.a.	n.a.	n.a.	n.a.	77	292	1,018	954	11.2
82	n.a.	n.a.	n.a.	254	79	27	134	n.a.	n.a.	n.a.	n.a.	n.a.	83	324	1,073	1,021	7.0
83	n.a.	n.a.	n.a.	286	48	32	150	n.a.	n.a.	n.a.	n.a.	n.a.	99	330	1,101	1,032	6.7
84	148	105	n.a.	325	45	39	186	n.a.	n.a.	n.a.	n.a.	n.a.	95	365	1,230	1,152	5.3
85	141	116	n.a.	339	48	44	177	n.a.	n.a.	n.a.	n.a.	n.a.	101	371	1,269	1,178	4.4
86	139	114	n.a.	348	56	49	186	n.a.	n.a.	n.a.	n.a.	n.a.	90	381	1,408	1,326	1.8
87	130	132	n.a.	341	42	57	188	n.a.	n.a.	n.a.	n.a.	n.a.	96	382	1,423	1,329	5.7
88	138	151	n.a.	390	48	69	167	n.a.	n.a.	n.a.	n.a.	n.a.	110	395	1,531	1,433	11.9
89	167	195	n.a.	462	72	67	198	n.a.	n.a.	n.a.	n.a.	n.a.	119	457	1,794	1,555	6.1
90	196	232	n.a.	538	90	69	232	9	5	19	38	n.a.	156	546	1,971	1,742	8.1
91	204	205	n.a.	564	108	69	255	10	9	21	41	n.a.	150	581	2,098	1,805	6.5
92	208	259	120	586	95	68	284	12	26	24	45	88	195	641	2,258	2,010	4.9
93	192	300	126	618	94	71	305	13	48	27	48	96	231	702	2,449	2,169	5.2
94	206	327	132	665	107	73	309	13	15	25	51	107	211	700	2,570	2,293	0.6
95	226	343	117	685	78	84	313	13	18	24	51	109	215	689	2,699	2,373	2.2
96	236	351	122	709	204	85	325	14	19	26	58	117	234	847	2,855	2,576	3.1
97	241	374	139	754	262	100	355	15	21	25	60	115	235	953	2,950	2,571	3.4
98	271	395	137	803	143	116	383	13	45	24	63	132	278	919	3,164	2,793	5.7
99	270	458	196	923	160	98	403	14	55	26	65	133	292	953	3,533	3,239	2.0
00	294	360	198	851	146	96	429	14	25	32	79	143	293	964	3,379	3,049	1.1
01	284	392	160	837	187	102	441	17	34	34	80	176	353	1,082	3,696	3,200	4.3
02	275	451	184	910	239	108	468	21	32	37	91	192	383	1,197	3,962	3,443	0.8
03	269	567	136	973	244	112	498	19	41	37	88	190	375	1,229	4,245	3,659	4.2
04	335	606	138	1,079	206	121	519	21	39	37	86	200	383	1,229	4,539	3,912	2.8
05e	353	616	152	1,121	209	131	525	19	50	40	95	219	423	1,289	4,731	4,078	2.4
06p	388	657	151	1,196	283	172	576	19	60	41	98	230	448	1,479	5,032	4,337	3.0
07p	418	707	148	1,273	191	181	630	19	31	40	96	228	415	1,416	5,350	4,611	3.0
08p	443	748	150	1,341	190	191	661	20	31	40	96	229	416	1,459	5,660	4,879	3.0
09p	457	808	176	1,414	298	205	696	21	33	42	102	241	439	1,638	5,971	5,147	3.0
10p	483	852	186	1,492	309	220	732	22	35	44	108	255	463	1,725	6,300	5,430	3.0
11p	509	899	196	1,574	321	235	770	23	37	46	115	269	489	1,815	6,646	5,728	3.0
12p	537	948	207	1,660	334	251	811	24	39	48	121	283	516	1,911	7,011	6,043	3.0
13p	567	1,000	218	1,752	347	267	853	26	41	50	129	299	544	2,012	7,397	6,376	3.0
14p	598	1,055	230	1,848	361	284	898	27	43	53	137	315	574	2,117	7,804	6,726	3.0
15p	631	1,113	243	1,949	375	302	945	28	45	55	145	333	606	2,228	8,233	7,096	3.0
16p	665	1,175	256	2,057	390	320	994	30	48	58	154	351	640	2,344	8,686	7,486	3.0
17p	702	1,239	271	2,170	405	339	1,046	31	50	60	163	370	675	2,465	9,163	7,898	3.0
18p	741	1,307	285	2,289	421	358	1,100	33	53	63	173	391	712	2,592	9,667	8,332	3.0
19p	781	1,379	301	2,415	438	377	1,158	34	56	66	183	412	752	2,725	10,198	8,790	3.0
20p	824	1,455	318	2,548	456	397	1,218	36	59	69	194	435	793	2,865	10,759	9,273	3.0

Sources: Author's estimates derived from RBF (2006A), Fiji Islands Bureau of Statistics (2006a) and personal communication, MoFNP (2005). AusAID (1995) Table A.13, World Bank (1991), p. 138 and World Development Indicators 2003 for the assumptions of Table A.2

Table A.2 Key assumptions of the central projection

Revenue and grants	Revenue and grants in current prices for 2006 to 2008 are from the 2006 budget statement. For subsequent years, the ratio of revenue and grants to GDP is assumed to equal the ratio projected for 2003 to 2008.
Wages and salaries	Expenditure for 2006 and 2007 is derived from the number of public servants and average pay rates implicit in the 2006 budget statement with pay rates adjusted for the recent increase agreed with certain unions. The full 16% increase in pay is assumed to be paid over 2006 and 2007. Thereafter, the annual increase in wages and salaries is equal to the average annual growth in real wages and salaries from 1990 to 2005 plus the inflation rate.
Interest costs	Derived from the projected stock of debt and the cost of debt. The nominal interest rate for 2006 to 2008 is the estimated average level for 2005 plus one percentage point, being the increase in official interest rates in early 2006. Thereafter, the nominal interest rate is the real, average annual rate from 1992 to 2005 plus the inflation rate.
Goods and services	Expenditure in current prices for 2006 to 2008 are from the 2006 budget statement. For subsequent years: expenditure in current terms on travel and communication, maintenance and operations and other purchases of goods and services is assumed to grow at the real average growth rate from 1990 to 2005 plus the inflation rate; while special expenses are assumed to grow at their real average growth rate from 1990 to 2005 in expenditure and net lending plus the inflation rate.
Other operating expenditure	Expenditure on operating grants and transfers and pension/compassionate allowances in current prices for 2006 to 2008 are from the 2006 budget statement. For subsequent years, the annual change in expenditure in current terms equals the real, annual average growth rate from 1990 to 2005 in expenditure and net lending plus the inflation rate.
Capital expenditure	Expenditure on capital purchases, grants and construction in current prices for 2006 to 2008 are from the 2006 budget statement. Thereafter, expenditure are equal to the real, annual expenditure per head from 1990 to 2005 for each of the three components adjusted for inflation.
GDP	GDP in current prices at factor cost to 2008 is from Table 28 of the RBF Quarterly Review, December 2006. Thereafter the annual change equals the real average annual change from 1995 to 2005 (of 2.5%) plus the inflation rate.
Population	Population to 2008 is from Table 28 of the RBF Quarterly Review, December 2006. Thereafter the annual change is set equal to the average annual growth rate from 1995 to 2005 (of 1.0%).
Inflation	Equals the average annual inflation rate (CPI) from 1995 to 2005 (of 3.0%).

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