

**FIJI ISLANDS**

**ECONOMIC  
AND ASIAN DEVELOPMENT BANK OPERATIONS  
UPDATE**

**November 2001**

## CURRENT EQUIVALENTS

(As of 1 October 2001)

Currency Unit	–	Kina (K)
K1.00	=	\$0.2880
\$1.00	=	K3.4722

## ABBREVIATIONS

ADB	–	Asian Development Bank
GDP	–	gross domestic product
SPARTECA	–	South Pacific Regional Trade Economic Cooperation Agreement
RBF	–	Reserve Bank of Fiji
TA	–	technical assistance
TCF	–	textile, clothing, and footwear

## NOTES

- (i) This fiscal year (FY) of the Government ends on 31 December.
- (ii) In this report, "\$" refers to US dollars.

## I. THE ECONOMY

1. *Republic of the Fiji Islands: 1999 Economic Report* provides a comprehensive analysis of economic developments up to 1999 and assesses critical development challenges and related policy issues. This paper reports on recent economic developments, current issues, and Asian Development Bank (ADB) operations in the Fiji Islands. It should be read in conjunction with the 1999 Economic Report, which was published in 2000 as part of ADB's Pacific Studies Series.

### A. Recent Economic Developments<sup>1</sup>

2. The performance of the Fiji Islands economy in 2000 was disappointing after a remarkable real gross domestic product (GDP) growth of 9.6 percent in 1999. According to revised estimates of the Reserve Bank of Fiji (RBF), real GDP fell by 2.8 percent in 2000 as a result of the armed unrest in May, the ousting of the elected government, and associated political instability and civil disorder that included looting of businesses in the main urban centers. Manufacturing, construction, and tourism-related sectors all contracted substantially. Factories in the textile, clothing, and footwear (TCF) industry laid off over 1,500 workers between May and September as Australian and New Zealand trade unions imposed bans on Fiji Islands exports and power cuts restricted production. Tourist arrivals dropped sharply during the same period. The political crisis also delayed the start of the cane sugar harvest and caused the quality of service delivery in public administration and utilities to decline. Export earnings dropped 20 percent, and aid flows fell. Monetary policy was tightened to protect foreign reserves and the exchange rate; and an interim civilian government reacted to declining revenues with severe expenditure cuts. However, substantial damage had been done to investor confidence and to the country's international image.

3. At the beginning of 2001, growth was forecast to be 4.8 percent on the basis of expected recoveries in manufacturing, tourism, and construction and the global growth of 4.7 percent. By May, however, the official forecast was for growth of only 1 percent. The global growth forecast had also been revised downward, implying slower growth in Fiji Islands' exports and tourism; and first-half activity in the TCF, construction, timber, and gold-mining sectors was below expectations. Five garment factories closed in early 2001, and many were operating well below capacity, as management fought to retain overseas markets. Cumulative to May, gold production was 16 percent lower over a year ago; and timber production, which fell by 22 percent in the June quarter over the previous quarter, was adversely affected by the reduced demand from the domestic construction industry and the Japanese export market. A business expectations survey conducted in June 2001 indicated that the proportion of respondents expecting an improvement in general business conditions in early 2001 was at an all-time low, and that less than half expected an improvement in 2001 as a whole. Private investment showed no signs of significant recovery. On the other hand, visitor arrivals from all major tourism markets in the first five months of 2001 were above the level targeted by the Fiji Visitors Bureau, and nonsugar agriculture and fishing were providing a positive growth stimulus.

4. The year-on-year inflation rate accelerated to around 5 percent at the end of the first half of 2001 from 1.6 percent in 2000, primarily reflecting a rise in prices of domestically produced food, transport, and heating and lighting. Inflation is forecast to decline slightly to between 4 and 5 percent at end of year due to excess capacity and weak wage growth.

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<sup>1</sup> Sources: Reserve Bank of Fiji (RBF), Quarterly Review, June 2001; RBF Press Release, 4 May 2001; and RBF News Reviews; and Fiji Islands Bureau of Statistics, Statistical News.

5. In an effort to stimulate the stagnant economy, in particular, to revive private investment, the Government budget for 2001 introduced a structural reform program comprising reduced personal income tax rates, lower business taxes, lower tariffs on business inputs, a proposed review of price controls, improved regulation of the financial sector, removal of rice import quotas, and increased public spending on infrastructure projects. With revenue projected to fall to 21.9 percent of GDP and expenditure to rise to 28.2 percent of GDP, the budget deficit in 2001 is estimated to rise to 6.3 percent of GDP. Consequently, the government debt will approach 45 percent of GDP and, through the associated interest burden, will tend to crowd out public expenditure on essential goods and services. Over the medium to long term, the Government will need to move closer to budget balance.

6. Monetary policy eased further at the end of the first quarter of 2001. RBF's minimum lending, repurchase, and rediscount rates were reduced from 8 to 6 percent, and the export finance facility rate for the Bank's funding to commercial banks was reduced from 3 to 2 percent. Money and credit conditions at the time of the easing reflected the depressed level of economic activity. In the year to May 2001, currency in circulation had declined by 6.0 percent and broad money growth had slowed to 3.0 percent compared with 5.3 percent in the corresponding period last year. Private sector credit growth is at a three-year low, declining by around 6.0 percent primarily as a result of lower personal borrowing and reduced lending to the wholesale and retail trade, agriculture, and professional and business services sectors. The growth in money supply reflected a 53.6 percent expansion in credit to the public sector.

7. During the first half of 2001, interest rates on time and savings deposits fell to 2.77 and 0.75 percent, respectively, thus becoming negative in real terms. The commercial banks' weighted average lending rate fell slightly from 8.38 percent in January to 8.37 percent in May.

8. Export revenue in the first half of 2001 was down compared with that in the corresponding period in 2000 because of reduced garment exports to the Australian market and lower receipts from sugar, fish, and gold. Timber exporters also faced a weakened Japanese market. Collectively, these five products accounted for about 80 percent of total domestic exports. The garment industry, which had overtaken sugar as the major merchandise exporter in 1998, no longer faced trade union bans in the primary export markets; but it now confronts new Chinese competition in a weaker Australian market. Early in the year there was also continued uncertainty over preferential treatment under the South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA). However, this was removed on 1 March when a SPARTECA (TCF-provision) scheme came into effect, supporting access to the Australian market.

9. Merchandise imports fell in the first half of 2001 because of the reduced demand for consumption and intermediate goods. Slow economic growth will limit import growth in the remainder of 2001, but a weak export performance will increase the trade deficit. Growth in tourism receipts will to some extent offset the expected increases in investment income and private transfer outflows. However, the current account surplus is likely to decline to less than 1 percent of GDP. Unless net direct investment flows become positive during the year, the balance of payments may record a small overall deficit in 2001. The drop in foreign reserves from F\$898 million at the end of December 2000 to F\$775 million at the end of June 2001 was seasonal; it is expected that reserves will be around F\$820 million at the end of the year. This reserves level will provide cover over five months of imports of goods and nonfactor services. The external debt stood at F\$530 million at the end of March 2001, with a debt service ratio of 2.6 percent. The latter is expected to remain below 3 percent in 2001.

10. The Fiji dollar depreciated against the US dollar and the pound sterling in the first half of 2001, and appreciated against the Australian and New Zealand dollars and the Japanese yen. The nominal effective exchange rate rose slightly from its value at the end of December 2000. The acceleration in inflation meant that the real effective exchange rate appreciated by approximately 1.5 percent, thus slightly reducing international competitiveness.

## **B. Current Issues**

11. The critical issue in the short term is sound macroeconomic management and restoration of confidence among investors and the community at large. In the 1990s, private investment averaged only 5 percent of GDP, and emigration of skilled professionals and others undermined the human resource base. In 2000, the political crisis dealt a major blow to investor confidence both domestically and overseas; and emigration increased by 9 percent overall (to 5,275), with emigration of skilled professionals rising by 25 percent.

12. A key reason for the stagnation in private investment is the uncertainty over property rights and their enforcement, particularly in regard to leases of sugarcane land. This uncertainty has been reinforced by unclear and unpredictable policy direction and costly bureaucratic procedures. The new administration must address these fundamental development constraints by elaborating policies in the areas of private sector development, trade, public enterprise reform, and restructuring of the sugar industry. The latter is plagued, not only by the unresolved land tenure issue, but also by poor industrial relations, deteriorating physical infrastructure, and the long-term prospect of losing preferential access to European markets. Another aspect that needs priority attention is the development of information and communication technology, which augurs well for the development of island economies such as the Fiji Islands.

13. Rebuilding confidence in the economy of the Fiji Islands following the political instability of 2000 will be a long-term process, just as it was following the two military coups in 1987. It must begin with sound economic management in the context of political and social stability which can lay the foundation for a return to sustained growth at a rate of 4 percent or more, with inflation at a modest rate of 3 percent, and external balance. Current projections are that the real GDP will increase by 4 percent in 2002; that inflation will slow to 3.5 percent; and that merchandise export growth will be around 9 percent, contributing—with tourism growth—to an improvement in the current account balance to 1.5 percent of GDP.

## **II. ASIAN DEVELOPMENT BANK OPERATIONS**

### **A. Operational Strategy**

14. ADB suspended its operations in the Fiji Islands following the coup on 19 May 2000. Subsequently ADB began limited resumption of operations in December 2000 and May 2001. Following recent elections which were widely regarded as free and fair, ADB has continued to expand partial resumption of activities. However, full resumption of normal programs is pending resolution of the constitutional appeal which is expected to be heard by the Court of Appeals in February 2002.

15. ADB's operational strategy in the Fiji Islands focuses on assisting the Government in its effort to stimulate growth by encouraging private sector investment and export-oriented activities. The strategy is directed toward broad infrastructure development including transport (road, ports and airports), urban and tourism sectors, with focus on poverty reduction. In line

with the poverty reduction strategy, ADB will assist in restructuring the sugar industry by supporting the industry's strategic plan. Over the last two years, ADB has shifted its focus from an almost exclusive emphasis on project to sector-based infrastructure lending, and to a program that gives more attention to overall economic issues including public sector reforms, financial sector reforms, and capital market development. ADB's technical assistance (TA) will focus on implementation of the ongoing reform program.

16. The ports development loan proposed for 2001 will support the urgent rehabilitation of the Suva and the Lautoka ports. These ports have deteriorated over the years and are incapable of handling the current cargo volume. The proposed project will positively contribute to the Fiji Islands' economic development and will enhance regional competitiveness. A water supply and sanitation loan is proposed for 2002 to improve Suva city's current water shortage problems. In 2003, a sugar industry loan is proposed to undertake sugar industry rehabilitation to improve efficiency and competitiveness. A Country Programming Mission in early 2002 will confirm 2002 program and develop 2003-2005 program.

## B. Lending and Technical Assistance Operations

17. Since the Fiji Islands joined ADB in 1970, ADB has approved 13 loans amounting to \$161.1 million (Table 1). They comprise three road upgrading loans, one port development loan, three power sector loans, three agricultural and natural resources loans, two development bank loans, and one low-income housing loan. The ongoing loan program consists of the Fiji Road Upgrading Project.<sup>2</sup>

**Table 1: ADB Loans to the Fiji Islands**  
(as of 31 October 2001)

<b>Loan No.</b>	<b>Project Name</b>	<b>Loan Approval (\$million)</b>
0089	Power Expansion	4.7
0174	Fiji Development Bank	2.0
0345	Second Power	16.2
0411	Suva Port	7.0
0536	Third Power	16.0
0703	Agricultural Development	3.2
0739	Second Fiji Development Bank	7.0
0781	Sigatoka Valley Rural Development	4.4
0906	Agriculture Diversification Program	20.0
0912	Road Maintenance Sector	13.0
1005	Low Income Housing Development	9.6
1164	Second Road Upgrading	18.0
1530	Third Road Upgrading (Sector)	40.0
<b>Total</b>		<b>161.1</b>

18. Since 1970, 65 TAs amounting to \$18.9 million have been approved (Table 2). Most of the TAs supported financing sector studies and development plans, and institutional development. ADB is helping the Fiji Islands to improve the policy framework in various key sectors such as transport and agriculture. More recent TAs focus on policy reforms including public enterprises, capital market, and development banks.

<sup>2</sup> Loan 1530-FIJ, *Third Road Upgrading (Sector) Project*, for \$40.0 million, approved on 26 August 1997.

**Table 2: Sector Distribution of ADB Technical Assistance**  
(as of 31 October 2001)

<b>Sector</b>	<b>No. of TAs</b>	<b>ADB (\$'000)</b>	<b>JSF (\$'000)</b>	<b>Others (\$'000)</b>	<b>Total (\$'000)</b>
Agriculture and Natural Resources	15	2.384	1.633	0.100	4.117
Energy	4	0.270	0.450	–	0.720
Finance	10	2.038	0.475	–	2.513
Social Infrastructure	8	2.254	1.250	–	3.504
Transport and Communications	16	3.434	2.000	–	5.434
Others	12	2.529	0.100	–	2.629
<b>Total</b>	<b>65</b>	<b>12.909</b>	<b>5.908</b>	<b>0.100</b>	<b>18.917</b>

ADB = Asian Development Bank, JSF = Japan Special Fund, TA = technical assistance.

### **C. Project Implementation and Postevaluation Findings**

19. The current portfolio consists of only one loan, the Fiji Road Upgrading Project. Loan implementation in the past has been generally satisfactory. However, the current project suffered delays in implementation due to temporary suspension of the project due to the coup in May 2000. Inadequate counterpart funds is a major problem in the timely project implementation (for 2001 the funds provided is 40 percent less against requirements). The Government assured that adequate funds will be provided for the Project in the 2002 budget. Future loans size should be carefully considered to ensure that it matches Government's ability to provide adequate counterpart funds for smooth implementation.

20. Project completion reports have been completed for 13 loans, and 10 projects—agriculture (3), energy (3), transport (2), and others (2)—have been postevaluated. Of the postevaluated, six projects were rated as generally satisfactory, two as partly satisfactory, and two as unsatisfactory. Project/program performance audit reports and project completion reports demonstrate the need to (i) consider sociocultural issues, (ii) ensure adequate capacity building, and (iii) provide flexibility in project design to allow for necessary adjustments. Adequate counterpart funds are generally budgeted for, but their release has sometimes been late. Lessons from past experience emphasize the need for prioritizing critical issues, establishing performance indicators, monitoring progress, and making suitable adjustments during implementation.