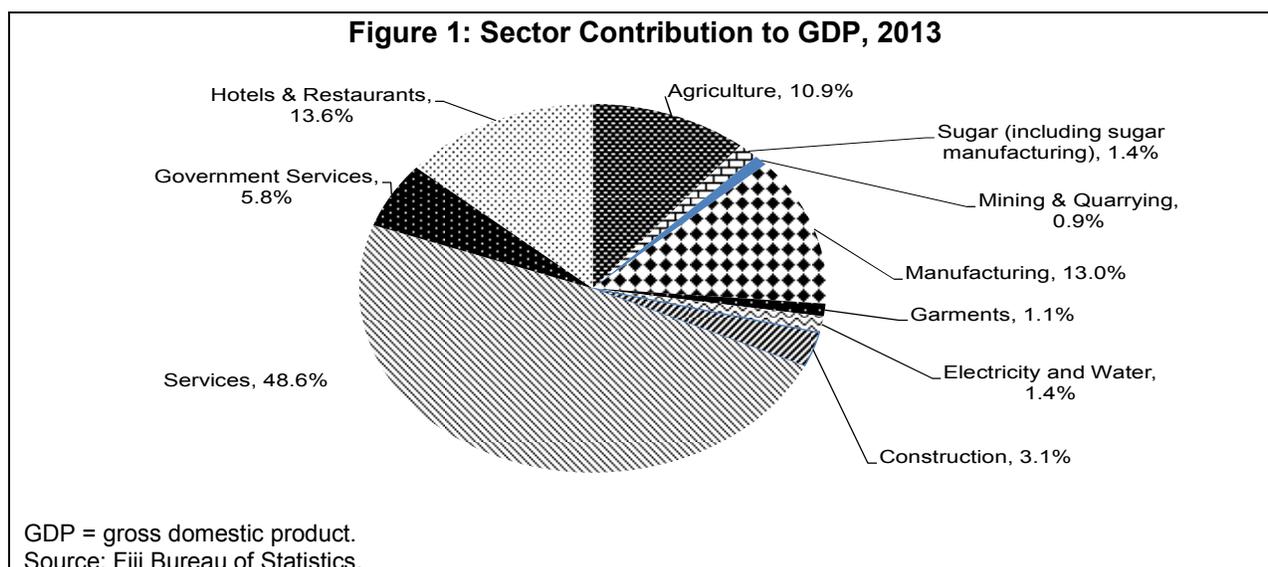


ECONOMIC ANALYSIS: SUMMARY¹

I. Context

1. **Country background.** Fiji is an archipelagic nation with a population of 860,000 people. It has 332 islands, with the majority of the population residing on the two main islands of Viti Levu (75%) and Vanua Levu (18%). Indigenous Fijians (*i-Taukei*) make up more than half the population; about another two-fifths are of Indian descent. About 50% of the population lives in rural areas, but based on current growth rates, Fiji's urban population will grow to about 60% of the national population by 2030. The country has forest, mineral, and fish resources. Tourism is the leading growth sector. The manufacturing sector employs about 26,000 workers and is one of Fiji's growing sectors; sugar, garments, food processing, beverages (including mineral water), and wood-based industries are significant. Sugar is the mainstay of the rural economy, with the industry employing about 3,000 people, while another 200,000 depend on it for their livelihoods. The economy has a strong service and light-industrial component; activities range from boatbuilding to brewing and paint manufacture. Mining is growing in importance. Relative sector contributions are reflected in Figure 1.



II. Economic Growth

2. Fiji's growth performance has been adversely affected by the country's vulnerability to both internal and external shocks. These include political unrest (four coups since 1987), natural disasters (cyclones and floods), global oil and food price shocks, and global financial and economic crises. From 1970 to 1980, the economy experienced moderate rates of economic growth, with real gross domestic product (GDP) increasing by an average of 6.5% per annum on account of high levels of public investment and increasing exports of sugar and copra. Until

¹ ADB. 2014. Asian Development Outlook, Manila, ADB. 2012. Pacific Economic Series, Fiji 2012: *Accelerating Reform to Return to Sustained Growth and Poverty Reduction*, Manila. ADB 2013. *Re-Invigorating Private Sector Investment, A Private Sector Assessment for Fiji*, Manila

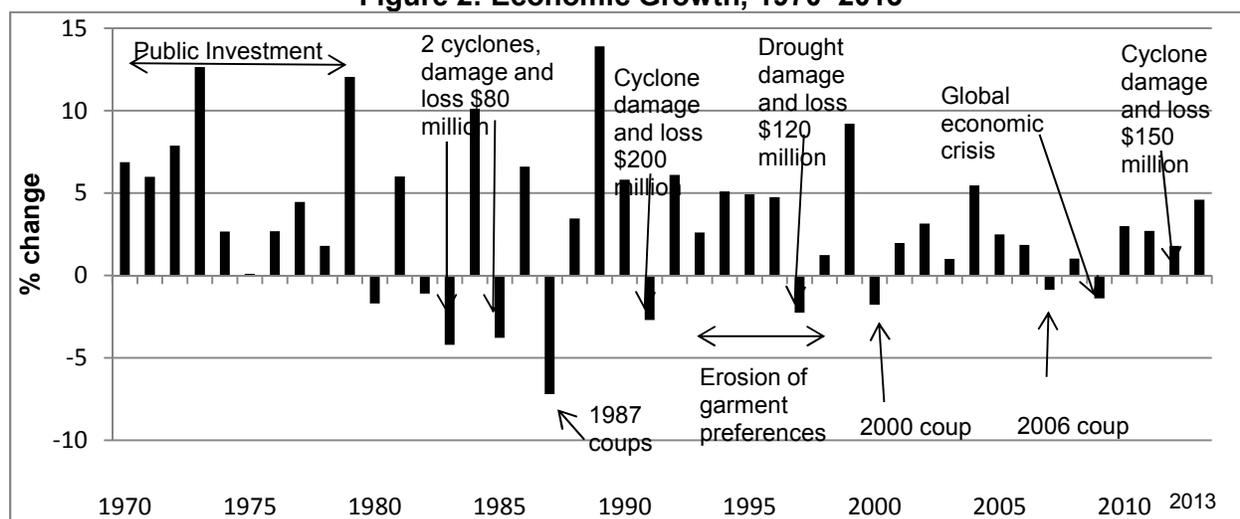
1986, economic policy was marked by a strong emphasis on import substitution, food self-sufficiency, and economic diversification, with the state playing a dominant role in economic activity.²

3. In the late 1980s, prior to joining the World Trade Organization (WTO), Fiji embarked on an important policy shift toward a more market-oriented, outward-looking development strategy. Against this backdrop, Fiji gradually liberalized its trade and reduced import restrictions in favor of export promotion. The more open trading approach led to increased opportunities in the economy, creating thousands of jobs in industries like tourism and textiles.

4. Over 2001–2006, the Fiji economy experienced extreme volatility in growth performance. Annual GDP growth fell to 2.7%, on average, while during 2007–2009 the economy contracted at an average rate of –0.4%. The pronounced volatility in year-on-year GDP growth is shown in Figure 2, reflecting the negative impact of natural disasters (cyclones in 1985, 1992, 1993, 2009, and 2011 and floods in 2009 and 2012); sudden changes in international commodity prices (oil shocks in 1973, 1979, 1981–1982, and 2008); and the effects of coups (1987, 1989, 2000, and 2006).

5. The economy has also undergone a number of structural changes since the early 1980s, including the rise and fall of key sectors over a relatively short time span. The outcome is that growth averaged just 2.4% during 1980–2013, compared with 6.5% during 1970–1979.

Figure 2: Economic Growth, 1970–2013



Source: Fiji Bureau of Statistics

6. **Export sectors.** One important cause of Fiji's weak growth record beginning in the mid-1990s has been the performance of the merchandise exporting sector. Since 1970, sugar and textile exports drove Fiji's economy, but both have experienced difficulty in competing effectively in deregulating global markets. The sugar industry has suffered from quality concerns, management problems, labor relations issues, non-renewal of land leases, shortages of harvest labor, and most importantly the phasing out of the preferential price agreement with the

² M. Reddy, et al. 2004. *Understanding Reform in Fiji*. Study Commissioned by the Global Development Network (Washington, DC) and the Foundation for Development Cooperation (Brisbane). Suva.

European Union—due to end in 2017—leading to sugar price reductions of 36% and a decline in sugarcane production. In 2010, the government began implementing industry reforms. These are making an impact, with sugar production increasing by 16.2% in 2013, reversing a contraction of 7.1% in 2012. The textile industry similarly declined following the end of the quota system under the Agreement on Textiles and Clothing and the full integration of textiles into the WTO tariff regime³. Overall, garment exports have declined from 34% of all merchandise exports in 1999 to only 11% in 2013; while sugar exports were 15% in 2013, down from 28% in 1999.

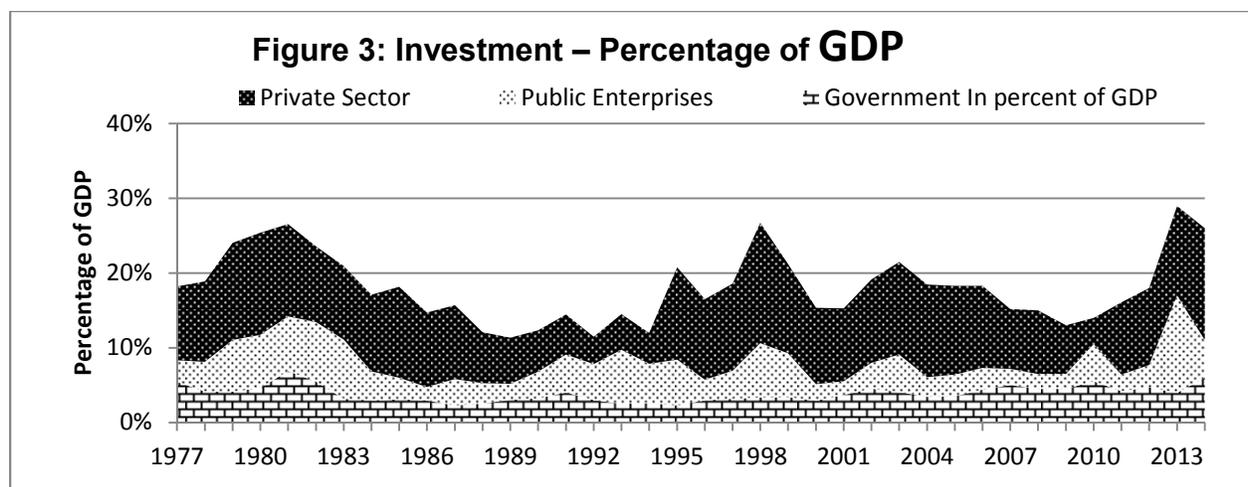
7. More recently, growth has been driven by Fiji's strong tourism industry, which has demonstrated a strong degree of resilience to the setbacks of cyclones and floods occurring in the tourism high season. Some 45% of Fiji's visitors come from Australia, with large numbers also coming from New Zealand, the United States, the United Kingdom, and the Pacific islands. About 650,000 tourists visited Fiji in 2013 (although this was down from a peak of 675,000 in 2012) and gross earnings from tourism were in excess of \$572 million (F\$1.3 billion)—more than the combined revenues of the country's top five merchandise exports in that year (fish, water, garments, timber, and gold). Mining is also an emerging sector with the potential to boost the economy's output significantly. Fiji's second highest foreign exchange earner after tourism is remittances from Fijians residing and working overseas. These have increased in importance and in 2013 were estimated to be equivalent to 3% of GDP.⁴

8. **Investment.** Investment has been on a downward trend since 1980 and has been a key factor contributing to the low growth rate of the Fiji economy (Figure 3). A pronounced decline in private investment explains most of the fall in Fiji's total investment levels. While public and state-owned enterprise (SOE) investments remained relatively stable at 10%–12% of GDP from 2000 to 2013, the ratio of private investment to GDP fell from an average of 11.3% in 2000–2005 to 7.5% of GDP during 2006–2010. Private investment then fell sharply to just 2%–3% of GDP in 2011—the lowest levels recorded since Fiji's independence in 1970. The government in its 2010–2014 Roadmap⁵ set an investment target of 25% of GDP. This target was reached in 2013 following a substantial ramping up of public investment in the economy—with government capital expenditure (largely on roads infrastructure) increased substantially in the 2013 budget—from 28% of total spending to 32%, and again in the 2014 budget to 38% of expenditure in an effort to stimulate demand. Private sector investment has shown signs of recovery, increasing to 15% of GDP in 2014 following a substantial government stimulus package, including reductions in corporate taxes from 30% to 20% (lower still at 10% for companies listed on the South Pacific Stock Exchange), making Fiji's corporate tax rates the most competitive in the region. Foreign investment remains below potential, with approvals and projects implemented being almost 50% lower in 2013 than in 2006.

³ The value of garment exports fell by 47% in 2005 alone following the withdrawal of the Agreement on Textiles and Clothing quotas.

⁴ IMF. 2013. *Republic of Fiji: 2013 Article IV Consultation. IMF Country Report No. 13/370*. Washington, DC. (Calculated from data in Tables 1 and 4).

⁵ Government of Fiji. 2009. *Roadmap for Democracy and Sustainable Socio-Economic Development: 2010-2014*. Suva.



GDP = Gross Domestic Product

Source: Fiji Bureau of Statistics and Reserve Banks of Fiji

9. **Business environment.** The government has implemented a number of structural reforms to improve the business climate for private investment, including significant efforts to improve infrastructure and enhanced land-leasing efficiency through the Land Bank. It is also developing an electronic registry to speed up investment proposals but much still needs to be done. Further improvements in the business environment are needed to encourage new private sector investment, including foreign direct investment, and to improve total factor productivity. The World Bank has rated Fiji 62nd out of 181 countries on ease of doing business.⁶ While among the better performers in the Pacific, investors still highlight barriers to starting a business, trading across borders, and paying taxes. Business input and transaction costs in Fiji are internationally not competitive—exacerbating the comparative disadvantage of being a relatively small and remote island state. In particular, the cost of international telephone and internet services are among the highest in the world. Electricity costs, while they compare favorably in the region and are based on the cost of production, are high on an international basis. The imposition of foreign exchange controls affects the repatriation of profits⁷. Price controls on many household staples, while intended to ensure access for the poor, can also be blunt instruments that limit competition and the development of local industry.

III. Macroeconomic Sustainability

10. **Public financial management.** Fiji has in place an adequate legal framework for public financial management and budgeting, provided for under the Financial Management Act, 2004 and Finance Instructions, 2005. Most policy and development activities of the government are reported publicly. There are, however, weaknesses in the application of the legal framework, notably in terms of compliance with legislative provisions, and in follow-up in response to identification of noncompliance. The act provides for an important role of the House of

⁶ World Bank. 2014. *Doing Business 2014: Understanding Regulations for Small and Medium-Size Enterprises (11th edition)*. Washington.

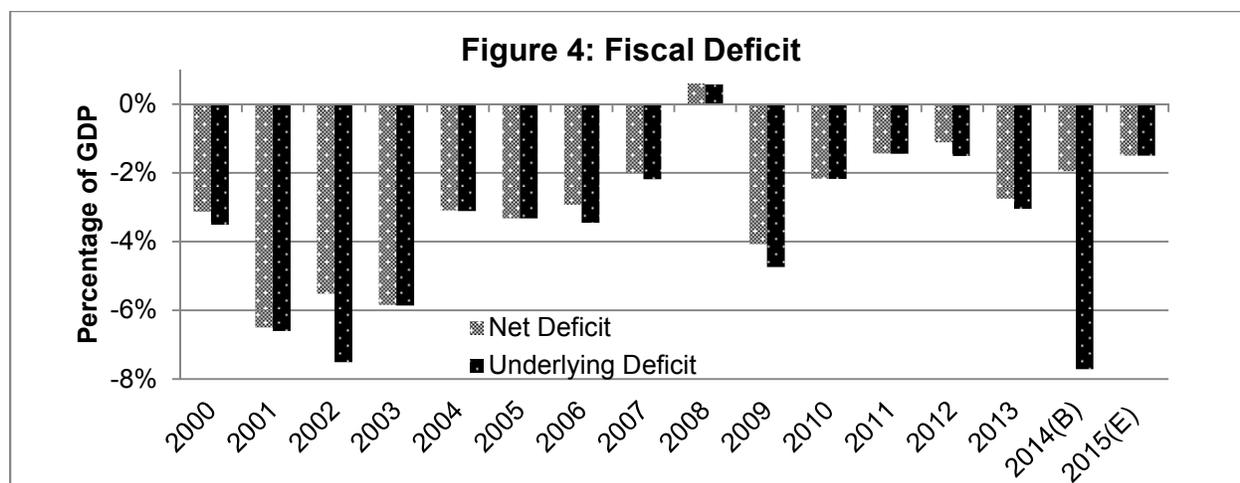
⁷ Measures taken by the Reserve Bank of Fiji (RBF) and as part of various budget announcements have eased the capital controls by increasing the delegation limits for which commercial banks have the authority to conduct transactions without RBF approval. Capital and profit remittances by firms and individuals still require Fiji Revenue and Customs Authority and RBF approval. According to the RBF, these procedures are not used to stop repatriation of profit or investment equity. However, they do create an additional regulatory hurdle for businesses and can disrupt the timing of such transactions.

Representatives in providing checks and balances on ministerial action. The House of Representatives has been reestablished in October 2014 after a lapse of 8 years, since the December 2006 coup. A further issue is reduced public financial management (PFM) capacity, with the departure of many skilled and experienced staff from the public service when retirement at age 55 was introduced in 2009, and with the surge in emigration that occurred after the events of 2006. Diminished capacity affects the quality of PFM. Efforts have been, and continue to be, made by the government to strengthen the link between the budget and its strategic priorities.

11. **Fiscal management.** The government has succeeded in reducing its net budget deficit from 5.1% of GDP in 2007 to an estimated 1.9% of GDP in 2014 (although this is predicated on the partial sale of a number of state-owned enterprises). Fiscal policy was eased in 2009 (after a period of tight policy from 2004 to 2008) in an effort to combat the recessionary effects of the global economic crisis. It was loosened further in 2012 when the government sharply increased its capital expenditure budget to boost investment. The government has also targeted growth in consumer spending through progressive salary increases for public servants, one-off tax cuts, higher tax thresholds, and the introduction of a minimum wage which increased disposable incomes, and increased access to consumer and mortgage finance to stimulate growth. To ensure inclusive growth, the 2014 budget introduced universal free primary and secondary education and a raft of social protection measures.

12. **Revenue and grants** averaged 26% of GDP in the 1990s. They fell in 2001 to below 24% of GDP, but recovered to 27% of GDP in 2013, through increases in indirect tax collections. Strengthening compliance has been a focus of government efforts in regard to direct taxes. Fiji Revenue and Customs Agency was established to help improve compliance and has been the subject of a major capacity building program. A range of other initiatives have been implemented to improve tax administration. These include mandatory reporting, the adoption of tax identification numbers, and the simplification of tax administration processes and procedures. The value-added tax rate was increased from 10.0% to 12.5% in 2003 and to the current rate of 15.0% from 2011. The tax system in Fiji has undergone a number of reforms to widen the base since 2003, including the introduction of a fringe benefits tax and a capital gains tax. The value-added tax registration threshold has been increased, along with reduced income taxes and the introduction of social responsibility tax for high income earners. Reforms have resulted in the implementation of pay-as-you-earn tax as a final tax from 2013. The customs tariff has four bands: 0 for tourist items, medicaments, and education requirements; 5 for investment goods; 15 for intermediate goods; and 32 for revenue generating and protected categories. Health-adverse and/or sin goods attract higher ad valorem tax rates. Despite significant improvements in compliance, opportunities for improvement still exist, and the widespread use of tax and customs duty concessions need to be reduced.

13. Improvements to Fiji's tax system and improved tax compliance and higher revenue collection have helped to contain the budget deficit, even as government expenditure has risen. In 2014, the budget deficit is projected to decline to 1.9% of GDP (from 2.8% in 2013), although this is predicated on the one-off partial sale of key public enterprises as well as the sale of overseas embassies. Indications are that this will not happen this year and that the fiscal deficit will be higher than projected.



Sources: Fiji Bureau of Statistics and Reserve Bank of Fiji

14. **Public debt.** To finance the country's capital investment program, the government has borrowed from nontraditional lenders such as the export-import banks in People's Republic of China, Malaysia and India, and the Fiji National Provident Fund (the state pension fund). Public debt levels have increased from F\$2.9 billion in 2006 to \$3.7 billion in 2012 and are expected to rise to \$3.9 billion in 2014 (Figure 4). Public debt is estimated at 49.5% of GDP in 2014 (not including the contingent liabilities of the state enterprises of about F\$1.2 billion, which, if added, would lift public debt to about 80% of GDP).⁸ Most of this debt is domestic and held primarily by the Fiji National Provident Fund. In 2011, Fiji authorities issued \$250 million worth of bonds (\$150 million being used to settle a previous global bond and \$100 million earmarked for infrastructure development). This has increased Fiji's external public debt to 14% of GDP—up from 10% in 2006. Nevertheless, external debt is still relatively low, and the government has managed to accumulate F\$140 million in a sinking fund toward repayment of the bond in 2016.

15. Since 2011, the government has made a number of large-scale financial commitments. The largest capital expenditure commitment in the 2011 budget was a F\$110 million allocation to Fiji Sugar Corporation for restructuring purposes. This represented nearly 6% of total expenditure, and about half of the budgeted deficit. In 2012, the government guaranteed a F\$120 million ANZ bank loan to Fiji Sugar Corporation to continue with the restructuring program—demonstrating the government's strong commitment to support the sugar industry in Fiji as the main source of income and livelihood for a large proportion of the population. In 2013, the government announced borrowing of F\$200 million to part finance the purchase of the first of three new airbus A330–200 aircraft (the estimated total cost is F\$1.06 billion). The intention of the government, through these purchases has been to boost tourism.

16. **Monetary policy.** Through the Reserve Bank of Fiji, the government has pursued an accommodative monetary policy. Interest rates are low (0.5%), and with relatively low private investment over a number of years, excess liquidity has built up in the system. Most recently, though, with the loosening of fiscal policy, domestic investment and domestic credit have grown rapidly—leading to higher imports and a fall in foreign reserves, which declined from the equivalent of 5.0 months of retained imports in January 2014 to 4.7 months in July 2014. Nonetheless, improved inward remittances and trade services (tourism and air transport)

⁸ Reserve Bank of Fiji. 2012. The Fiji Economy. Presentation to the Fiji Institute of Accountants. Suva.

continue to support Fiji's external position. Prices have stabilized since 2013. The devaluation of Fiji's exchange rate by 20% in 2009 saw inflation rise to double digits, but it appears to be contained at about 3% with no upward pressure on prices on the horizon.

17. **Foreign exchange and balance of payments considerations.** Fiji's budget deficits have been almost entirely domestically funded, which raises the risk of foreign reserves being eroded over time. This could put pressure on the balance of payments and exchange rates, and compromise macroeconomic stability. Fiji applies controls on capital flows to avoid or minimize the need for exchange rate adjustment, but this has led to large one-off devaluations—the most recent being 20% in 2009. Although these controls have been relaxed since 2012, their presence and the prospect that they will be tightened in difficult economic conditions is a deterrent to foreign investment. The use of capital controls also shields the domestic economy from the need to generate internationally competitive investments, which has an adverse effect on growth. This is particularly relevant to some of Fiji's state-owned trading enterprises.

18. **Macroeconomic sustainability.** The International Monetary Fund (IMF) in its Article IV Mission to Fiji in July 2014 assessed the government's expansionary macroeconomic policies as being broadly appropriate, but noted the need for macro-prudential measures to be implemented to address emerging imbalances in the economy—specifically higher investment and consumption expenditure, which are attracting higher imports and putting pressure on reserves, liquidity, and interest rates at too early a stage of Fiji's economic recovery. The IMF has advised the government that sustaining and increasing the growth potential of the Fiji economy will require a rebalancing of the economy away from its focus on public investment to a greater focus on private investment.⁹ This will entail much-needed reforms to improve the business environment. The IMF also noted domestic and external risks to the outlook. Domestic risks were seen to arise from the complex political situation, although on the upside, the successful elections and a smooth transition to reform-oriented democratic government could result in stronger confidence in the economy and higher capital inflows. On the external risks, the IMF noted that Australia and New Zealand, the two most important tourism markets for Fiji, could be adversely affected by lower commodity demand from the People's Republic of China and elsewhere.

IV. Conclusion

19. The key challenge for Fiji will be sustaining growth and ensuring it is more inclusive through generating jobs. This will require significant public and private investment, but given emerging fiscal constraints, increased private investments will be particularly important. Doing so will require further SOE reform, continued rehabilitation and new private investment in infrastructure and further efforts to strengthen the business environment..

20. Elevated levels of public investment and higher private consumption have put Fiji onto a higher growth path, but some rebalancing towards private sector investment is needed to sustain growth levels and contain budget deficits over the longer term. Ongoing reforms to the public service will be important to remove roadblocks to policymaking and open up space for structural and economic reforms under the new government. Continuing to move forward with reforms designed to create a more business-friendly environment for both domestic and foreign investors will be critical to sustaining Fiji's growth performance and to reducing poverty.

⁹ IMF. 2013. Fiji: Article IV Staff report. December. Washington, DC.