Fiji Islands

The pace of economic contraction accelerated last year owing to damage done by floods, the impact of the global recession on tourism and exports, and political uncertainties. Production of sugar, a major export, fell for a third year. The outlook remains subdued, with a small contraction in GDP forecast for 2010, but growth may resume at low levels in 2011. Inflation is expected to be moderate in both years. Reforms to encourage investment are a prerequisite for stronger and sustained growth.

Economic performance

GDP contracted for a third year in a row in 2009, with the pace of contraction accelerating to an estimated 2.5% (Figure 3.32.1). In addition to the impact of the global recession, which hurt tourism and exports, severe flooding in January 2009 did damage to crops and infrastructure that cost around 5.3% of GDP, and further discouraged tourism.

These setbacks hit an economy already facing low investor confidence and a loss of assistance from traditional donors and multilateral agencies, resulting from a military coup in December 2006 that installed an interim government. The extended decline in GDP also reflects longer-term constraints to economic growth arising from problems with access to land, weaknesses in the public sector, and a decline in the important sugar industry.

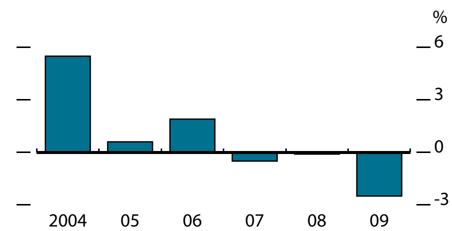
Official estimates show that most sectors contracted in 2009, including wholesale and retail trading by nearly 16%; transport, storage, and communications by just under 9%; agriculture and forestry by about 5%; and even education, public administration, and defense by about 3%.

Sugar production dropped further (Figure 3.32.2), by an estimated 19% in 2009, mainly owing to continuing land tenure issues that have led to a reduction in sugarcane output and technical failures in upgrading sugar mills. The financial viability of the mill upgrades depends on cane throughput of 4.2 million tons, but in 2009 only about 2.2 million tons was crushed.

Tourist arrivals fell by about 25% early in 2009, reflecting weakness in global travel, the floods across a third of the country, and increased competition from other Pacific destinations. Full-year arrivals declined by nearly 8%, and tourism revenue fell by an estimated 12% on account of aggressive price discounting.

On the fiscal side, the interim government cut operating expenditure (nearly 80% of total outlays) by 10%, assisted by reductions in civil service jobs. Capital expenditure remained far below target (around half in 2009), due to deficiencies in civil service implementation capacity. While revenue fell by 5.6% due to the fall in economic activity, the aggressive cuts in spending kept the budget deficit to 2.5% of GDP, or below target.

3.32.1 GDP growth



Sources: Fiji Islands Bureau of Statistics. http://www.statsfiji.gov.fj; Ministry of Finance. *Economic and Fiscal Update: Supplement to the 2010 Budget Address*. http://www.mfnp.gov.fj

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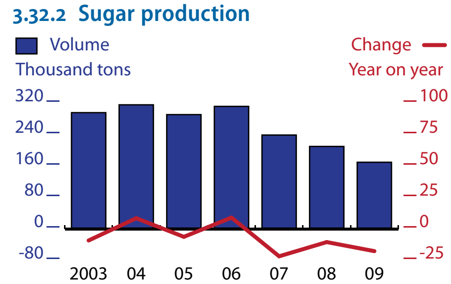
3.32.2 Sugar production



Source: Fiji Sugar Corporation *10-Year Statistical Review*. http://www.fsc.com.fj; Reserve Bank of Fiji. 2010. *Economic Review*. February. http://www.rbf.gov.fj

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This chapter was written by Emma Ferguson of the Pacific Subregional Office, ADB, Suva.

When foreign exchange reserves fell in early 2009 to about US$300 million, the Reserve Bank of Fiji responded by tightening exchange controls and, to encourage exports of goods and services, devalued the Fiji dollar by 20% in April. The central bank also directed commercial banks to cap lending interest rates at December 2008 levels. However, lending slowed as banks became more cautious in the context of political and economic uncertainties. Later in 2009, the central bank removed the ceilings on lending rates, as well as credit ceilings that had been in place since 2006.

Weak external markets caused a 28% fall in merchandise exports in US dollar terms in 2009. Declines in exports of clothing, sugar, and timber more than outweighed gains in shipments of fish and gold. Merchandise imports dropped even more steeply, by 35%, with falls in most major categories including fuels (due to lower oil prices) and manufactured goods (due to the weak domestic economy).

The trade deficit shrank, contributing to a narrowing in the current account deficit to an estimated 8.7% of GDP. Foreign exchange reserves recovered by year-end to US$568 million, equivalent to 3.7 months of import cover (Figure 3.32.3). Reserves were bolstered by US$93 million from the general allocation of special drawing rights last year by the International Monetary Fund, and by a pickup in remittances that was stimulated by the devaluation.

Lower prices for imported food and fuel brought inflation down to an average of 3.7% from 7.7% in 2008. By December, however, year-on-year inflation had increased to 6.8% (Figure 3.32.4), largely a result of the devaluation.

Government debt rose (Figure 3.32.5), to the equivalent of about 52% of GDP. Most is domestic debt owed to the national pension fund. But once contingent liabilities of government-owned enterprises, such as Fiji Sugar Corporation, are included, debt is much higher, at around 70% of GDP.

The Bureau of Statistics last year rebased GDP data for 2006–2008 to reflect structural changes in the economy. It reduced the weighting for agriculture and increased that for communications and manufacturing, leading to revisions in the 2006 growth outcome to 1.9% (from 3.4%), and in the 2007 GDP contraction to 0.5% (from 6.6%).

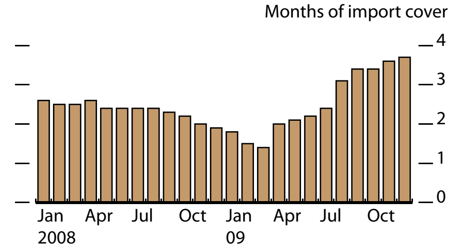
Economic prospects

Any significant rise in sugar output depends on extensive replanting to improve the quality of the sugarcane, on a substantial increase in the area planted, and on a successful upgrading of the sugar mills. However, land tenure problems for tenant cane-growers have yet to be resolved. The outlook for tourism income is also subdued this year. Furthermore, the interim government's position that elections will not be held until 2014 remains a hurdle for improvement of relations with development partners.

A preliminary assessment of damage inflicted by Cyclone Tomas, which hit northern areas of the country in March 2010, indicated that it had little impact on GDP but put some upward pressure on prices.

The 2010 budget, which targets a deficit of 3.5% of GDP (Figure 3.32.6), aims to stimulate growth through infrastructure spending and tax breaks to encourage investment, including a value-added tax refund system for tourists as well as investment incentives. Implementation of the budget

3.32.3 Foreign exchange reserves



Source: Reserve Bank of Fiji. http://www.reservebank.gov.fj

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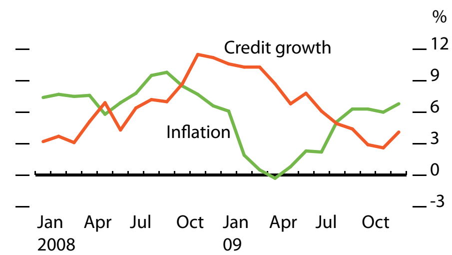
3.32.4 Monetary indicators



Source: Reserve Bank of Fiji. http://www.reservebank.gov.fj

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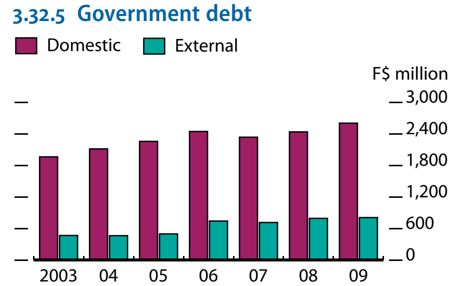
3.32.5 Government debt



Note: External debt comprises debts of the government, statutory bodies, and the private sector.

Source: Reserve Bank of Fiji. 2009. *Quarterly Review*. December. http://www.rbf.gov.fj

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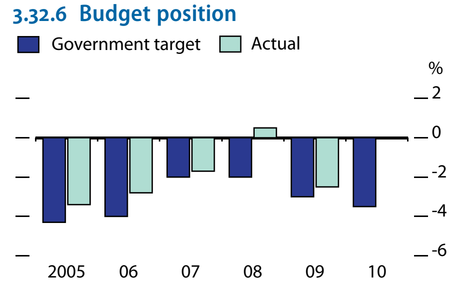
3.32.6 Budget position



Note: Excludes loan repayments.

Sources: Ministry of Finance. *Economic and Fiscal Update: Supplement to the 2010 Budget Address*. http://www.mfnp.gov.fj; Reserve Bank of Fiji. *Quarterly Review*. Various issues. http://www.reservebank.gov.fj

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depends heavily on meeting revenue targets (the tax breaks could erode revenue) and on improving civil service capacity to undertake capital projects (given recurring problems in meeting capital spending targets).

Efforts by the interim government to reform the civil service and inefficient public enterprises should benefit the economy over the medium term, but in the short term will likely lead to more job losses.

In view of these factors, GDP is forecast to decline by 0.5% in 2010. Growth could resume at low levels next year (about 0.5%), if the problems in the sugar industry start to be resolved and if global trade and tourism pick up as expected. (Analysis of the prospects, and of policy options, is hampered by restrictions on publicly available data, including budget information.)

The planned removal of price controls on many basic food items during 2010 should benefit the food processing industry, though their removal needs to be offset by targeted assistance to the poor. (Around 40% of the population is now below the income level needed to provide for essential consumption.)

Imports are forecast to grow faster than exports this year (higher prices for imported oil will be a factor), pushing out the trade deficit. This will contribute to a forecast widening in the current account deficit to about 11.0% of GDP in 2010. That gap could narrow to about 8.0% in 2011 as exports of goods and services benefit from the expected acceleration in global trade and tourism.

Inflation will moderate from the end-2009 rate, as the devaluation's impact on prices fades. Weak domestic demand will limit the upward pressure on inflation arising from higher prices for oil and commodities and from the removal of price controls on food. Year-average inflation is forecast at just over 3% in the next 2 years.

3.32.1 Selected economic indicators (%)

	2010	2011
GDP growth	-0.5	0.5
Inflation	3.4	3.1
Current account balance (share of GDP)	-11.0	-8.0

Source: ADB estimates.

Development challenges

Over recent years, the country has lost its preferential treatment in major export markets for clothing and sugar, owing to the expiration of trade agreements. A major challenge is to attract investment that will broaden the economic base to compensate for declines in those two industries. However, private investment is discouraged by political uncertainty (four coups since May 1987) and deficiencies in the regulatory and legal environments, as well as by a lack of skilled labor. The investment-to-GDP ratio has generally been low, at around 15%.

Foreign investment regulations were revised in February 2010 to allow for 100% foreign ownership of certain businesses. However, it will be important to address the deficiencies in the investment climate to achieve a sustained rise in foreign direct investment.

Increases in investment by the government require not only higher allocations for development outlays, as compared with operating expenses, but also improvements in budget implementation capacity. Capital expenditure needs to be protected at a time that fiscal consolidation efforts are being pursued to ensure macroeconomic stability and to stabilize public debt. In regard to the latter, the International Monetary Fund has encouraged the authorities to adhere to a target of reducing public debt to 45% of GDP by 2014.