Fiji Islands

Growth improved in 2006 because of a pickup in sugar production, expansion in construction, and growth in services stimulated by consumption demand. However, exports were weak and the current account deficit widened, placing pressure on foreign reserves. Even before the Government was removed from office by a military coup in December, the outlook for 2007 was a concern. Recession is now forecast for this year, followed by a modest recovery. Development challenges are myriad, including a need to attract more private investment.

Economic performance

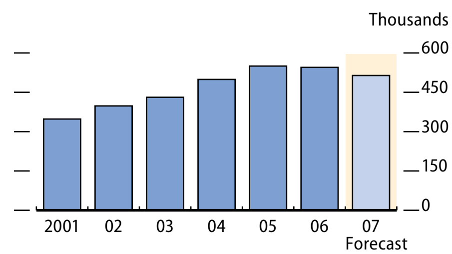
The economy grew by an estimated 3.4% in 2006, having averaged 2.4% growth in the 5 years following a coup in 2000. Growth last year was achieved despite a decline in tourism and the closure of the country's gold mine. Visitor arrivals fell slightly to 545,000 from 549,900 in 2005 (Figure 2.30.1), reflecting the impact of the 5 December military coup that removed the Government elected in May 2006. Several governments advised their citizens not to travel to the country and many December and forward bookings were canceled. An estimated 1,100 employees in tourism lost their jobs while others were placed on short working hours. As a result, growth in the wholesale and retail trade and hotel and restaurants sector was estimated at a modest 2.0%. The closure of the unprofitable Emperor gold mine, also in December, led to the loss of 1,800 jobs. The impetus for growth thus came from other sectors.

Construction powered forward at 12.3%, driven by major government projects as well as hotels and resorts. The electricity and water sector expanded by 5.0%. The agriculture, forestry, and fisheries sector grew by 3.9% as sugarcane production rose by 9.3%, and as both forestry and fisheries activity continued rising. However, the quality of sugarcane itself in 2006 was inferior to that of the previous year, and raw sugar production grew at the slower rate of 7.3%. Growth of 4–5% was recorded for services including transport and communications.

Following the loss of preferential access to some export markets over recent years, the steep decline of the clothing industry continued in 2006, with production dropping by 25%. In contrast, mineral water production for export expanded further.

On the demand side, credit-fueled consumption growth was reflected in a 4% increase in retail sales volume in 2006, and investment demand (helped by the construction projects) continued to expand, though private investment remained low at the equivalent of 8% of GDP. Public sector fixed capital formation was 10% of GDP. The deficit in trade in goods and services widened as domestic demand spilled over into imports and the export performance was disappointing. Imports (in US dollar terms) grew by 12.7% in 2006, while exports fell by 1.8%. The surplus on the services and transfers accounts climbed, with the increase primarily due

2.30.1 Visitor arrivals



Source: Reserve Bank of Fiji, *Presentation to the Fiji Employers Federation*, 21 February 2007.

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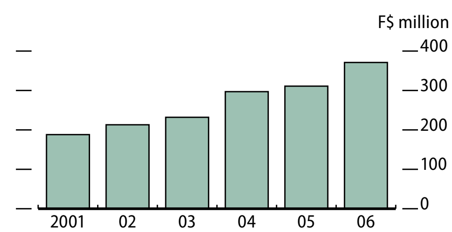
2.30.2 Personal remittances



Source: Reserve Bank of Fiji, *Presentation to the Fiji Employers Federation*, 21 February 2007.

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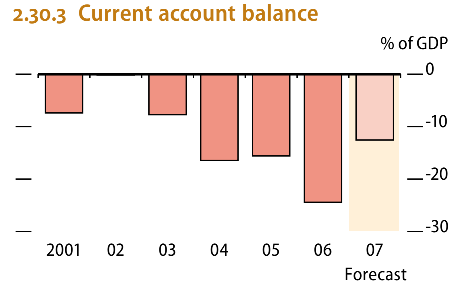
2.30.3 Current account balance



Sources: Ministry of Finance, *Economic and Fiscal Update*, 3 November 2006; staff estimates.

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to personal remittances (Figure 2.30.2), but this was insufficient to offset the broadening trade gap. The current account deficit widened to an estimated 24.4% of GDP from 15.6% in 2005 (Figure 2.30.3).

As a result of the deterioration in the current account, foreign reserves came under pressure. The Reserve Bank of Fiji (RBF), the central bank, raised its policy indicator rate twice in the first 6 months and increased the banks' reserve-deposit ratio. In September, the Government raised $150 million from its first international bond issue. Post-coup, RBF further tightened exchange controls, introduced credit ceilings on noninvestment lending, and raised interest rates on RBF lending to commercial banks. The bond issue and the other measures eased the pressure on foreign reserves, which totaled $476.5 million at end-2006 (3.3 months cover of goods imports), down slightly from 2005.

The nominal and real effective exchange rates of the Fiji dollar appreciated by 0.1% and 0.6%, respectively, in the year to December 2006. Monetary tightening and exchange rate stability contributed to moderate average inflation of 2.5% in 2006. The budget deficit was estimated at 2.9% of GDP if sales of government assets are included in revenues and 3.6% if asset sales are excluded (Figure 2.30.4).

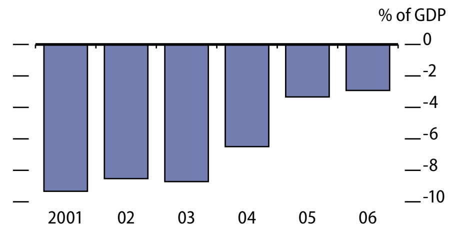
A policy framework for the 2007 budget reaffirmed the Government's intention of narrowing the deficit over the medium term to reduce its debt burden, which stood at 55% of GDP at end-2006 (inclusive of the international bond issue). Strategies included slowing the growth in operating expenditures by restructuring the public service over the period of the Strategic Development Plan 2007–2011. Following the December coup, the military-installed interim administration—the coup leader and commander of the Royal Fiji Military Force is prime minister—began formulating its own policies that incorporate elements of the 2007–2011 plan, such as restructuring the public service.

Economic prospects

The economic outlook was of concern even before the latest coup (and see Box 2.30.1). Growth from 2001 had been driven by unsustainable fiscal expansion and credit-based consumption, both of which put increasing pressure on the balance of payments. The previous Government's 2007 budget and the Strategic Development Plan projected that growth would slow to just over 2% in 2007 and 2008 as construction contracted from its 2006 peak, fiscal consolidation led to a shrinkage in public administration, and major export industries grew modestly. The sugar industry, which accounted for 6% of GDP and 26% of exports in 2005, faces a progressive reduction in preferential prices in the European Union (EU) market of 5% in the 2-year period 2006–2007, 12% in 2008, and 19% in 2009, as well as issues of renewal of land leases and declining productivity. Growth for this industry was predicated on the effective resolution of land lease issues and the implementation of reforms. It was expected that production in the clothing industry, which provided 14% of export income in 2005, would stabilize and that tourist numbers would rise by 6–8% in both 2007 and 2008.

Growth projections have been revised down since the coup and the closure of the Emperor mine. Previous coups in May and September 1987

2.30.4 Budget balance



Sources: Reserve Bank of Fiji, *Quarterly Review*, December 2006; Ministry of Finance, *Economic and Fiscal Update*, 3 November 2007.

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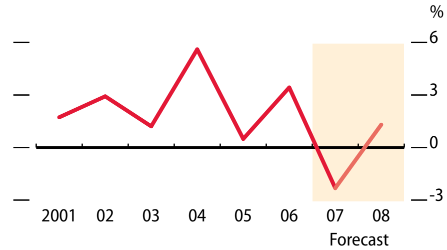
2.30.5 GDP growth



Sources: Fiji Islands Bureau of Statistics, *Key Statistics December 2006*; staff estimates.

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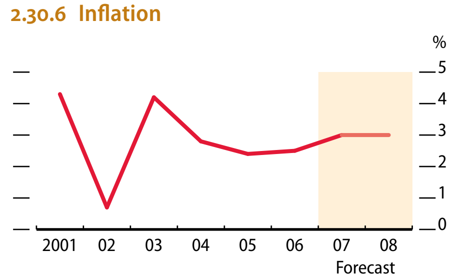
2.30.1 Selected economic indicators

	2007	2008
GDP growth	-2.3	1.3
Inflation	3.0	3.0
Current account balance (% of GDP)	-12.6	-

Source: Staff estimates.

2.30.6 Inflation



Sources: Fiji Islands Bureau of Statistics, *Key Statistics December 2006*; staff estimates.

Click here for figure data

and May 2000 undermined investor confidence, damaged the country's tourism image, led to trade bans, and reduced international funding. GDP fell by 6.4% in 1987 and 1.7% in 2000. The December coup may have a similar impact. Several donors suspended most new aid proposals, although many existing projects have continued. The EU has announced consultations with Fiji Islands authorities that could result in suspension of new aid, including assistance crucial to restructuring the sugar industry. A return to democracy seems unlikely to happen soon, given that the prime minister has stated that a general election will not be held until 2010.

The official forecast is that GDP will contract by 2–4% in 2007. A decline of 2.3% is a plausible outcome (Figure 2.30.5 above). Tourist arrivals are now forecast at 514,000, down 5.7% from 2006. Regional airline Air Pacific reported a 40% drop in forward bookings for the first 3 months of 2007. A tourism action group formed after the 2000 coup was reestablished to strengthen marketing efforts, in the hope that hotel occupancy rates would pick up from 25% lows. However, accommodation capacity was earlier expected to increase by up to 1,500 new rooms in 2007–2008 as new hotels were completed. A much more severe contraction is now forecast in the construction sector as some projects are postponed or canceled.

Elsewhere, it is assumed that clothing production for export will decline only marginally in 2007, but this could prove optimistic if overseas buyers switch their orders to other countries, or if trade sanctions are imposed. About 1% growth in sugarcane and raw sugar production is forecast, but the medium-term outlook for the industry will sour considerably if the EU suspends subsidies and aid.

The public administration sector will probably contract more than envisaged in the 2007 budget. A revised budget announced by the interim Government has targeted a deficit of 2% of GDP in 2007. Given that the new administration has decided not to proceed with a rise in value-added tax, as well as the implications for revenue collection of a recession, arriving at that target has required proposing cuts in spending across all departments. The interim Government sought to cut the wages bill by reducing pay rates and the retirement age for public servants, but has confronted labor union opposition to the proposals.

The loss of gold export earnings in 2007 and a decline in clothing exports will be only partly offset by rises in exports of mineral water, sugar, and fisheries and forestry products. If the marketing efforts persuade visitors to stay longer and spend more, tourism earnings may not fall in lockstep with lower tourist numbers.

Recession and the tightened monetary and exchange rate policies will have a crimping effect on import growth in 2007, but official transfers will fall to an extent that partly depends on the decision regarding the EU aid program. The current account deficit is forecast to narrow to 12.6% of GDP. Foreign reserves, which fell further to $449 million in February 2007, will remain under pressure through the year, but tight fiscal and monetary policies should contribute to financial stability. Inflation is expected to remain moderate at about 3% (Figure 2.30.6 above). The economy is seen emerging from recession in 2008, with growth of 1.3%.

2.30.1 Development challenges

The historical drivers of growth have been sugar, clothing, gold, and tourism. All except tourism faced uncertain futures before the latest coup. Sugar had seen a decline in growing and milling productivity due to underinvestment; suffered from poor working relationships between mill management, unions, and farmers; and confronted the progressive loss of farmers as land leases ended without renewal. In consequence, sugar production fell by nearly half over a decade to 289,000 tons in 2005, after which a phased 4-year 36% reduction in the preferential price paid by the EU began.

Wide-ranging reform of the sugar industry remains a core challenge, as underlined by the fact that the country's unit cost of production is about four times that of best-practice sugar-producing countries.

A future for the clothing industry depends on the extent to which producers can shift from the past low-value-added "cut, make, and trim" approach to higher-value-added production for niche markets. Gold mining has stopped. And tourism has to engineer a recovery in a competitive market, a process that took 4 years after the 2000 coup. New industries also need to be identified. For example, pine and mahogany have potential, but need sustainable use of natural resources and substantial investment.

The broader challenge is to encourage private investment and export development that together generate faster, sustained economic expansion that is compatible with external balance. The Government has targeted an investment ratio of 25% and a GDP growth rate of 5% as minimal requirements if inroads are to be made into unemployment and a poverty rate of 30%. Yet to achieve these aims, the business environment has to be improved through legal and regulatory reform.