Fiji Islands

Economic growth slowed in 2005, though tourism and related hotel activity continued to expand. The sugar and clothing industries, losing their preferential benefits in overseas markets, need major adjustments to remain viable. In 2006–2007, economic growth is expected to recover slightly because of a buoyant tourism sector, but the current account deficit will remain significant.

Economic performance

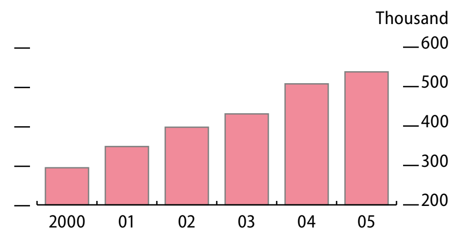
The economy expanded by an estimated 1.7% in 2005, after average growth of 3.4% from 1999 to 2004. Production of clothing and gold, two important export industries, fell from 2004's levels. Clothing was hit hard by the end of quotas to the United States. However, tourism remains a pillar of the economy and a major foreign exchange earner, with arrivals up by 6% in the first 10 months of 2005 (Figure 2.30.1). As a result, the hotel and restaurant subsector grew at a robust 13% in 2005. Construction, as well as manufacturing other than for clothing, grew modestly.

A decline in export earnings, combined with a rise in imports, widened the trade deficit in 2005. Merchandise imports, driven by growth in consumption and the rising cost of oil, grew by 6.5%. The country's main merchandise exports are sugar, clothing and footwear, fish, gold, timber, copra, and mineral water, with sugar and clothing relying heavily on preferential treatment in major markets. In 2005 export earnings fell by 3.2% mainly because of declines in clothing and footwear, and fisheries products. Export earnings from clothing dropped by 47% in 2005 after the country lost its clothing quota to the US. The current account deficit amounted to nearly 13% of gross domestic product (GDP). Foreign reserves were adequate, equivalent to 4.2 months of goods imports.

Inflation last year slowed to 2.4%. Price controls on certain items such as fuels, and the policy of pegging the Fiji dollar's exchange rate to a basket of currencies of the country's main trading partners, helped control inflation. However, concerns regarding possible currency overvaluation are emerging. To damp domestic credit growth for consumption purposes, which expanded by 19% in 2005, the Reserve Bank of Fiji raised the official interest rate in October to 2.25% and in February 2006 to 3.25%. The money market anticipates a further monetary tightening.

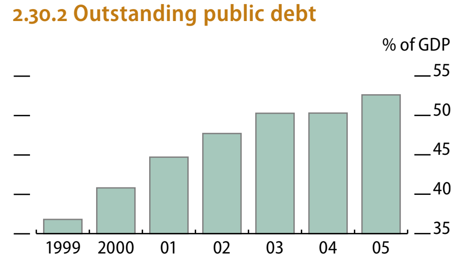
The fiscal deficit widened by about 1 percentage point to 4.3% of GDP in 2005. Such deficits have led to an increase in domestic public borrowing; outstanding public debt rose to 53% of GDP in 2005 from 37% in 1999 (Figure 2.30.2). Most of the debt is held by the Fiji National Provident Fund, and just 7% of the total is public external debt.

2.30.1 Tourist arrivals



Note: Data for 2005 are for January–October.
Source: Ministry of Finance and National Planning, *Economic and Fiscal Update: Supplement to the 2006 Budget Address*, 4 November 2005.

2.30.2 Outstanding public debt



Source: Ministry of Finance and National Planning.

Economic outlook

The outlook is conditioned on continued growth in tourism and successful restructuring of the sugar industry. Clothing and footwear exports are assumed to lose their competitive advantage in the Australian market as the advantage attributable to preferential access diminishes.

Prospects for 2006 and 2007

GDP growth is expected to edge up to 2.0% in 2006 and 2.4% in 2007, largely a consequence of gains in tourism (Figure 2.30.3). The entry of budget airlines into the market is supporting the industry. Construction, financial services, fisheries, timber, and transport are projected to record some growth. Mineral-water production, which more than doubled over 2001–2005, is expected to become the seventh-largest foreign exchange earner, reflecting international popularity for the product's pristine image.

The outlook is not as clear for other major industries. In sugar, the European Union will cut the subsidized price it pays for white sugar from the Fiji Islands (among others) by 36% over 4 years, starting this year. Compounding the problem, some tenant farmers face the expiration of land leases. About 6,000 sugarcane farmers have already left the industry, and some 154,000, or 18%, of the country's population are expected to move out of the sugar industry in the next 2–3 years. The contraction of the industry will affect many types of workers—cane cutters, drivers, mill workers—as well as their families. The impact will be cushioned by a program to develop alternative livelihoods and an expected sizable European Union adjustment package this year, with additional assistance in later years. The sugar industry may be viable in the future if cane growers and mills can raise productivity and produce other sugar-based products such as ethanol.

The clothing industry, too, is struggling since it lost guaranteed access to major markets through quotas. Furthermore, preferential access to clothing (and footwear) markets in Australia is becoming less valuable as that country reduces tariffs. After the Fiji Islands lost its clothing quota for the United States market, some garment makers last year relocated to countries with lower-cost labor, leaving 6,000 people, predominantly women, out of work. Clothing and footwear has been a significant industry, accounting for almost one third of total merchandise exports at peak production in 2000 (Figure 2.30.4). Due to the high import content of clothing and footwear, the net loss of foreign-exchange earnings was held to about $18 million in 2005.

The high price of imported oil is putting cost pressure on some industries. For example, Emperor Gold Mining Co., the largest gold miner in the country, cited the price of oil as a reason for cutting its costs, including significant staff layoffs, in 2005. Energy consumption throughout the economy is expected to increase, which will push up imports. Remittance income, which has increased sharply over the past 5 years to around $175 million annually to become the largest source of foreign exchange after tourism, is expected to stay at around this level. But the current account deficit will remain significant, creating balance-of-payments pressures. Inflation is forecast at around 3% (Figure 2.30.5).

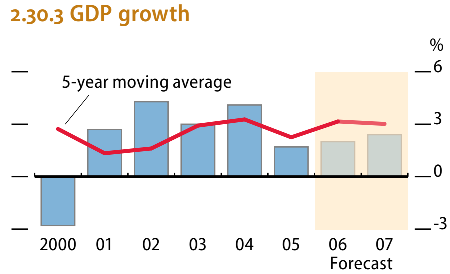
Economic growth of around 2% will be insufficient to generate the employment and incomes needed to substantially reduce poverty and

2.30.1 Selected economic indicators

	2006	2007
GDP growth	2.0	2.4
Inflation	2.7	2.7

Source: Staff estimates.

2.30.3 GDP growth



Sources: Fiji Bureau of Statistics, *Key Statistics*, September 2005, available: http://www.statsfiji.gov.fj/Economic/ecostats_index.htm, downloaded 1 December 2005; Ministry of Finance and National Planning, *Economic and Fiscal Update: Supplement to the 2006 Budget Address*, 4 November 2005; staff estimates.

improve welfare. The problems in the sugar and clothing industries are impeding tax revenues; at the same time they are raising demand for social services, which points to further budget deficits. The Government has set itself a challenging target to narrow the fiscal deficit to 4.0% of GDP for 2006 and 2007. Progress on a public sector reform agenda will be important to achieve this and to contain public debt. The Government's fiscal position is also exposed to the performance of state enterprises, given its recurrent transfers to fund those enterprises, as well as loan guarantees and other liabilities.

Medium-term outlook

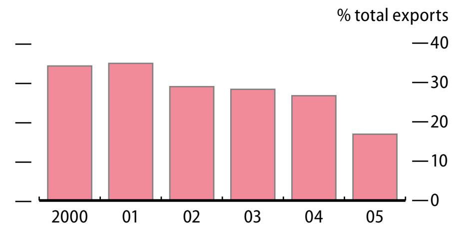
In the medium term, the economy is likely to continue posting growth of around 2%, supported by tourism and associated businesses (such as hotels, restaurants, and retailing services), as well as by agriculture, fisheries, telecommunications, timber, and transport. The Government has an ambitious 5% annual growth target, and hopes to spur private sector development and lift the investment rate to 25% of GDP. (Total investment is now around 17% of GDP, up from 12% in 2000.) The Government has committed to improving the business environment, reforming the public sector so as to reduce the cost of doing business, and promoting competition and efficiency through structural reforms.

The current account could deteriorate further if no export industry with an underlying comparative advantage replaces sugar or clothing and footwear. Sugar export earnings will likely dwindle unless reforms planned for the industry succeed in raising productivity. The clothing and footwear industry is scaling down, though it may have scope for some niche operations. Tourism, in contrast, seems likely to remain a major foreign exchange earner. Other industries, such as production of mahogany wood and mineral water, which are based on the country's resource endowment, have potential for further development.

The Fiji Islands has made more progress in achieving the Millennium Development Goals than many other Pacific countries, and is close to achieving its targets in education, health, and gender-related issues. However, the most recent official Household Income and Expenditure Survey in 2002 indicated that 28% of the population do not earn an income adequate for basic needs. Poverty is increasing, particularly in rural areas. The Government has adopted a target to reduce poverty by 5% a year over the medium term. Spending on poverty reduction is expected to increase, though this will also contribute to the fiscal deficits.

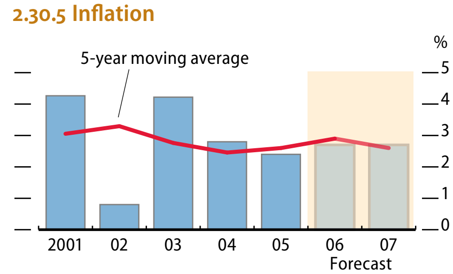
Uncertainties center on how the sugar and clothing industries will fare in their quest to remain viable and whether alternatives will emerge to maintain growth, employment, and tax revenues.

2.30.4 Clothing and footwear exports



Source: Fiji Bureau of Statistics, available online: http://www.statsfiji.gov.fj/Key%20Stats/Foreign%20Trade/8.5_Major%20Domestic%20Exports.pdf, downloaded 19 March 2006.

2.30.5 Inflation



Sources: Fiji Bureau of Statistics; staff estimates.