Current economic trends in selected South Pacific countries

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World economic developments in 1991 have been unfavourable for the South Pacific countries (Chart 1). The price of copper is lower than it has been since the end of 1988 (Chart 2). The average prices of sugar, copra and coffee are also depressed (Charts 3 and 4). Gold prices are below their previous levels and may remain below US$400 per ounce if inflation expectations remain low. Despite the plans of several companies to enlarge their exploration activities in Papua New Guinea and Fiji, future exploitation may be discouraged unless gold prices rise markedly above present levels. Tourist income has risen in Fiji and Vanuatu. Aid receipts have probably increased in real terms, and remittances, have, as yet, been little affected by the deceleration of economic activity in New Zealand, Australia, and the United States.

Recent signs of recovery in the industrial nations (such as the rise in employment in the United States) suggest that the prices of traditional export crops—coffee, cocoa, and copra—may improve in the near future. However, the prospects for a return to the price levels of the mid 1980s are uncertain. Sugar revenues are largely dependent on European Community price support policies that may be weakened following the GATT negotiations. Therefore, alternative sources of foreign exchange are being developed. There is considerable potential for fishery development provided agreements on conservative catch limits can be maintained. With the growing complexity of fishery operations, it will be necessary to involve foreign operators, frequently linked to their markets—such as Japanese consumers and US owned canneries. Forestry product prices have returned to their 1987–89 levels and most of the Pacific islands still have plentiful supplies of hardwoods. However, long-term exploitation of this resource requires respect for conservation practices and the payment of adequate royalties if the community is to benefit from harvesting. Unfortunately, this respect and payment have frequently been absent in the Pacific.

Fiji is pursuing export markets for fresh, dried and canned fruit. Western Samoa is expanding passionfruit exports and developing the New Zealand market for taro. Tonga has become an important vanilla exporter and is expanding output of other spices.

Chart 1 **International indices** (1980 SDR value = 100)

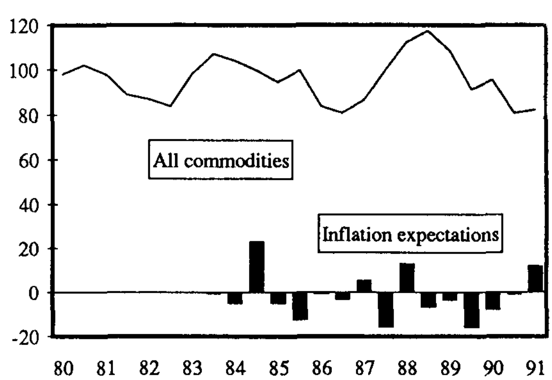
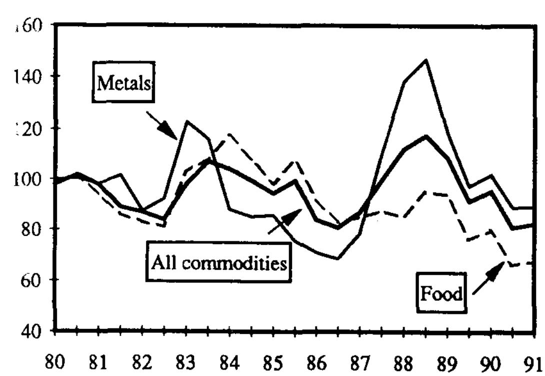


Chart 2 **International trade price indices** (1980 SDR value = 100)



The uncertain prospects for strong stimuli from foreign sources in the form of marked price increases for the islands' exports or increases in aid receipts (they may even decline in real terms) has evidently stimulated a reaction that the islands themselves should accept more respsibility for overcoming their recent slow rates of progress. This reaction is evidenced in three trends.

It is becoming accepted that the recent disappointing performance is partly the result of 'inward looking' frameworks 'hampering the competitiveness of the economy...at the expense of an export oriented strategy'. The South Pacific Forum Pacific Islands Countries/Donor Meeting of 4–7 February concluded that 'Development planning in island economies needs to be modified and made more effective'. The time for 'bulky development plans presented as a shopping list for donors' is over. 'A more strategic approach involving the development of sound macroeconomic policies providing an incentive package for productive investment' is now required. 'As a consequence the whole approach towards planning and line ministries personnel will have to be (re)considered. It is necessary to recognize that many current policies cannot be complemented by the 'small often overworked' administrations in these countries.[1]

In order to provide an incentive package for productive investment, the South Pacific countries are promoting private sector investments. The proposed replacement of the Papua New Guinea National Investment Development Agency by the Investment Promotion Authority, with emphasis on promotion, and the raising of permitted participation by non-resident investors, is one indication of this changed approach, as is the continued activity of the Fiji Trade and Investment Board.

As a consequence, 'the need to deregulate the business environment is gaining recognition'.[2] As an example, 'Western Samoa ...has eliminated all of the inefficient government-owned corporations, paving the way for more private sector participation'.[3] The closing of the Commodities Board was perhaps the most important of these eliminations. However, it is only one incident in the general re-examination of the role of government intervention in the marketing of commodities, particularly export products. The recent bankruptcy of several marketing schemes as a result of conflict between unrealistic government objectives and market realities has given urgency to this re-examination.[4] The replacement of some import quotas by tariffs and the reduction of customs duties on industrial inputs (thereby eliminating some of the effective disprotection of local activity) by Papua New Guinea is one example of a move away from an inward looking framework towards a more export oriented strategy.

Mineral production, including potential petroleum development, is providing foreign exchange and will produce government

Chart 3 **Mineral price indices**
(1980 SDR value = 100)

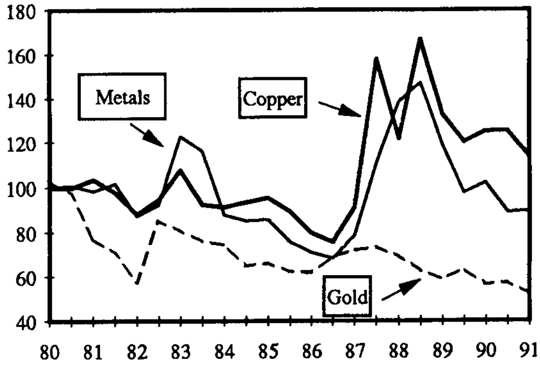
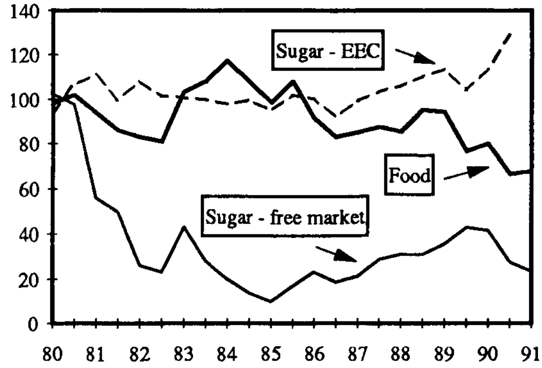


Chart 4 **International sugar price indices**
(1980 SDR value = 100)



1 This and the following two paragraphs are largely based on the statement issued by the South Pacific Forum Secretariat after the Pacific Islands/Donor Meeting.

2 Savenca Siwatibau in Bauer, Kasper, and Siwatibau, *Aid and Development in the South Pacific*, Sydney and Auckland, The Centre for Economic Studies, 1991.

3 South Pacific Forum, loc. cit.

4 See 'Statutory marketing authorities in South Pacific island nations' in this issue.

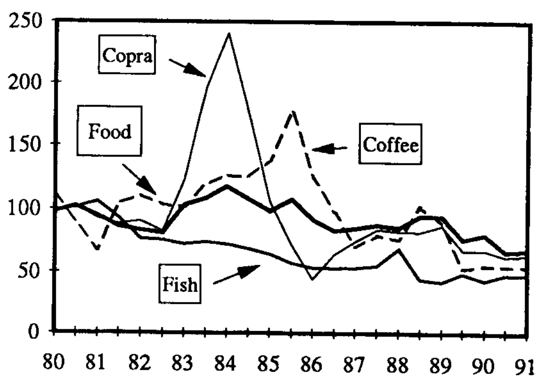
revenues and landowner rents in Papua New Guinea and, to a lesser extent in Fiji and the Solomon Islands. It will be a considerable time before Bougainville returns to production, if ever. However, mining investments are large, lumpy and have a high import content, particularly in their early stages. They are largely enclave activities, that will leave little behind when the resources are exhausted.

Most Pacific manufacturing has been oriented towards domestic markets that are small and fragmented. The dependence on import substituting protection has discouraged the development of activities that could compete on world markets. Labour productivity is lower and wages are higher than in competing Asian countries. Electricity costs, in US$ per kilowatt hour, for example, are 0.14 for Fiji, 0.16 for Papua New Guinea and 0.21 for Vanuatu, while they average 0.07 in the United States.

Since 1987, Fiji has undertaken various measures, including the granting of import tax exemptions to manufacturing industries exporting almost all of their output.[5] The government has recently proposed a program of labour market reform that, if successful, would allow more wage flexibility. Tonga and the Cook Islands are also developing clothing exports.

Rapid development of internationally competitive manufacturing in the Pacific island economies will require direct foreign investment and the employment of skilled expatriate labour. This can conflict with domestic 'localization' objectives, both in terms of ownership and employment. Currently, manufacturing exports from the Pacific island economies receive preferential access into most developed country markets, under schemes such as the South Pacific Area Regional Trade and Economic Cooperation Agreement, the Generalised System of Preferences or the Lomé Convention. However, the effective preference that they provide is declining as Australia, New Zealand and other participants in the GATT negotiations lower their general levels of tariffs and the European Community relaxes its Common Agricultural Policy.

Chart 5 **International food price index** (1980 SDR value = 100)



Tourism has been a growth sector in the last few years for those countries that have promoted it, particularly Fiji and Vanuatu. However, this industry is sensitive to political disturbances, both domestic and international. The Gulf War raised the attractiveness of the Pacific as a tourist destination. The absence of cyclone damage and the convenience of air connections are also important.

Aid flows from international and bilateral donors have been maintained, but there must be some concern as to whether this level of aid will continue. The political and economic changes in Eastern Europe imply large aid flows to that region, presumably at least partly at the expense of others. Donors are likely to reassess their existing aid allocations, and in this respect the Pacific island states are vulnerable to some degree. They have been the recipients of very high per capita aid flows, mainly grants, for some time, with little to show in the way of increased financial independence.

The Forum countries recognize that their small size creates relatively high costs for separate administrations. It also makes any marked expansion of output, other than of traditional agricultural products, dependent on obtaining the economies of scale that are only made possible by the adoption of export-oriented policies. They have declared their support for a partnership between island countries if there is to be a strengthening of trade and investment opportunities. They have demonstrated cooperation on political issues of common interest, but attempts at economic cooperation have been less successful. There is some cooperation in sea transport, but little in air transport. Tourism illustrates some of the problems involved. There are potential economies of scale in coordinated air scheduling and marketing of tourist destinations in the region. One difficulty with a common approach is that all destinations will be affected by any disruption,

5 See 'Experiences of export processing zones: could they be effective in Papua New Guinea?' in this issue.

civil or climatic, to any one of them. Tourism in Vanuatu was adversely affected by the events in New Caledonia in 1985. Most countries therefore have chosen to establish separate identities as tourist destinations despite the potential benefits of a more cooperative approach. This general problem of size is one of the most pressing facing the islands.

It is significant that governments in the region still make decisions that are not in the best interests of their neighbours. A recent example of this is Fiji's plans to monopolize purchase of oil products through FINAPECO, a fully government owned entity. Several smaller island nations (Cook Islands, Kiribati, Niue, Tonga, Tuvalu, Vanuatu and Western Samoa) currently receive their oil products through one of the companies operating in Fiji. Their choices are to continue receiving their supplies from Fiji, at the risk of becoming locked into one international supplier, probably at a higher price, or to seek an alternative source. Either way supplies will be more costly. After examining the alternatives Vanuatu has switched to sourcing from Noumea.

Papua New Guinea

The program agreed on at the meeting of the Consultative Group for Papua New Guinea in May 1990 was predicated on the government undertaking major structural adjustments. This program included two components: short-term stabilization measures designed to offset the negative impacts of the continued closure of the Panguna mine and the low level of agricultural export prices, and medium-term (three to ten years) structural adjustment policies designed to promote increased activity and efficiency in the non-mining sector of the economy. These measures are to be designed and implemented in the context of an economy with problems of land mobilization, inadequate supplies of skilled labour and maintenance of law and order.

The stabilization measures adopted included: a devaluation of the kina (by 10 per cent); a cut in budgeted government expenditure (of K73.8 million); agreements with unions on wage restraint; and, with some exemptions, no growth in bank credit to the non-mining private sector. As a result of these measures the balance of payments had an overall surplus of K30 million in 1990, compared to a deficit of K52 million in 1989, and a projected deficit of K270 million in the absence of stabilization action. At the end of 1990, foreign exchange reserves were sufficient to cover 3.6 months of imports (or 5 months of non-mining imports). The annual inflation rate of 7 per cent was lower than expected, given the devaluation and oil price increases. Real wages are estimated to have declined by 5.1 per cent in 1990. Real GDP was down by 1.6 per cent. Overall, the stabilization measures appear to have achieved their objectives.

There is cause for concern in the way demand was restricted. The Bank of Papua New Guinea estimates that the actual government deficit in 1990 was K62.5 million (compared to a budgeted deficit of K3.4 million). Total revenue was K18.7 million below, and total expenditure K40.6 million above, budget. This implies that only K33.2 million of the budgeted expenditure cuts were carried out—in fact only K2.2 million once net expenditure carried over is considered. Although the resulting deficit is small (2 per cent of GDP), this episode must reinforce concerns about the ability of the government to monitor and control its fiscal operations. Furthermore, it suggests that most of the adjustment was forced on the non-mining private sector, the very sector the medium-term measures are intended to promote. When the severity of the decline in non-mining activity became apparent, monetary policy was eased. However, outside the exempt areas, there was little growth in bank credit in 1990 (average credit was 6.1 per cent higher in 1990 than in 1989).

At this stage, the predictions for the main macroeconomic variables in 1991 are: real GDP to increase by 7.8 per cent (mainly arising from developments in the mining sector); inflation to be 7 per cent; a government deficit of K60 million (to be financed entirely from external sources, including World Bank and IMF credits); and an overall surplus on the balance of payments of K20 million. Monetary policy will be accommodating and credit to the non-mining private sector is targeted to support a nominal rate of growth of 11 to 14 per cent. Private sector employment is projected to increase by 4–5 per cent.

Medium-term economic policy is formulated in the context of an uncertain and possibly transitory minerals boom. The mining sector is essentially of the 'enclave' type, with few links to the remainder of the economy. Under present projections, its net contribution to the domestic economy is expected to peak in the mid 1990s, declining quite rapidly thereafter. However, the potential for future minerals developments means that the resources boom could extend through the 1990s. There is no doubt that revenues from the minerals sector can make an important contribution to the development of the non-mining economy. Extracting the maximum long-term benefits will require careful macroeconomic management if the competitiveness of the non-mining traded goods sectors is to be maintained. This will involve the government saving part of the financial resources flowing from the minerals sector in the interim. The use of the Mineral Reserve Stabilisation Fund to finance uncontrolled budgeted deficits should not be part of such a strategy.

Agriculture dominates the non-mining economy in terms of both output and, particularly, employment. Producer incomes have been supported by bounty payments initially from the stabilization funds, and as these funds have become exhausted, from government assistance. It is recognized that an important part of the medium-term structural adjustment process will be to raise the efficiency of the domestic agricultural sector to the point where it is competitive at world prices. Such adjustment is unlikely to occur as long as domestic producers are insulated from world prices. To this end, the support scheme established for cocoa in October 1989 involved interest bearing loans which were to be repaid when the world price exceeded the support price, and a support price declining to the world price at the end of a three year adjustment period. Proposals for similar schemes for coffee, copra and palm oil are to be submitted before the end of July 1991. Naturally there will be considerable political pressure to maintain some form of support if world prices do not rise in the near future, and the government will need to take a firm line if the adjustment program is to succeed. The first major reduction in support prices under the cocoa scheme scheduled to take place on 1 April 1991 has been deferred pending a study of the cost structure of the industry.

Agricultural research and extension are also to receive increased funding as part of the program to increase efficiency in the sector. Efforts in this area are likely to be hampered by the general shortage of skilled labour and training facilities. Overall, it appears that significant adjustment in the sector is likely to be a slow process. It has been suggested that industry organized agencies such as the Coffee Industry Board might be given more responsibility for agricultural extension, research and development, and marketing.

The remainder of the non-mining sector contributes 40 per cent of GDP, but only 6 per cent of employment. Its output is oriented towards the domestic market. Given the limitations of the domestic market and the need to obtain the economies of scale made possible by export production, meaningful growth in this area will require that the sector become, and remain, internationally competitive. The recent crises have provided an opportunity to initiate the reforms necessary for this purpose, and some action has been taken.

Labour market reform should be high on the agenda. Real labour costs in Papua New Guinea are much higher than in comparable countries.[6] The indexation system, though only partial, has allowed little flexibility in the wage structure. Real wages were projected to fall by approximately 7–8 per cent during 1989–91 as a result of an agreement between the government and the Public Employees Association, and to remain steady thereafter (at least until 1995). While this is a step in the right direction, further reductions are necessary if international competitiveness is to be achieved. The success of recent challenges to the wage agreement suggests that even these gains may not be sustained.

Until this year, the government had not used exchange rate adjustments to protect the competitiveness of the non-mining traded goods sectors. The devaluation of 1990 indicates that perhaps a more flexible approach is being adopted, but, as long as wage indexation prevails, this variable will have limited impact, at least in the non-agricultural sectors.

The 1991 Budget also began a process of trade and tax policy reform, designed to remove some of the distortions introduced since the late 1970s. These included the substitution of tariffs for quantitative restrictions over the next four years, reductions in import duties on most industrial inputs other than petroleum, a broadening of the tax base, and a reorientation of indirect taxation towards consumption.

Measures have been taken to improve public sector efficiency. These have included steps to reduce the size of the public sector, both in terms of number of employees and activities. Public sector employment is approximately 17 per cent of total formal employment. It was intended that public sector employment decline in 1990–91, before increasing again with the proposed expansions in education, health and agricultural extension and

6 F. Jarrett and K. Anderson, 'Microeconomic policy in Papua New Guinea: the factor markets', *Pacific Economic Bulletin*, June 1990:15–19.

research. However, the number of public sector employees actually increased. Local employees increased from 52,774 to 52,990 while the number of expatriates declined from 1,426 to 1,288. The reliance on voluntary retrenchments meant that positions often had to be refilled. There were also special new hirings of teachers and defence personnel, and expansion of these services, particularly the latter, is likely to continue.

The May 1990 meeting of the Consultative Group agreed on an assistance program of US$560 million for 1991–92 to support the country's adjustment program. This includes part of the US$710 million allocated for 1990. US$290 million will be grants and US$270 million will be concessional loans. The total agreed at the Singapore meeting includes US$210 million of budgetary aid from Australia, US$260 million in project-related assistance and US$90 million in quickly disbursed balance of payments support.

As a prelude to a privatization program, a comprehensive list of government investments has been prepared in order to identify those that might be privatized and those that should be liquidated. Priority in privatization will be given to local investors. However, with limited domestic savings, foreign investment will be required. It is also questionable if private savings should be used to acquire existing enterprises instead of financing new investment.

Commodity exports in 1990 reflect the disruptions in North Solomons Province and low world prices of agricultural products. The Panguna Mine was closed for all of 1990 compared with only 4.5 months of 1989, and other activities in the area came almost to a halt. North Solomons formerly produced 35–40 per cent of cocoa, 25–30 per cent of copra and 10–15 per cent of logs exported. An index of kina prices of agricultural, forestry and fisheries products declined 8.4 per cent in 1990 (on top of a 17.4 per cent decline in 1989), despite the 10 per cent devaluation. In kina terms, total exports were down 2 per cent on 1989. Mineral exports were up 10.7 per cent, reflecting increased production at Ok Tedi, full year production from Misima, and the commencement of production at Porgera in September 1990. Most of the gold produced was sold under forward contracts and therefore was not affected by the decline in spot prices in 1989 and 1990. Future sales cannot be expected to reflect a similar disparity. Agricultural, forestry and fisheries exports were down 28.4 per cent reflecting lower prices of all major exports and reduced export volumes except for palm oil.

On the brighter side, there are indications that services may begin to be restored to Bougainville in the next few months. It will be much longer before output will be forthcoming from Panguna. There has been considerable damage to infrastructure, and output is unlikely to recommence before 1994 at the earliest, if the mine is ever reopened.

Fiji

The Fijian economy is recovering from the adverse economic events following the 1987 political disturbances. The Interim Government has demonstrated sound economic management but external factors have been favourable. Current account receipts grew by 21.1 per cent in 1990, led by record tourist numbers. Imports increased by 17.5 per cent. Problems remain, however. Political uncertainty has been a contributing factor in the emigration of many skilled Indo-Fijians, and it is yet to be seen whether the new Constitution will achieve long-term political stability. Production in the forestry industry is hampered by financial problems, and production in gold mining by an industrial dispute. Unlike tourism, many of the other export industries, including the sugar, canned tuna and garment industries, rely on preferential access to importing markets. With the uncertainty over the long-term availability of such preferential access, it is important that investment be directed to activities in which Fiji can be internationally competitive.

GDP at constant prices is estimated to have risen by 5 per cent in 1990 and is expected to rise by 3–4 per cent in 1991. Inflation remains high, however, with the CPI increasing by 9.5 per cent over the year. The annual rate has fallen slightly during the early part of 1991, and current forecasts are for an annual inflation rate of 8–9 per cent. The budget deficit for 1990 was F$54.7 million, below the original budget estimate of F$74.8 million. This was mainly because of unexpectedly high revenue collections. Once debt repayments are excluded, the net deficit is F$1.3 million (0.6 per cent of GDP). The 1991 budget projects a budget deficit of F$69.8 million, and a net deficit of F$20.5 million (1 per cent of GDP).

The balance of payments is estimated to have been in surplus by F$55.5 million in 1990, contrasted with a deficit of F$17.5 million in 1989. At the end of 1990 foreign reserves were F$381 million, F$65 million (including a revaluation gain of F$9 million) higher than at the end of 1989 and equivalent to approximately 5 months imports. The trade account deficit was slightly larger than in 1989, and the current account surplus considerably smaller. While services income, particularly income from tourism, increased, the net inflow of transfers declined, mainly as a result of a large increase in emigrant transfers. The real effective exchange rate appreciated by 3.8 per cent over the year.

Visitor arrivals were almost 279,000 in 1990, an increase of 11.3 per cent on the 1989 total. Estimated earnings from tourism in 1990 were F$340 million, making it the largest foreign exchange earner. Predictions are for 290,000 visitors in 1991, and so far at least, it appears that the recessions in the major countries of origin have not had a negative impact on tourism. Arrivals for the first quarter of 1991 are the highest ever for that period of a year. Air Pacific recently announced plans for a second service to Japan.

1990 was a difficult year for the Fijian sugar industry, despite high export earnings (F$243 million compared with F$208 million in 1989 and F$198 million in 1988). Harvesting was delayed by a dispute over the price agreement, and there were technical and industrial problems at some mills (some of them associated with the emigration of skilled maintenance workers). The actual crop (4.0 million tonnes) was lower than expected (4.1 million tonnes), as was the sugar content (9.8 tonnes of cane per tonne of sugar rather than 9.4). As a result the total sugar output was 408,000 tonnes rather than the expected 435,000 tonnes. World prices also fell. A good crop is anticipated for 1991 (3.8–4.0 million tonnes of cane and 430,000–450,000 tonnes of sugar), if weather conditions are favourable. Although the world price has continued to fall, the bulk of Fiji's sugar is sold to protected markets or under long-term agreements at prices that are higher and more stable. Dissatisfied growers continue to threaten harvest delays.

The garment industry now ranks as the second largest exporter and third largest foreign exchange earner, with export earnings of F$159 million in 1990, up from F$52.1 million in 1989. These exports have a high import content, and are sensitive to economic conditions in the major markets (Australia and New Zealand). The industry's long-term prospects are placed in some doubt by planned trade liberalization moves in Australia. There may be short-run gains from the removal of quotas in 1993, but the margin of preference received by Forum island countries will be reduced in the longer term, although they will continue to receive duty free access. Efforts are under way to expand exports to the United States and the European Community.

The growth in garment exports is a major success of the Tax Free Factory Scheme introduced in December 1987. To qualify enterprises must export or re-export at least 95 per cent of their output. The total value of tax free factory exports was F$210 million in 1990. Since its inception 274 projects have been approved under the scheme, of which 113 had been implemented by the end of 1990, 74 of these in garments. It is estimated that tax free factory employment grew by 20.7 per cent and garment employment by 23.7 per cent in 1990. By the end of the year tax free factories comprised 45.5 per cent of manufacturing employment, and the garment industry 83 per cent of tax free factory employment. Of the 113 projects implemented, 55 are wholly locally owned, 35 wholly foreign owned and 23 local–foreign joint ventures. Of those with foreign participation, 26 have New Zealand participation, 18 Australian and 10 East or Southeast Asian. These figures show the importance of the Australian and New Zealand markets to the current success of the scheme, but the increasing interest from Asian investors shows a wider market potential. The absence to date of any legislation supporting the scheme must be of some concern to long-term investors, and may be inhibiting investment outside the relatively mobile garment industry. There are plans to review the concessions provided under the Tax Free Factory and Tax Free Zone schemes, and to introduce revised schemes in 1992, but the Minister for Finance and Economic Planning has assured existing investors that the commitments to them will be fully met.

The 1991 Budget emphasized the government's commitment to a process of deregulation and an outward oriented trade strategy. Features included programs of tariff reduction aimed at moving tariffs to a low uniform rate, removal of price controls, removal of import licensing requirements on many primary products, the encouragement of competition in the domestic market, reduction in the size of government and a zero net government deficit, corporatization of some public organizations and commercialization of some government departments. So far post and telecommunications and the national fishing venture (IKA corporation) have been corporatized. Tax reform concentrates on broadening the tax base to include farming income, and the income of public enterprises and statutory bodies.

The National Economic Summit in May 1991 concentrated on two main issues. The first was the value added tax (VAT) the government will introduce on 1 July 1992, largely in replacement of the existing system of indirect taxes. While the final details of the total tax package will not be revealed until the 1992 Budget, the VAT rate is expected to be 10 per cent and to yield revenue equal to approximately 6 per cent of GDP. The associated increase in the CPI will be close to 5 per cent. Domestic accommodation, bus transport and unprocessed foods will be exempt. There will be cuts in personal income tax rates to compensate for the accompanying price increases, and company tax rates will be brought into line with income tax rates. Some scepticism has been expressed as to whether the administrative capacity exists to introduce and operate such a system.

The other major issue discussed at the Economic Summit was labour market reform. The government sees this as the biggest remaining challenge to establishing an internationally competitive economy. Wage settlements are to be deregulated and wage guidelines will no longer be handed down for the economy as a whole. With wages now open to negotiation between employees or trade unions and employers, the government is concerned to limit the power of unions and proposes to amend the relevant legislation to this effect. In the current climate there is evidently concern that some union activities may be politically motivated. Three options are under consideration with respect to the role of minimum wages. The government would prefer to abolish wages councils entirely, but failing this, to have them cease issuing minimum wage orders in the manufacturing sector, including garments. Alternatively, the tax free factories and tax free zone firms could be exempt from wages council orders. These proposals have generated considerable controversy.

In complete contrast to its generally deregulatory stance, the Government of Fiji has set up a wholly government-owned company (FINAPECO), which will have the sole right to import all petroleum products into Fiji. FINAPECO has signed an agreement to purchase 10,000 barrels of crude oil per day from PETRONAS, the Malaysian crude oil company, to be processed by ESSO at its refinery in Singapore. The final products will be sold to the existing onshore companies for distribution in Fiji. The reason given for this strategy is the relocation to Fiji of 'substantial economic and financial activity' now located in Australia and New Zealand. The government accepts that this is likely to add to costs and argues that although prices to consumers will not be lower, they will be more stable. The likely success of this move must be subject to questioning, particularly the sourcing of the entire supply of petroleum products from one location. It is also to be hoped that this is an aberration rather than an indication of things to come.

Solomon Islands

Output increased by approximately 5.5 per cent in the Solomon Islands in 1991. The balance of payments continued to be the most significant symptom of the country's difficulties. While the deficit (SI$18 million) was lower in 1990 than in 1989 (SI$24 million) it drained foreign reserves so that they fell to an amount equivalent to one months imports. They have remained at this level, causing concern regarding their adequacy if output rose and imports increased.

The government deficit (SI$26 million in 1990) coupled with the government's reluctance or inability to borrow abroad was the proximate cause of the country's difficulties. With a low level of domestic saving, SI$20 million of the deficit was borrowed from the domestic banking system. In order to limit the inflationary effects of this financing, the Central Bank pursued a restrictive monetary policy, so that the prescribed maximum lending rate for commercial banks was raised to 18 per cent (approximately 8 per cent in inflation adjusted terms) and private credit was crowded out. With inflationary expectations—based on the 30 per cent increase in narrowly defined money, rather than on the decline in the average rate of price increases from 15–16 per cent to 10 per cent—the total of savings and time deposits declined slightly.

While wage increases in the private sector were in the range of 6–15 per cent in 1990, the remunerations of permanent secretaries of government departments were more than doubled, and large pay increases have been granted to other senior public servants. The rest of the government service struck for similar increases in April 1991. It will be difficult to prevent this wage explosion from spreading to the private sector in 1991–92.

The government is aware of the danger of this inflation to the competitiveness of Solomon Islands industries. The exchange rate, that is based on a trade weighted basket of currencies, was allowed to depreciate by 11 per cent during 1990. It is clear that the authorities are using the exchange rate as a policy instrument.

Although the government has continued the privatization of government entities, to reduce their drain on public finances, and broadened the indirect tax base, the fiscal outlook remains serious. The 1991 Budget anticipates a SI$51.5 million borrowing requirement. The expected limit on domestic borrowing without extreme inflationary implications is SI$34 million (a 30 per cent increase on the 1990 burden). It is hoped to draw SI$10 million from the National Provident Fund, thereby reducing the drain on the domestic banking system to only slightly more than its 1990 level. It is planned to use an outstanding STABEX (European Community Stabilization of Exports Scheme) claim of SI$10 million to meet part of the shortfall. Already the Central Bank credits to the government exceed the statutory limit of 30 per cent of the government's average ordinary revenues of the most recent three years. The commercial bank liquid assets ratio of 35 per cent is in excess of prudential requirements and cannot be legally raised above 40 per cent. It seems inevitable that private sector credit will continue to be crowded out, with consequences for the economy's flexibility.

Projections based on the experience of the first quarter of 1991 are not encouraging. Revenues from customs duties, that comprise over 50 per cent of total government revenue, are down 20–30 per cent on budget projections. This reflects the contraction in imports induced by the tight monetary policy and, possibly, a delayed reaction to the increases in tariff rates in 1990. The government has already borrowed SI$20 million from the Central Bank in 1991. The commercial banks are currently liquid and could absorb the burden again, although they would not welcome an increase in the liquid assets ratio and a repeat of last year's credit crunch. If this is to occur, they would prefer to know sooner rather than later, as otherwise the funds will be used for private sector lending. The unavailability of credit has had a noticeable impact on private investment, with prospects of an increasing number of private sector bankruptcies. Despite restrictive credit conditions several large investment projects are slated to begin in 1991. Many of these involve foreign investors with access to cheaper overseas (Australian) credit.

Total commodity exports in 1990 were 4 per cent higher in value than in 1989. Timber exports (34 per cent of the total) increased by 47 per cent. Fish exports (30 per cent of the total) fell by 19 per cent, reflecting adverse climatic conditions and problems with the government-owned National Fisheries Development Limited (NFD). NFD was sold to a Canadian company during 1990 and should be in operation for all of 1991. The new cannery at Noro was in full production for the first time during 1990, employing 450 people and producing just over 500,000 cases. The value of canned fish exports more than doubled as a consequence. The cannery is expected to get closer to its full capacity of 900,000 cases in 1991. Copra exports (6 per cent of the total) were down 48 per cent in 1990 despite an increase in smallholder output. The Commodity Export Marketing Authority supported prices to growers throughout 1990 at 50 and then 40 cents per kilo, thereby exhausting its reserves in the process. The government provided SI$2 million in financial support in 1990, and has budgeted a further SI$5 million in 1991. It seems unlikely that government support at this level can be continued, particularly with substantial increases in copra output expected in the next four years. The value of cocoa exports (6 per cent of the total) increased by 38 per cent in 1990, mainly because of slightly higher prices. Cocoa production is expected to increase by almost 30 per cent in the next few years. Palm oil production was up, but prices were so low that the value of palm oil exports (10 per cent of the total) declined by 2 per cent.

There are signs of increased activity in the minerals sector. A new Mining Act was passed by Parliament in 1990, and an application for a mining lease for the Gold Ridge deposit is awaiting government approval. The Papua New Guinea petroleum discoveries have generated cautious optimism for exploration in that sector also.

Tourist potential remains largely unexploited. Solomon Airlines is expanding its services, but is reportedly facing financial difficulties. An expansion and upgrading of hotel accommodation will also be needed. The previously government-owned Mendana Hotel was sold to the Japanese Kitano Construction Corporation in 1990 and is currently undergoing a SI$6 million renovation. The 1991 Budget provides for improvements to Henderson Airfield, an expensive and highly capital-intensive infrastructural venture.

Replacement of the Foreign Investment Act with a new Investment Act in November 1990 along with a new Income Tax Act will grant tax concessions and holidays. Although complex, the new rules may provide incentives for investment with a sacrifice of increasingly scarce government revenue.

Western Samoa

The destruction caused by Cyclone Ofa in February 1990 reduced coconut and other agricultural production in Western Samoa, and destroyed a large part of the country's infrastructure with a consequent 3 per cent decline in GDP. This infrastructure still requires considerable repair and makes a return to pre-cyclone output difficult. However, coconut production is recovering surprisingly quickly. Output is now rising slowly but is unlikely to reach its 1989 level in 1991. It seems that when production of one product, such as cocoa, expands, others such as bananas and copra decline. However, in recent years exports of tinned coconut cream and taro (largely to New Zealand) and passionfruit pulp have expanded. The recessions in New Zealand, Australia and the United States have had little effect on remittances, partly because of the perceived need to rebuild much of the country's capital stock (for example, homes of emigrants' families). Reconstruction aid has also continued to be received. As a consequence, the balance of payments position is comfortable with foreign reserves close to three-quarters of a year's foreign payments.

The first election with universal suffrage left the political system essentially unchanged. However, the extension of voting rights to the many young people who either emigrate or remain unemployed may raise serious problems for the future. The government is progressing with the reforms outlined in the 1990 Budget, particularly the reduction in import duties on imported raw materials. These liberalizations may involve budgetary difficulties, but these will be reduced, in part at least, by the growth in output that they should encourage. An incentive scheme including a 10 year exemption from duty on imported raw materials and equipment, and an income tax holiday, has been established for new foreign investment. However the obtaining of work visas by expatriates is still difficult and uncertain. Finally, the requirement that 16 overworked bureaucratic agencies must approve an application for consideration under the scheme will lead many participants to make their investment elsewhere before final approval is obtained.

The decision to terminate the Cocoa and Copra Marketing Board and return the trade in these products to private markets may be the most important decision made in recent years. Replacing the Marketing Board's pricing policy, that provided a premium for low grade copra, and permitting producers to take advantage of world prices, is likely to encourage improvement in the quality of cocoa exported and increase the incomes of producers. The end of the Board's insulation of producers from the effects of macroeconomic policies, such as changes in exchange rates, should also stimulate export and other production and accelerate the country's growth.

Vanuatu

Vanuatu's strong growth in 1989 (estimated real growth rate of 4.5 per cent) has continued in 1990 (over 5 per cent) and is expected to continue in 1991 (3.5 per cent), the cyclone season having passed without disruption. Inflation that was 8 per cent in 1989, declined to 6 per cent in 1990. In agriculture, copra production appears to have fully recovered from cyclone Uma. Output was 80 per cent above that of 1989 and of higher quality despite the ageing of the tree stock. The decline in world prices more than offset this output gain, however, and receipts from copra exports fell by 20 per cent. The Commodities Marketing Board continues to support the price to growers, and is currently subsidizing at a rate of vatu 7,000–8,000 per tonne. Increased cocoa production (40 per cent higher than in 1989) was reflected in increased export receipts (45 per cent higher). Beef exports fell slightly, but timber exports were down considerably (80 per cent on 1989), partly reflecting the prohibition on log exports and problems with the two new sawmills.

Vanuatu's tourist income reflects the sensitivity of the industry to political events, cyclones and the convenience of air connections. The number of tourists has increased steadily since 1987, reaching an estimated high of 35,000 in 1990. This reflects the expansion of services by Air Vanuatu, advertizing and public relations campaigns in the major markets (Australia and New Zealand) and major potential markets (the United States, European Community and Japan), the extension of facilities at Bauerfield International Airport, and special events such as the 10th Anniversary of Independence Celebrations and the 21st South Pacific Forum Meeting.

There are signs that this volume is close to current capacity, however. Room occupancy rates reached high levels in mid 1990. The future growth of tourism will depend on an expansion of facilities—both flights and rooms. The number of rooms has not changed markedly since 1986, and expansion is likely to be a costly and lengthy process, particularly if it is confined to existing sites because of land and ownership disputes and the government policy of containing the impact of tourism on the local culture. While tourism has good long-term potential, the prospects for the immediate future will be affected by the recession in the two largest markets, and any disruptions accompanying the election in November 1991.

The Finance Centre continues to grow and to become more broadly based. The Maritime Register established in 1981 has grown and now contains 396 ships. This is a highly competitive industry, and part of the growth reflects problems of competitors (Panama, for example). Offshore companies have been affected by legislative changes in Australia and New Zealand that have made tax havens less attractive, and this has seen a withdrawal of business. Even so, there has been a slight growth as the Centre becomes more widely known internationally. The offshore banking and insurance business has been steady. Legislation relating to financial fraud and money laundering became effective in 1990.

The existence of the Financial Centre gives Vanuatu potential access to expertise that is scarce in all Pacific island economies. However, with present basic policies, the government faces severe constraints. It is reluctant to finance development by loans, even concessional ones. Therefore, unless other policies are changed, it will have to rely on increases in aid that are unlikely to be forthcoming (it already receives the equivalent of US$200 per capita per year). A broadening of its tax base is one possibility. Currently, import duties account for 70 per cent of government revenue. Yet company or income taxes could have negative implications for the competitiveness of the Finance Centre. There is no suggestion for such a change being currently entertained. There was a surplus on the recurrent account of vatu 26 million in 1990, but this was not enough to cover budgeted development expenditures of vatu 221 million. Hence, despite its policy stance, the government borrowed the equivalent of vatu 150 million (that is, 3 per cent of its total budget).

Clear signals of government intentions are awaited if developments are to proceed in several areas. New updated legislation providing a firm legal basis for the Finance Centre is in prospect, but may not emerge before the forthcoming election. The uncertainty facing potential foreign investors should also be resolved. A committee has been set up to draft a foreign investment code, including 'one-stop-shop' provisions, but the conditions relating to the employment of essential expatriates are in need of simplification and clarification.

Tonga

Inflation continues to be an important economic issue in Tonga. The consumer price index increased by 15.3 per cent from December 1989 to December 1990. Price increases continued into 1991, partly reflecting higher world oil prices and the implementation of increased port and service charges in January. To the extent that non-recurring increases in taxes and duties are responsible for these unusually high rates of price increase, inflation should moderate in the future. The government's recurrent deficit is now predicted to be approximately pa'anga 3.0 million in 1990/91, rather than the originally balanced budget.

Real GDP growth is forecast to be 3 per cent in 1990/91, down from 3.5 per cent in 1989/90. This figure may be revised upward in light of the record output and exports of squash (16 per cent of exports) and vanilla (18 per cent of exports) in 1990/91, although current indicators of real demand show it to be static or declining.

The record export receipts from squash and vanilla helped gross foreign reserves to reach pa'anga 40.6 million, or 6 months of imports. It is expected that reserves will decline over the next few months, however. From the end of February 1990 to the end of February 1991, total overseas exchange receipts (apart from passport sales) increased 18 per cent (merchandise exports increased 33 per cent). During this period total overseas payments increased only 3 per cent. The result is a fall in the overall overseas transactions deficit from pa'anga 14.9 million to 2.5 million. Receipts from private remittances continued to increase, but may now be beginning to show the effects of the slow-down in economic activity in Australia and New Zealand.

The sale of 'Tongan Protected Persons' passports were valued at pa'anga 7.2 million over the period February 1990 to February

1991, down from pa'anga 11.6 million in the year to February 1990. Receipts from passport sales are invested abroad and since their inception in 1983 sales have totalled US$16.7 million. There have been problems with the 'legality' of the early sales, and some opposition to their continued sale has emerged in Tonga. At this point plans are for sales to continue. Most foreign passport holders have no plans to live in Tonga, but should they decide to do so, the King has stated that they would be accommodated by the government.

The government has become increasingly concerned regarding the operations of the Commodities Board, which engages in over twenty activities (including the operation of a shopping arcade and the sale of building materials). Between November 1990 and January 1991, the government was required to grant, lend or guarantee the Board's loans, for a total of pa'anga 3.5 million. Consequently, it has reorganized the Board and appointed a new managing director, and is looking to the divestment of many of its activities.

The National Reserve Bank of Tonga has changed the system of exchange rate determination. From 11 February the value of the pa'anga has been set by reference to a weighted basket of currencies, reflecting the composition of Tonga's external transactions. Previously, it had been at par with the Australian dollar.