FOR AGENDA

SM/84/273

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December 18, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Fiji - Staff Report for the 1984 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1984 Article IV consultation with Fiji.

This subject will be brought to the agenda for discussion on a date to be announced.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Browne (ext. 7329).

Att: (1)

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FIJI

Staff Report for the 1984 Article IV Consultation

Prepared by the Staff Representatives for the
1984 Consultation with Fiji

(In consultation with the Exchange and Trade Relations,
Fiscal Affairs, Legal, Research and Treasurer's Departments)

Approved by Douglas A. Scott and Eduard Brau

December 17, 1984

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I. Introduction

The 1984 Article IV consultation discussions with Fiji were held in Suva during October 8-19. The Fiji representatives included officials of the Ministry of Finance, the Reserve Bank, the Central Planning Office, and other government departments and public enterprises. The staff team also met with the Minister of Finance, Mr. Mosese Qionibaravi. The staff team comprised Messrs. Browne (head), Shah, Kohsaka, and Lim and Miss Pugh as secretary (all ASD). Mr. Ismael, Executive Director for Fiji, attended some of the discussions.

Fiji has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange and trade system free of restrictions on payments and transfers for current international transactions.

II. Economic Background

1. Economic trends since 1980

Following a decade of satisfactory growth combined with the avoidance of overall balance of payments deficits, disquieting trends emerged from 1980 in output, wages, the budget, and the external accounts. With little expansion in the production of sugar, the main export, the average annual growth of real GDP slowed to less than 1.5 percent in 1980-84, compared with 4 percent in the preceding five-year period (Chart 1). Taking into account a decline in the terms of trade of about 25 percent, real national income per capita fell by about 13 percent (Chart 2). Wage earners were protected through indexation from the impact of inflation (Chart 3). Additional wage increases were also granted, while the incomes of sugar growers declined sharply because of lower export prices (Chart 4). 1/

The Central Government budget deficit widened to an average of 5 percent of GDP in 1982-84, mainly because of the growth in total outlays. The rapid growth in wage and salary payments was the major factor accounting for the increase in current expenditure from 19 percent of GDP in 1980 to 25 percent in 1984 (Chart 5). Capital expenditure declined in 1983-84, as a result of the completion of major hydroelectric and water supply projects and measures to curb the deficit, contributing to a closer balance between investment and domestic savings. External concessionary financing of the budget was reduced. Domestic financing from the National Provident Fund and the banking system increased from 1 percent of GDP in 1980 to more than 4 percent in 1984.

1/ Wage developments in 1970-84 are considered in more detail in an Annex to the forthcoming report, Fiji: Recent Economic Developments.

Internal cash generation of the public enterprises declined, with operating losses incurred by the national airline and the sugar and fishing corporations. Heavily influenced by public sector demand, the growth in domestic credit was pronounced (Chart 6). In view of the openness of the economy, expansionary financial policies stimulated imports rather than domestic price pressures. The rate of inflation abated from 14 percent in 1980 to 6 percent in 1984, primarily because of lower rates of increase in import prices.

The external current account deficit averaged 6 percent of GDP in 1981-84, compared with 3 percent in the preceding five-year period when the growth in export earnings had been strong (Chart 7). The decline in export receipts as world sugar prices collapsed was only partially offset by lower petroleum imports and higher receipts from tourism. External commercial borrowing was undertaken in 1980-82 to support a high level of investment and, in 1983-84, to compensate for lower external concessional assistance. External debt, including a small amount of short-term debt related to oil and other trade financing, increased to 36 percent of GDP. While the present debt service burden of 14 percent of exports of goods and services is manageable, it has risen from 8 percent in 1980. Gross official reserves, equivalent to more than three months of imports, are adequate.

The real effective exchange rate of the Fiji dollar, measured in terms of relative consumer price movements in Fiji and its five main trading partners, has been stable in recent years (Chart 8).

2. The economy in 1984

Real GDP increased by 8 percent, representing a remarkably swift recovery from the effects of severe cyclones and drought which had reduced output in 1983. Production of sugar increased by 70 percent; the normal size cane harvest reflected favorable weather and the effectiveness of special Government measures instituted during the planting season. Tourist arrivals increased by 20 percent, well above the trend rate of growth, after allowance is made for the smaller number of visitors because of the cyclones in 1983.

Despite the large gains in output, real national income per capita was little changed because of the deterioration in the terms of trade. However, the growth in nominal wages and salaries accelerated. In addition to the national wage adjustment of 6 percent, closely in line with the increase in consumer prices, a new wage and salary structure was introduced for Central Government workers. Executive Directors observed, at the time of the last consultation discussions, that wage increases in prospect for 1984 were excessive in view of the movements in the terms of trade and that they would weaken the competitiveness of Fiji's exports and intensify demand pressures.

The external current account deficit was reduced to 3 percent of GDP, compared with a forecast deficit of 5.5 percent of GDP at the time of the Executive Board discussion of the 1983 consultation papers. Exports increased by 15 percent in SDR terms. Notable gains were made in exports of coconut oil, gold, forestry products, and nontraditional goods. Although a substantially higher volume of sugar was exported, the increase in receipts was modest because of very depressed prices on the free market. Imports were unchanged in SDR terms. A rise in consumer goods imports was offset by declines in petroleum imports, due to the introduction of hydro-generated electricity, and in machinery imports, due to the lower level of investment. The net surplus on services remained high, mainly because of the growth in tourist receipts.

Capital account developments were less favorable than in earlier years. Gross official concessionary inflows declined following the lack of new commitments in recent years. External commercial borrowing was undertaken in order to prevent a decline in gross official reserves but on a smaller scale than originally envisaged.

The stance of financial policies was expansionary. The Central Government budget deficit widened to more than 5 percent of GDP. Tax revenue was well in excess of the budget estimate, mainly as a result of higher income tax receipts associated with the growth in wage incomes. Although the tax ratio in terms of GDP did not rise compared with 1983, when receipts were unusually high, it was 2 percentage points higher than in 1982.

The growth in current expenditure was also substantially in excess of the budget estimate. The wage and salary bill rose by 16 percent, even though the number of employees stabilized because of a hiring freeze. The budget had assumed unchanged wage and salary rates, since at the time of its preparation the arbitration decision with respect to the implementation of a new wage and salary structure was not known. Subsidies and transfers increased by 47 percent. A major factor was the large pension payments to the National Provident Fund, the result of legislation enabling Central Government employees to transfer voluntarily from the government pension scheme; the response to this measure greatly exceeded expectations. Interest payments rose by 25 percent, reflecting the growth in outstanding debt.

In order to accommodate the increase in current expenditure, capital expenditure was curtailed, mainly by eliminating temporary projects that had been planned to create employment in rural areas. However, the overall deficit exceeded the budget forecast and domestic bank financing was much larger than in most past years.

The finances of the public enterprises remained weak. The eight major enterprises recorded a combined operating loss of 0.5 percent of GDP and received budgetary appropriations, mainly to finance investment expenditure, of 1.6 percent of GDP. The Fiji Sugar Corporation, after a decade of profitable operations, recorded a sizable loss in the year ended March 1984, and a further loss is expected in the current year. In addition to the effects of a poor 1983 sugar crop, substantial wage increases were granted to mill workers, whose pay rates are influenced more by wage developments in the government sector than the profitability of the sugar sector. Air Pacific, whose finances had weakened considerably after the oil price rises of 1979-80, incurred larger losses following the introduction of service to Hawaii in 1983.

Monetary policy remained expansionary in the first three quarters of 1984, despite increases in the Reserve Bank's lending rate to commercial banks and in the liquidity ratio, which specifies minimum commercial bank holdings of approved public sector securities. Growth in credit to the public sector was modest, because part of the credit needs of the public enterprises were met by borrowing from the National Provident Fund and the Central Government's recourse to bank credit was concentrated in the fourth quarter. However, large borrowing was undertaken by the private wholesale and retail trade. The Executive Board had concluded during the 1983 consultation discussions that monetary policy should be tightened in order to restrain imports and promote external adjustment. The liquidity ratio was raised from 15 percent to 18 percent in September in order to limit the banks' ability to extend further credit to traders. Rates for commercial bank advances from the Reserve Bank were raised to ensure compliance with the ratio. The average bank lending rate moved up to 13 percent; bank deposit rates were positive in real terms throughout the year. The structure of interest rates was sufficiently high to discourage capital outflow.

III. Report on the Discussions

The discussions focussed on the need for adjustment in recent wage and financial policies in view of the medium-term balance of payments outlook. At the time of the consultation discussions, the stance of policies for 1985 had not been finally settled. The authorities initially favored a gradual approach to adjustment, tolerating temporarily higher budget and external current deficits in order to meet wage commitments. On reflection, while recognizing that Fiji could probably borrow abroad without difficulty for a limited period, the authorities felt that undue delay in adjustment could lead to a further weakening of external competitiveness and to the emergence of external debt servicing difficulties toward the end of the decade. Consequently, it was decided to implement a comprehensive wage freeze until the end of 1985, supported by tax measures to reduce the budget deficit and tighter monetary policy.

1. Economic prospects for 1985

Real GDP is projected to increase by only 1 percent. Little growth in sugar production is expected in the absence of major new investment to expand the area under cultivation; such investment is not economic at present. The number of tourist arrivals is forecast to rise by about 5 percent. Public investment is expected to decline in relation to GDP, mainly because the large public enterprise capital program of recent years has been completed. To compensate for this, the Fiji Development Bank is increasing lending to the private sector.

The external outlook is not promising. Export receipts are not projected to increase in SDR terms despite a higher volume of sugar exports. Export unit values are forecast to decline by 10 percent, in part because a larger proportion of sugar output will have to be sold on the weak free world market. The increase in net receipts from services and transfers will be modest because of limited growth in tourist arrivals and external grant assistance. Without measures, imports would increase strongly and the external current account deficit would widen markedly.

No recovery in official capital inflow is foreseen. Satisfactory programs have been agreed for the provision of external grant assistance from the main donors, including Australia, New Zealand, Japan, and the European Community. However, delays have been experienced in the finalization of new projects that might attract external loans, particularly from the multilateral donors. Taking into account repayments on existing loans, the net inflow of concessional loan assistance is forecast to fall below the equivalent of 1 percent of GDP.

In these circumstances, the authorities considered that an appropriate external current account target would be a deficit no higher than 4 percent of GDP (Table 1). In order to secure this outcome, adjustment measures were designed to limit the growth in imports to 6.5 percent in SDR terms. It was expected that gross commercial external borrowing could be held to less than 1 percent of GDP. The overall balance of payments deficit could be financed by a decline in gross reserves. The authorities had no firm reserve target but would continue to hold foreign assets in excess of minimum needs in order to ensure that financial market perceptions about Fiji remained favorable.

2. Wage policy

The Tripartite Forum, comprising representatives of the trade unions, employers, and the Government, establishes annual wage guidelines after conducting a full-scale review of economic prospects and hearing detailed presentations of proposed wage adjustments from the concerned parties. The guidelines influence wage levels in most sectors of paid employment, although with the weaker demand for labor in recent years, the gap between union and non-union rates has widened. The guidelines have virtually no direct impact on the incomes of sugar growers and sugarcane cutters, whose earnings depend primarily on export earnings, and on the subsistence agricultural sector.

The main determinant of the annual wage guideline was always the rate of price increase, and consumer prices are influenced strongly by import prices, since imports of goods are equivalent to more than 40 percent of GDP. Consumer prices are little influenced by export

Table 1. Fiji: Balance of Payments, 1982-85

(In millions of SDRs)

	1982	1983	1984 Estimate	1985 Projection
Exports (domestic)	176	164	188	189
Sugar	(122)	(103)	(107)	(107)
Other	(54)	(61)	(81)	(82)
Imports (retained)	346	355	355	378
Petroleum products	(70)	(55)	(47)	(45)
Machinery	(62)	(78)	(72)	(82)
Other	(214)	(222)	(236)	(248)
Trade balance	-170	-191	-166	-189
Services (net)	71	109	110	118
Private transfers	-3	-2	-2	-2
Official transfers	19	25	22	23
Current balance	-83	-59	-36	-50
Official capital inflow	51	51	46	38
Concessional (gross)	(44)	(38)	(26)	(26)
Commercial (gross)	(7)	(13)	(20)	(12)
Official repayments	-13	-19	-27	-24
Concessional	(-10)	(-13)	(-14)	(-16)
Commercial	(-3)	(-6)	(-13)	(-8)
Private capital, net	32	36	17	24
Errors and omissions	-12	-11	--	--
Overall balance	-26	-2	--	-12
Memorandum item:		(In percent of GDP)		
Current deficit	7.6	5.6	3.0	4.0

Sources: Data provided by the Fiji authorities; and staff estimates.

prices; exportable goods have a weight of less than 10 percent in the consumer price index. No provision existed to moderate the wage increases to reflect the loss of national income from lower export prices. During a period of deterioration in the terms of trade, these procedures resulted in a shift of income from the export sector to wage earners.

In recent years, Central Government employees were granted wage increases in addition to the guideline. Merit and seniority raises averaged 4 percent of the wage and salary bill, which was in excess of the growth of productivity. In December 1983, an arbitration decision on the implementation of a new wage and salary structure raised rates by an average of 8 percent backdated to January 1982. After negotiation with the trade unions, it was agreed to make a substantial backpayment in November 1984, with the remainder to be paid with interest in 1986. In September 1984, the Ability to Pay Committee of the Forum rejected the Government's argument that resources were lacking to pay the recommended 1983 national wage increase of 6 percent. Most of this is to be paid in December 1984, with the rest deferred until 1986. Further, the Forum recommended a 6 percent increase as the 1984 wage guideline; if past practice had been followed, government workers would have been granted this increase.

The authorities shared the view of the staff team that the growth in wages had been excessive in 1981-84. If wages had moved in line with real national income adjusted for the terms of trade during this period, the wage level would have been lower by 15 percent at the end of 1984. Continuation of past procedures for wage determination would have assured further rises in real wages in 1985. With the limited growth of output and the deterioration in the terms of trade that were in prospect, real national income would fall and pressure on the balance of payments would intensify. The additional pressure on sugar growers' incomes and profit margins could induce cost saving in the form of reduced use of fertilizer and other inputs, with detrimental effects on output. Moreover, further wage gains would impede efforts to reduce the budget deficit and the demand for imports.

The authorities believed that wage restraint was essential for fiscal and competitive reasons. Accordingly, all remunerations of the public and private sectors were frozen at November 1984 levels until the end of 1985. However, the freeze will permit payments to government employees that had already been agreed for December 1984. The freeze would prevent the payment of the 1984 national wage guideline and 1985 merit increases to government workers which, under the previous policy, would have resulted in further growth in wages. Additional items will be brought under price control for the period of the freeze, although the Government intended to continue limiting controls to a relatively small range of basic commodities. It was envisaged that consumer prices would rise by 5-6 percent in 1985, reflecting the effects of indirect tax rises contained in the budget and import price increases.

The Government also instituted a review of the formula for setting national wage guidelines to take account of movements in national income and the terms of trade. On this question, consultations would be held with employers and trade unions. The staff team stressed the need for external factors to be given weight in the process of wage determination. In particular, it was suggested that wage earners should no longer be compensated for increases in import prices that are associated with a deterioration in the terms of trade.

3. Fiscal policy

a. The Central Government budget

The 1985 Central Government budget contains adjustment measures that will reduce the overall deficit to less than 4 percent of GDP, 1.5 percentage points lower than in 1983 (Table 2). The freeze will reduce the wage and salary bill by 1.4 percent of GDP, although the effect will be mitigated by the termination of the temporary 5 percent income tax surcharge and the rise in the threshold for the payment of income tax. Revenue measures equivalent to about 1.4 percent of GDP, mainly in the form of higher customs and excise duties, also were introduced although these will only maintain the existing revenue ratio. The Government did not consider fundamental changes in revenue at this time because of the recent establishment of the Financial Review Committee, composed of representatives of a wide cross section of the community, which is to complete a comprehensive review of the tax system by May 1985. The Committee is examining the incidence and projected yield of direct and indirect taxes as well as charges for services, taking into account the cost of Government and its revenue requirements.

Revenue is budgeted at 24 percent of GDP. Income tax collections will decline by 3 percent. Customs and excise duty collections will increase by 18 percent, mainly because of higher duty rates. A large part of the higher duties will be collected on items that are not produced domestically, including motor vehicles, liquor, and petroleum products. The growth in nontax revenue will be small, mainly because of low profit transfers from public enterprises and little increase in receipts for the United Nations peacekeeping forces in the Middle East. External grants, which have increased in recent years, are expected to remain at about 1 percent of GDP.

Total expenditure is budgeted at 28.5 percent of GDP, 1.5 percentage points lower than in 1984. Current expenditure will fall in relation to GDP for the first time since 1980. The wage and salary bill will decline by 2 percent because of the income and hiring freezes; no redundancies are planned. The cost of subsidies and transfers will also decline in the absence of the special pension transfers. Expenditure on goods and services will not be permitted to rise. Interest payments will increase substantially in view of the growth in outstanding debt, but will not reach the budgeted amount which, following the practice of recent years, contains a reserve provision that will not be required.

Table 2. Fiji: Central Government Budget, 1982-85

(In millions of Fiji dollars)

	1982	1983	1984 Budget	1984 Revised	1985 Budget
Revenue and grants	265	293	309	328	348
Tax revenue	211	238	249	269	286
Income tax	(120)	(130)	(132)	(149)	(146)
Customs and excise	(86)	(103)	(112)	(114)	(135)
Other taxes	(5)	(5)	(5)	(6)	(5)
Nontax revenue	44	45	46	44	46
External grants	10	10	14	15	16
Expenditure	338	337	370	396	400
Current	247	280	290	329	324
Wages and salaries	(134)	(150)	(151)	(174)	(170)
Provident Fund	(7)	(7)	(7)	(8)	(8)
Goods and services	(39)	(44)	(36)	(38)	(35)
Interest	(26)	(32)	(46)	(40)	(53)
Subsidies and transfers	(42)	(47)	(50)	(69)	(58)
Capital	91	57	80	67	76
Fixed assets	(57)	(30)	(48)	(37)	(43)
Grants and net lending	(34)	(27)	(32)	(30)	(33)
Overall deficit	-73	-44	-61	-68	-52
Externally financed	18	5	6	10	15
Domestically financed	55	39	55	58	37
Provident Fund	(29)	(28)	(45)	(30)	(30)
Other nonbank	(7)	(4)	(5)	(6)	(4)
Banking system	(19)	(7)	(5)	(22)	(3)
Memorandum items:			(In percent of GDP)		
Revenue and grants	23.6	25.1	24.4	24.8	24.9
Tax revenue	18.8	20.4	19.7	20.4	20.4
Nontax revenue	3.9	3.9	3.6	3.3	3.3
Expenditure	30.1	28.9	29.2	30.0	28.6
Current	22.0	24.0	22.9	24.9	23.1
Capital	8.1	4.9	6.3	5.1	5.5
Deficit	6.5	3.8	4.8	5.2	3.7

Source: Data provided by the Fiji authorities.

Capital expenditure is budgeted to increase by 13 percent. Capital works programs are being expanded, particularly on rural roads for which external assistance is expected. Transfers to public enterprises are not projected to rise, mainly because of lower investment in the electricity sector, although increased allocations are made for a timber and woodchip project and the Fiji Development Bank. In recent years, implementation difficulties and other factors limited investment spending to about one quarter below the budgetary allocation. The 1985 estimates again contain a number of projects that are not finalized and for which the expected external financing may not materialize.

b. The public enterprise finances

The main immediate policy objective with respect to the public enterprises is to reduce considerably the operating deficits that have been incurred in recent years. A substantial improvement in the finances of this sector is in prospect for 1985, although this will not result in an overall surplus (Table 3). The income freeze will help to reduce operating losses. Another major contributing factor is the changed condition of Air Pacific, which is to be managed by a foreign airline under an arrangement negotiated in October 1984; losses should be reduced greatly by cancellation of service to Hawaii and other cutbacks. The deficit of the Fiji Sugar Corporation will decline because of higher receipts, but the absence of profitability with a normal size sugar crop remains a matter of concern. The fishing corporation has cut the size of its fleet in order to reduce the operating deficit, but its future success remains in doubt despite the apparent potential of Fiji waters. Civil aviation charges will be adjusted if necessary to avoid losses on the operation of the international airport. A public enterprise unit is to be established in the Ministry of Finance with Fund technical assistance during 1985 to monitor developments in this sector more closely.

4. Monetary and credit policy

At the time of the discussions, it was expected that the growth of domestic credit would be about 16 percent in the year to December 1984 (Table 4). Credit to the Government would expand strongly in the final part of the year, particularly because of the large wage, salary, and pension payments. The authorities felt that, in order to restrain imports, private sector credit should not increase further in this period. Although commercial bank advances had risen to an unusually high 75 percent of deposits in September 1984, scope for additional lending still appeared to exist. Therefore, the Reserve Bank raised the cash ratio in early December from 5 percent of deposits to 6 percent, bringing the cash and liquidity ratios together to 24 percent of deposits.

The authorities had not drawn up a firm monetary program for 1985 at the time of the discussions. The main objective of monetary policy

Table 3. Fiji: Major Public Enterprise Finances, 1982-85

(In millions of Fiji dollars)

	1982	1983	1984 Estimate	1985 Projection
Operating profit and loss				
Air Pacific 1/	-5.4	-6.5	-9.0	-1.5
Civil Aviation Authority	-0.4	0.3	-0.1	-0.5
Fiji Electricity Authority	1.1	1.0	5.3	2.8
Fiji Pine Commission	-0.1	-1.4	0.1	0.1
Fiji Sugar Corporation 1/	2.4	-5.0	-2.0	-1.1
Housing Authority	-0.9	-0.6	-1.3	-1.2
Ika Corporation 2/	-0.6	-1.1	-0.3	-0.1
Ports Authority of Fiji	1.2	1.4	0.6	0.5
Total	-2.7	-11.9	-6.7	-1.0
Budgetary appropriations 3/				
Air Pacific	0.5	1.6	2.0	--
Civil Aviation Authority	1.8	2.1	2.7	2.0
Fiji Electricity Authority	10.7	6.4	7.7	--
Fiji Pine Commission	4.2	5.6	5.5	9.2
Fiji Sugar Corporation	--	--	--	1.0
Housing Authority	1.5	1.5	0.9	2.9
Ika Corporation	0.8	0.8	2.0	1.6
Ports Authority of Fiji	--	--	--	--
Total	19.5	18.0	20.8	16.7

Sources: Data provided by the Fiji authorities; and staff estimates.

1/ Financial years ended March of the subsequent calendar year.

2/ Financial years ended June; Ika Corporation is engaged in fishing.

3/ Operating grants and other subsidies, capital grants, loans and equity from the Central Government.

Table 4. Fiji: Monetary Survey, 1981-84

(In millions of Fiji dollars; end of period)

	1981	1982	1983	1984 Estimate
Net foreign assets	120	106	108	108
Reserve Bank	117	109	108	106
Assets	(117)	(123)	(123)	(121)
Liabilities	(--)	(-14)	(-15)	(-15)
Commercial banks	3	-3	--	2
Assets	(9)	(5)	(8)	(6)
Liabilities	(-6)	(-8)	(-8)	(-4)
Domestic credit	279	334	381	443
Government	20	39	33	55
Public enterprises	26	49	73	67
Private sector	233	246	275	321
Other items, net	-35	-45	-45	-45
Total liquidity (M3)	364	395	444	506
Memorandum items:	(Annual percentage change)			
Domestic credit	20.7	19.4	14.3	16.3
Public sector	7.7	91.3	20.5	5.7
Private sector	23.6	5.6	11.8	16.7
Total liquidity (M3)	6.3	8.5	12.2	14.0
Velocity of broad money 1/	2.90	2.85	2.63	2.61

Sources: Data provided by the Fiji authorities; and staff estimates.

1/ Nominal GDP in relation to total liquidity at the end of the period.

would be to provide appropriate support for the implementation of tighter wage and fiscal policies. While monetary policy could not carry the main burden of adjustment, it was important to avoid credit expansion, which would stimulate imports. With that end in view, banks had been requested to curb lending to the private sector, particularly credit to the wholesale and retail trade. The proposed reduction in the 1985 government budget deficit, which would virtually eliminate the need for bank borrowing, and the improved public enterprise finances would help to achieve a markedly slower rate of growth of domestic credit. Maintenance of the present structure of interest rates was expected to preserve positive real rates for most bank deposits and all bank lending and an appropriate differential with foreign markets.

5. Exchange rate policy

The exchange rate of the Fiji dollar is determined daily against a basket of the currencies of five major trading partners (Australia, New Zealand, Japan, the United States, and the United Kingdom). The weights in the basket are based on the value of merchandise trade, tourist receipts and external debt payments. For several years, the real effective exchange rate index has been maintained broadly unchanged by making occasional small discrete changes against the basket. In this period, the Fiji dollar depreciated against the U.S. dollar, appreciated against the New Zealand dollar, and remained relatively stable against the Australian dollar.

While the exchange rate is kept under close review, the authorities have doubted the efficacy of a more flexible policy because of the relative inelasticity of export production and the institutional arrangements for incomes policy, through which wage earners were compensated for higher import prices. In view of the growth in real wages and the deterioration in the terms of trade associated with falling export prices, the staff team argued that the maintenance of a stable real exchange rate as conventionally measured masked the underlying loss of competitiveness of the economy. Recent wage increases stimulated import demand and the fall in sugar prices reduced the purchasing power of exports, but neither of these developments had a significant impact on domestic and foreign consumer prices.

The staff team suggested that exchange rate flexibility would reinforce wage restraint and thereby help to achieve the desired degree of adjustment in costs and relative prices of tradable and nontradable goods that would contribute to the strengthening of the balance of payments. The wage freeze provides an opportunity for the introduction of a flexible exchange rate policy without adverse consequences in terms of compensatory wage and salary increases. Implementation of the change in income policy arrangements, which is under review, would permit the benefits of a flexible exchange rate policy to accrue to the export sector after the period of the freeze.

6. Medium-term perspective

The medium-term balance of payments outlook is less favorable than during the 1970s. The world market for sugar is expected to remain depressed for some time because of high world stocks and the expectation of continued excessive production. Achievement of a sustainable external current account position requires adjustment to the reduced opportunities for sugar. This, in turn, will require a lower elasticity of imports to overall growth than prevailed in 1970-84 and the promotion of non-sugar exports. Without adjustment measures, the staff team considered that the external current account deficit could reach 5-6 percent of GDP during the second half of the decade, which would not be sustainable. The scenario presented in this section, with which the authorities broadly concur, provides for a medium-term current account deficit of 2.5 percent of GDP (Table 5). The smaller deficit would be associated with lower import growth and, to a lesser extent, with higher export growth. This would require adjustment measures additional to the wage freeze and other policies already announced for 1985, particularly since large wage payments for government employees are scheduled for 1986. Moreover, pressures for further wage rises that might emerge when the freeze is lifted would have to be resisted.

The authorities stated that opportunities would be exploited for export diversification and import substitution in order to help minimize the impact of the balance of payments constraint on growth and development objectives. Prospects for additional import substitution were limited by the small domestic market, but progress was expected in the production of rice, maize, and some manufactured goods. On the export side, greater output was expected of forestry products, following the construction of the sawmill and woodchip complex, and of tropical fruits and manufactured goods for which improved access has been accorded by Australia and New Zealand under the SPARTECA agreement.

Although concessionary assistance was expected to remain below the amounts received in recent years, some increase in private capital inflow was expected for hotel and forestry projects. Modest commercial borrowing to secure equilibrium in the overall balance of payments would be consistent with a stable external debt service ratio of 14 percent. Outstanding external debt would decline to 32 percent of GDP in 1989. The staff team considered that this outcome would permit the financing of sufficient imports to achieve an overall growth of real GDP of about 3 percent annually in the second half of the decade.

IV. Staff Appraisal

Economic growth slowed after 1980 because of the stagnation in sugar production and the modest increase in tourism. The external current account position deteriorated because of the collapse of world sugar prices, higher import prices, and sustained growth in imports. In addition, the overall balance of payments weakened because of the decline in official concessionary capital inflow associated with the

Table 5. Fiji: Medium-Term External Debt Profile, 1984-89

(In millions of SDRs)

	1984	1985	1986	1987	1988	1989
Exports (domestic)	188	189	209	225	223	247
Imports (retained)	355	378	387	415	437	467
Trade balance	-166	-189	-178	-190	-204	-220
Services (net)	110	118	122	130	140	152
Transfers (net)	20	21	22	23	24	25
Current account	-36	-50	-34	-37	-40	-43
Gross capital receipts	68	70	72	73	79	89
Public	46	56	40	43	49	59
Project finance	26	26	28	25	25	25
Commercial loans	20	12	12	18	24	34
Private	22	32	32	30	30	30
Direct investment	7	17	17	15	15	15
Loans	15	15	15	15	15	15
Debt service	69	71	80	80	78	90
Principal	37	32	31	34	34	39
IMF repurchases	--	5	7	2	--	--
Interest	32	34	42	44	44	51
Memorandum items:						
Export prices (1977=100)	135.6	122.0	130.5	139.6	139.6	148.0
Free market sugar prices (US cents per pound)	6	6	9	10	11	12
Import prices (1977=100)	179.2	186.4	193.9	201.7	209.7	218.1
Terms of trade (1977=100)	75.7	65.5	67.3	69.2	66.6	67.9
Exports of goods and services (in mns. of SDRs)	476	492	530	567	596	634
Interest rate on commercial borrowing	12.0	12.0	10.5	10.5	9.5	9.5
Debt service ratio (in percent of current receipts)	14.5	14.4	15.1	14.1	13.1	14.2
Current account deficit (in percent of GDP)	3.0	4.0	2.5	2.5	2.5	2.5
Outstanding external debt (in millions of SDRs)	432	448	466	488	519	561
Public	300	315	326	338	357	386
Private	99	106	118	130	142	155
Use of Fund credit	13	8	2	--	--	--
Short-term	20	20	20	20	20	20
(In percent of GDP)	36.4	34.0	32.6	31.6	31.2	32.3

Sources: Data provided by the Fiji authorities; and staff estimates.

reduced availability of projects suitable for external financing. This contributed to a deterioration in the external debt profile and a rising debt service burden. In 1984, despite the impressive recovery in sugar and tourism from the effects of unfavorable weather, and the accompanying reduction in the external current account deficit, the underlying weaknesses were not reversed.

The lack of adaptation of wage policies to the less favorable external economic environment contributed importantly to the imbalances. From 1980, with the low growth of output and the loss in the terms of trade, real national income per capita declined. During this period, the indexation of wages to consumer price increases and the additional payments to government employees resulted in continued growth in real wages. The counterpart of the larger share of wages in national income was the sharply reduced share of income of the export sector. Maintenance of past procedures for wage determination and implementation of deferred wage settlements for government employees would have accelerated these trends in 1985-86, while the income of the export sector would remain depressed by low world sugar prices. Without adjustment measures, the external current account deficit would rise to an unsustainable level.

Action to bring wages into line with the economy's capacity to pay is fundamental to strengthening the balance of payments. Wage rates that are unduly high create excessive demand for imports in an open economy such as Fiji's. They also impose cost pressures and inhibit the movement of resources to the traded goods sector. The staff welcomes the decision to impose a wage freeze as an important initial step to arrest the further rise in wages and shift of income from the export sector. Nevertheless, by the end of 1985, only part of the needed correction will have been accomplished.

The 1985 budget contains measures of fiscal restraint that will contribute to external adjustment. Higher indirect taxes, mainly in the form of increased duty rates on goods for which domestically produced substitutes are not available, will help to reduce import demand. Wage restraint will permit a reduction of current expenditure in relation to GDP. On the other hand, the decision to remove the temporary income tax surcharge and raise the income tax threshold will partly offset the effects of the freeze. Moreover, wage costs continue to account for an unduly large share of total expenditure and limit the opportunity for improving the structure of expenditure to accord more closely with development objectives.

The measures of wage and fiscal restraint are supported by tighter monetary policy. The recent strengthening of reserve requirements through higher cash and liquidity ratios and the maintenance of positive real interest rates are welcome. The prospective improvement in the public enterprise finances will also help to curb a major source of recent credit expansion. These factors, and the sharply reduced needs of the Government, will permit an appropriately moderate growth in the monetary aggregates in 1985.

The present external debt service burden is manageable and Fiji enjoys a satisfactory credit rating. The adjustment action that is underway will help to preserve market access. However, additional measures are needed to secure a shift in resources toward the traded goods sector. Medium-term balance of payments sustainability presupposes further adjustment action toward this end.

The freeze provides an opportunity to introduce the needed exchange rate flexibility without compensatory adjustments in wages and salaries. A change in wage fixation methods to sever the virtually automatic link that has existed between increases in import prices and corresponding adjustments in wages would permit the benefits from a more flexible exchange rate policy after the period of the freeze to accrue to the export sector and contribute to strengthening the balance of payments.

It is proposed that the Article IV consultation with Fiji continue to be held on the standard 12-month cycle.

FIJI

Basic Data

Area	18,333 square kilometers
Population (1984)	685,000
Population growth (1981-84)	1.9 percent per annum
GDP per capita (1984)	SDR 1,750

	1981	1982	1983	1984 Est.	1985 Proj.
Demand and supply		(In millions of Fiji dollars)			
GDP at current market prices	1,056	1,124	1,168	1,320	1,400
GDP at 1977 factor cost	720	712	684	737	744
Real GDP growth rate (in percent)	6.0	-1.1	-3.9	7.8	1.0
Sugar production (in '000 tons)	470	486	276	470	490
Tourist arrivals (in '000)	190	204	192	230	242
Investment and savings		(In percent of GDP)			
Gross investment	34.3	26.2	26.2	23.9	
Gross domestic savings	20.1	20.3	21.0	21.6	
Prices and wages		(Percentage change)			
Consumer prices	11.2	7.0	6.8	6.0	5.0
Tripartite Forum wage guideline	11.0	10.0	6.0	6.0	...
Terms of trade	-22.0	-3.0	15.6	-8.6	-13.5
Central Government budget		(In percent of GDP)			
Revenue and grants	25.0	23.6	25.1	24.8	24.9
Current expenditure	20.1	22.0	24.0	24.9	23.1
Capital expenditure	9.0	8.1	4.9	5.1	5.5
Overall deficit	4.1	6.5	3.8	5.2	3.7
External financing	2.4	1.6	0.4	0.8	1.1
Domestic financing	1.7	4.9	3.4	4.4	2.6
Of which:					
Banking system	-0.2	1.7	0.6	1.7	0.2
National Provident Fund	1.9	2.6	2.4	2.3	2.1
Money and credit		(Percentage change)			
Domestic credit	20.7	19.4	14.3	16.3	
Public sector	7.7	91.3	20.5	5.7	
Private sector	23.6	5.6	11.8	16.7	
Total liquidity	6.3	8.5	12.2	14.0	

	1981	1982	1983	1984 Est.	1985 Proj.
Balance of payments			(In millions of SDRs)		
Exports (domestic)	192	176	164	188	189
Imports (retained)	-416	-346	-355	-355	-378
Net services and transfers	79	87	133	130	139
Current account balance	-144	-83	-59	-36	-50
(In percent of GDP)	13.5	7.6	5.6	3.0	4.0
Official capital	63	38	32	19	14
Private capital	53	32	36	17	24
Errors and omissions	12	-12	-11	--	--
Overall balance	-16	-26	-2	--	-12
External debt					
Public	205	243	279	300	314
Private	82	91	96	99	106
Use of Fund credit	--	13	13	13	8
Short-term	20	20	20	20	20
Total outstanding debt	307	367	408	432	448
(In percent of GDP)	28.8	33.1	38.4	36.4	34.0
Principal	15	15	19	37	37
Interest	20	25	28	32	34
Debt service	35	40	47	69	71
(In percent of exports of goods and services)	8.2	9.1	10.8	14.5	14.4
International reserves					
Gross official reserves	118	115	111	111	94
(In months of imports)	3.1	3.5	3.4	3.4	2.7
Net reserves of the banking system	121	98	97	97	85
Effective exchange rate indexes			(1980 = 100)		
Nominal	100.5	102.0	100.8	100.9	
Real	101.0	100.6	99.8	100.1	
Exchange rate			(End of period)		
U.S. dollar per Fiji dollar	1.14	1.06	0.96	0.89	
SDR per Fiji dollar	0.98	0.96	0.91	0.89	

Sources: Data provided by the Fiji authorities; and staff estimates.

Fiji - Fund Relations
(As of October 31, 1984)

I. Membership Status

(a) Date of Membership: May 28, 1971
(b) Status: Article VIII

A. Financial Relations

II. General Department (General Resources Account)

(a) Quota: SDR 36.5 million
(b) Total Fund holdings of currency:
SDR 42.2 million (115.6 percent of quota)
Fund credit: SDR 13.5 million (37 percent of quota)
Of which:
CFF SDR 13.5 million (37 percent)
(d) Reserve tranche position: SDR 7.81 million
(e) Current Operational Budget: Not included
(f) Lending to the Fund: None

III. Current Stand-by or Extended Arrangement and Special facilities

(a) Current stand-by: None.

(b) Stand-by and extended arrangements in last 10 years: None

(c) Special facilities in last two years: None

IV. SDR Department

(a) Net cumulative allocations: SDR 6.958 million.
(b) Holdings: SDR 6.46 million (92.8 percent of net cumulative allocation)
(c) Current Designation Plan: Not included

V. Administered accounts

(a) Trust Fund Loans: Not eligible.
(b) SFF Subsidy Account: None.

VI. Overdue Obligation to the Fund: None

B. Nonfinancial Relations

VII. Exchange rate arrangement

Since April 1975, the exchange rate of the Fiji dollar has been linked to a basket of currencies of the five major trading partners: the United States, Australia, and New Zealand dollars, the pound sterling, and the Japanese Yen. The weights used in the basket are based on the value of merchandise trade, tourist, and external debt transactions. The exchange rate is determined daily in relation to the currency basket and Reserve Bank buying and selling rates for transactions in U.S. dollars are communicated to commercial banks.

VIII. Last Article IV Consultation

The 1983 Article IV consultation discussions were held during October 17-28, 1983. The Executive Board discussed the Staff Report SM/83/267 on February 3, 1984. It was proposed to hold the Article IV Consultation on the standard 12-month cycle.

IX. Technical Assistance

(a) CBD : An expert is Research Director of the Reserve Bank of Fiji.
(b) Fiscal: A tax review mission visited Fiji in 1983. Assistance on the improvement of income tax collection procedures and the establishment of a public enterprise unit in the Ministry of Finance is being provided.
(c) Legal : Assistance in revising the income tax legislation is being provided.

X. Resident Representative/Advisor: None

Financial Relations of the World Bank
Group with Fiji as of September 31, 1984

(In millions of U.S. dollars)

	Loans 1/	Of which: Undisbursed
Debt outstanding (including undisbursed)	122.21	--
Commitments for FY 1985	None	
Technical assistance:	None	
Recent report:	Issues and Options in the Energy Sector (Number 4462-FIJI), June 1983. A Country Economic Memorandum is in preparation.	

Over the five-year period 1979-83, the IBRD group was the largest single source of external concessional assistance. Apart from the IFC loan of US$6 million to the Fiji Sugar Corporation which was approved in July 1983, the World Bank group has made no new loan commitments to Fiji since January 1981. All past IBRD loans are fully disbursed. A tree crop project of US$12 million that was scheduled to receive Executive Board approval in mid-1984 was withdrawn at the request of the Fiji authorities. No new IBRD loan commitments are expected in FY 1985 but a loan to be cofinanced with the ADB to the Fiji Development Bank (US$3 million from IBRD and US$4 million from ADB) is an FY 1986 stand-by project that could be approved in FY 1985 if processing by ADB is completed. In addition, the World Bank has two projects in the planned lending program, US$10 million for road upgrading in FY 1986 and US$10 million for education in FY 1987.

2/ As of September 30, 1984.

Fiji--Statistical Issues

1. Coverage, Currentness, and Reporting of Data in IFS

		Latest Data in December 1984 IFS
Real Sector	- National Accounts	1981
	- Prices (consumer)	October 1984
	- Production	n.a.
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	1981
	- Financing	1981
	- Debt	1981
Monetary Accounts	- Monetary Authorities	September 1984
	- Deposit Money Banks	September 1984
	- Other Financial Institutions	December 1982
External Sector	- Merchandise Trade: Values	September 1984
	- Merchandise Trade: Prices	Q2 1984
	- Balance of Payments	Q4 1983
	- International Reserves	October 1984
	- Exchange Rates	October 1984

During the past year, the reporting of data for inclusion in IFS has been satisfactory.

2. Outstanding Statistical Issues

Monetary Accounts

Data on other financial institutions are either reported with a considerable time lag or not at all, even though some nonbank financial institutions (e.g., the National Provident Fund) contribute substantially to domestic credit.

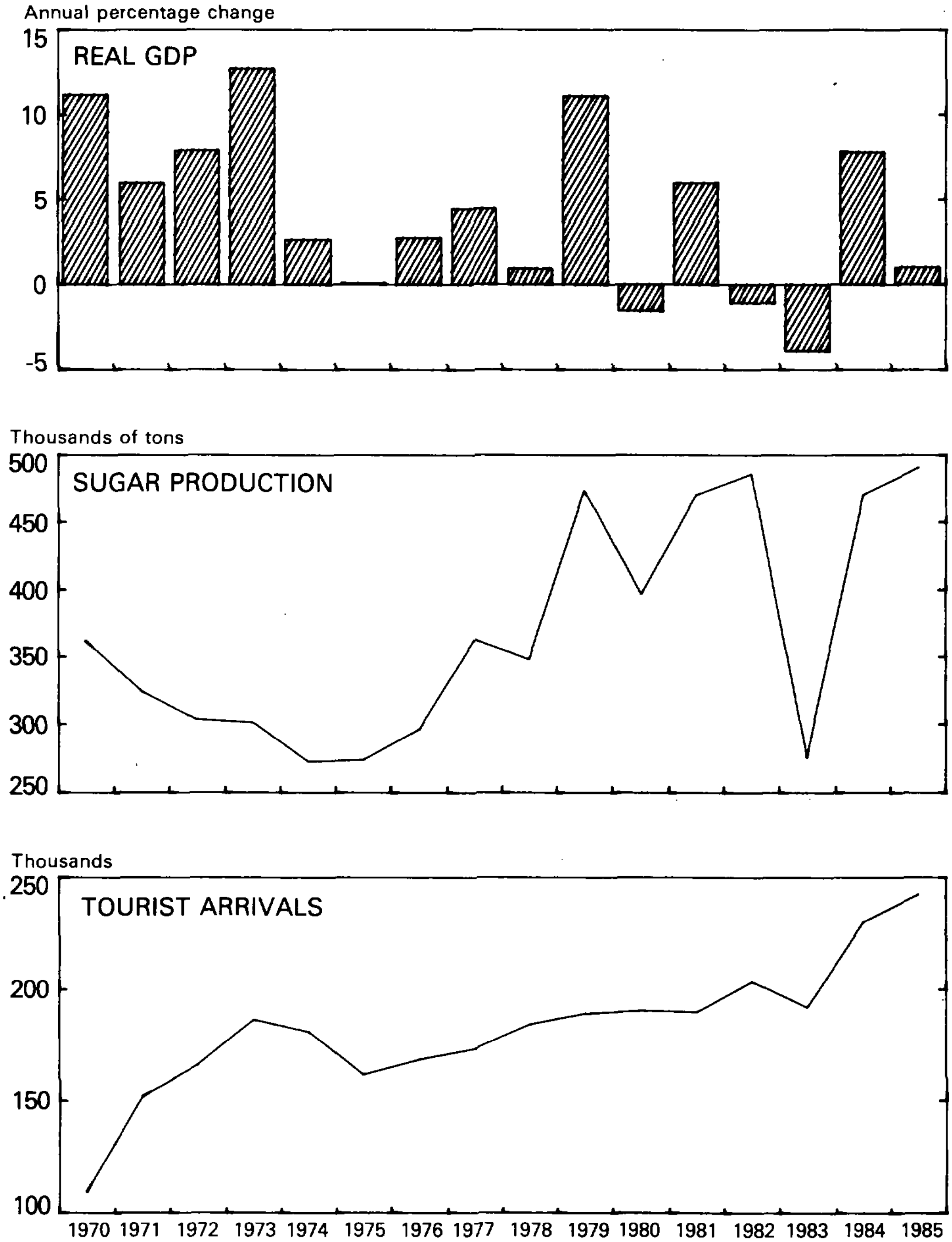
Government Finance

Data published in IFS are the same as those in the GFS Yearbook and cover operations of the budgetary Central Government only. Data for extrabudgetary units need to be reported in order to produce data for consolidated Central Government and general Government.

CHART 1

FIJI

GDP, SUGAR AND TOURISM, 1970-85



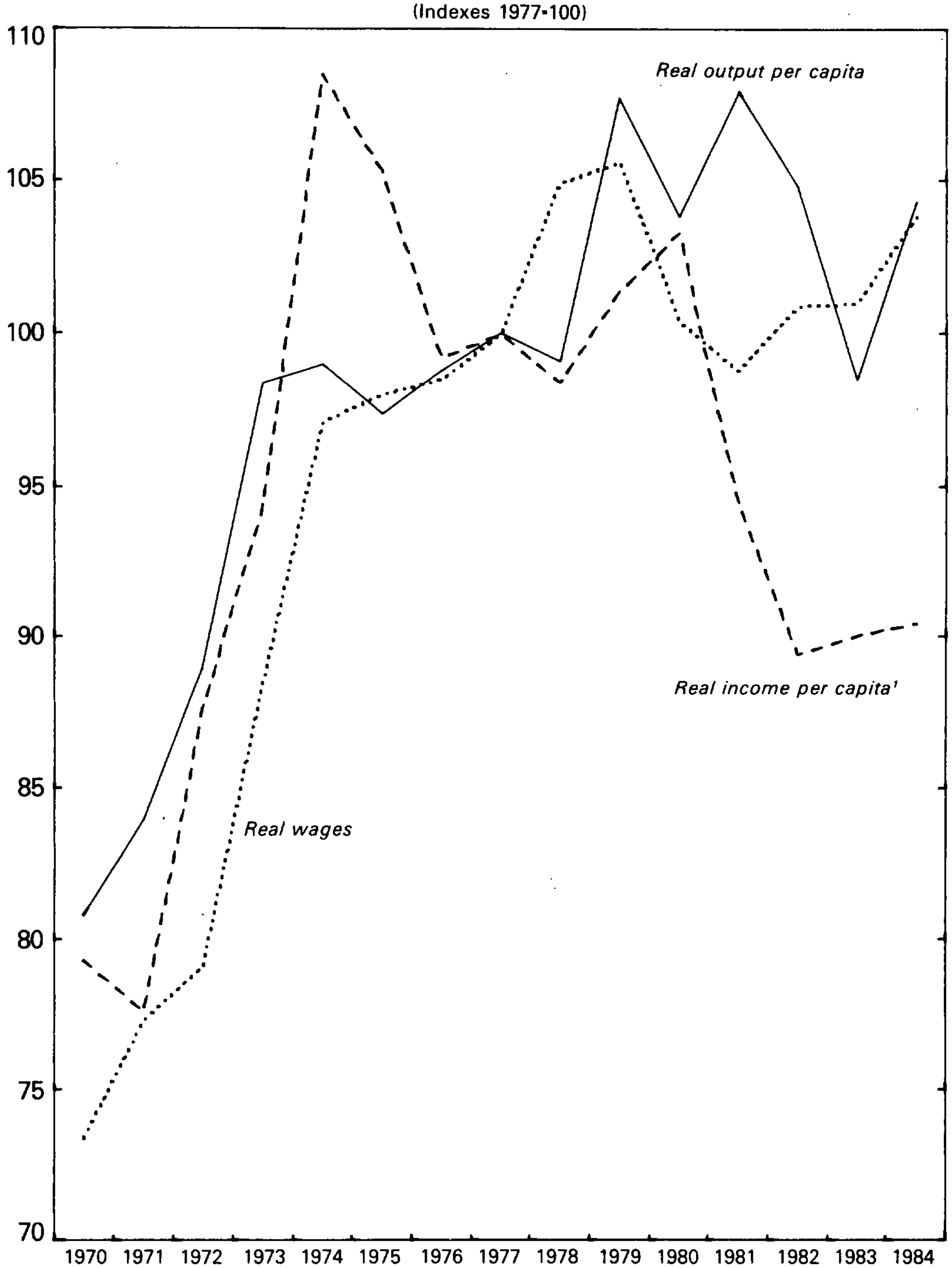
Sources: Data provided by the Fiji authorities and staff estimates.

CHART 2

FIJI

OUTPUT, INCOME AND WAGES, 1970-84

(Indexes 1977=100)



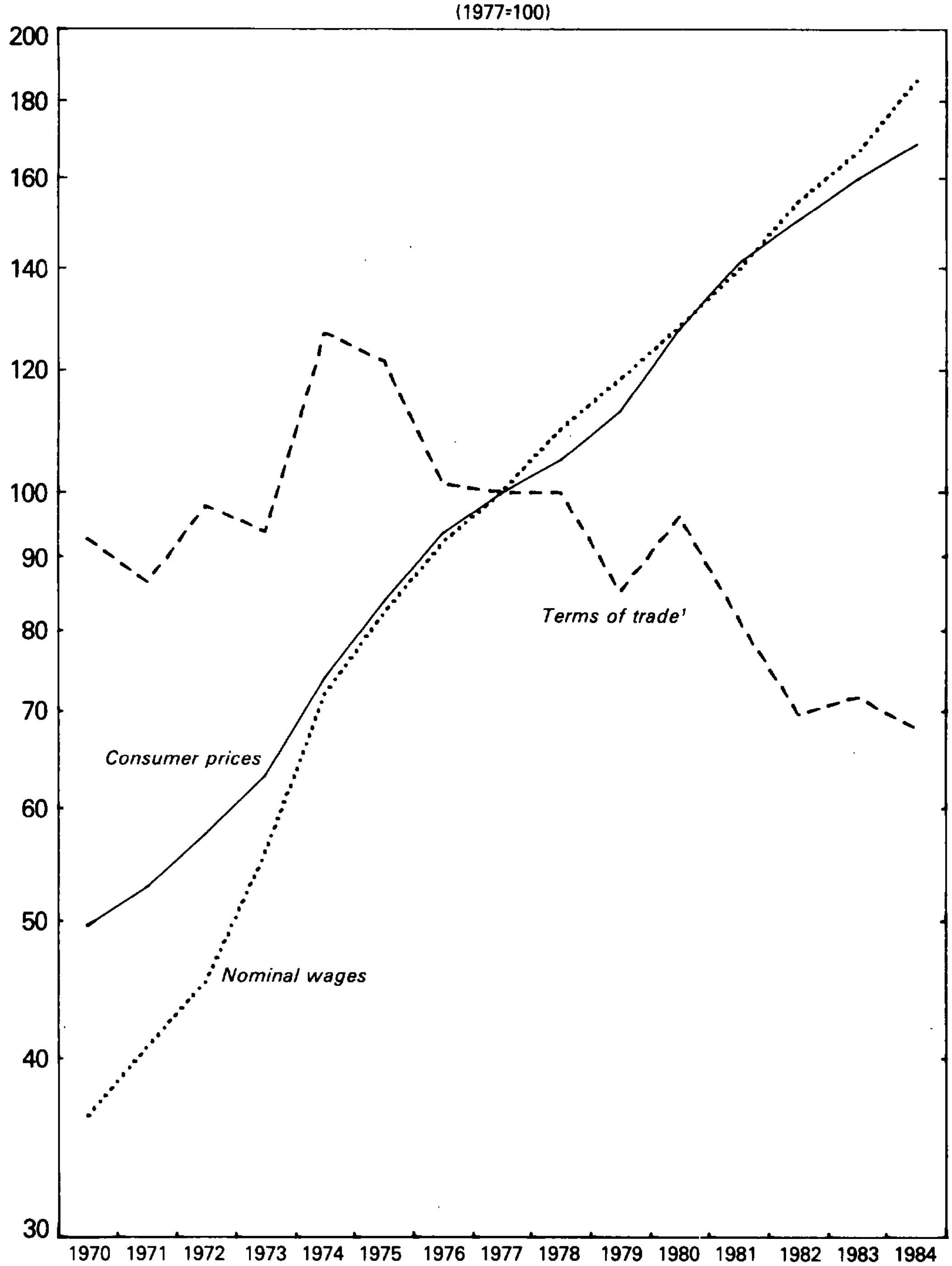
Sources: Data provided by the Fiji authorities and staff estimates.
[1] Real GDP adjusted for external terms of trade changes.

CHART 3

FIJI

PRICES, WAGES AND TERMS OF TRADE, 1970-84

(1977=100)



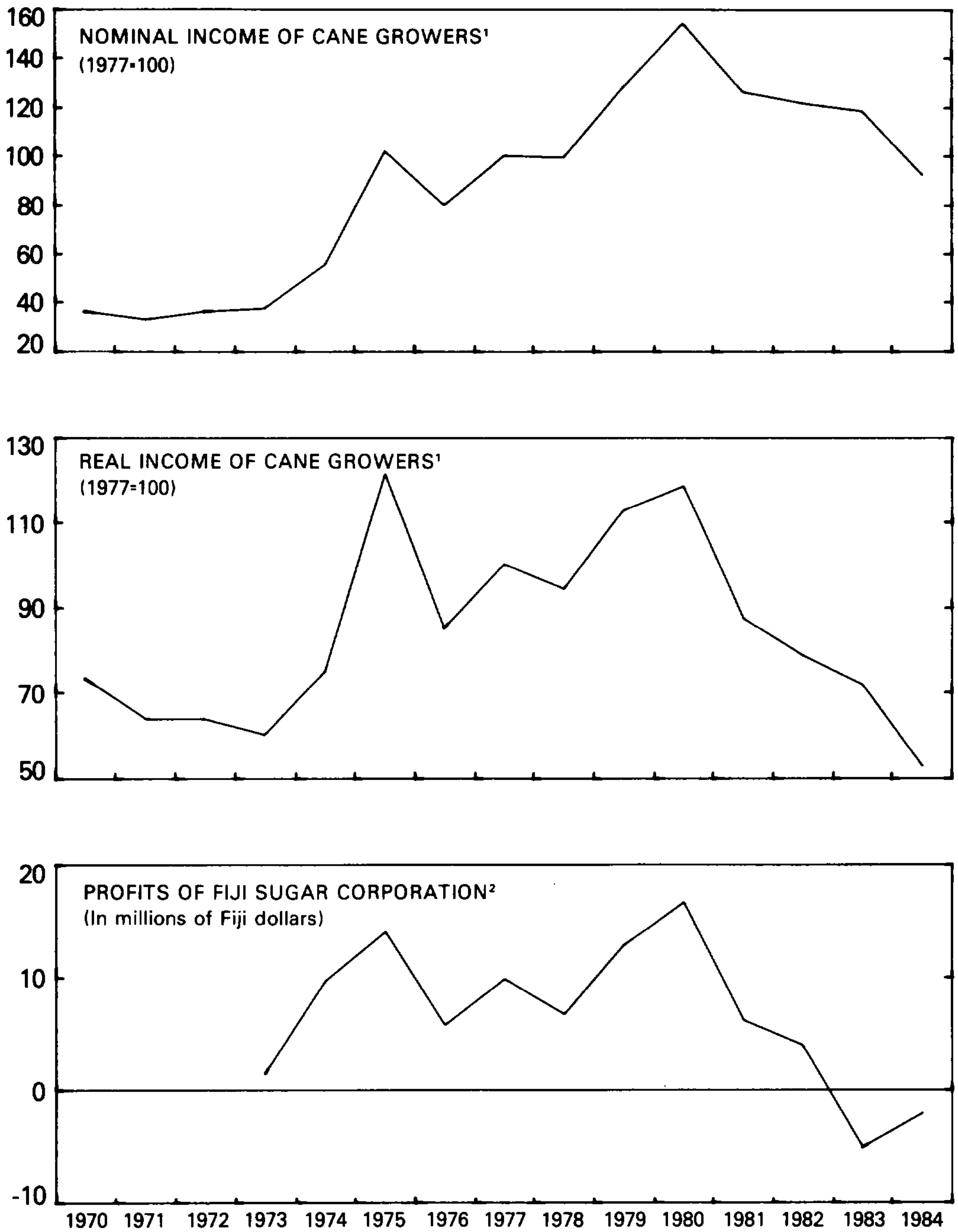
Sources: Data provided by the Fiji authorities and staff estimates.

[1] In terms of Fiji dollars.

CHART 4

FIJI

SUGAR INCOMES, 1970-84



Sources: Data provided by the Fiji authorities and staff estimates.

[1]Gross receipts from the Fiji Sugar Corporation. The consumer price index is used to deflate nominal income.

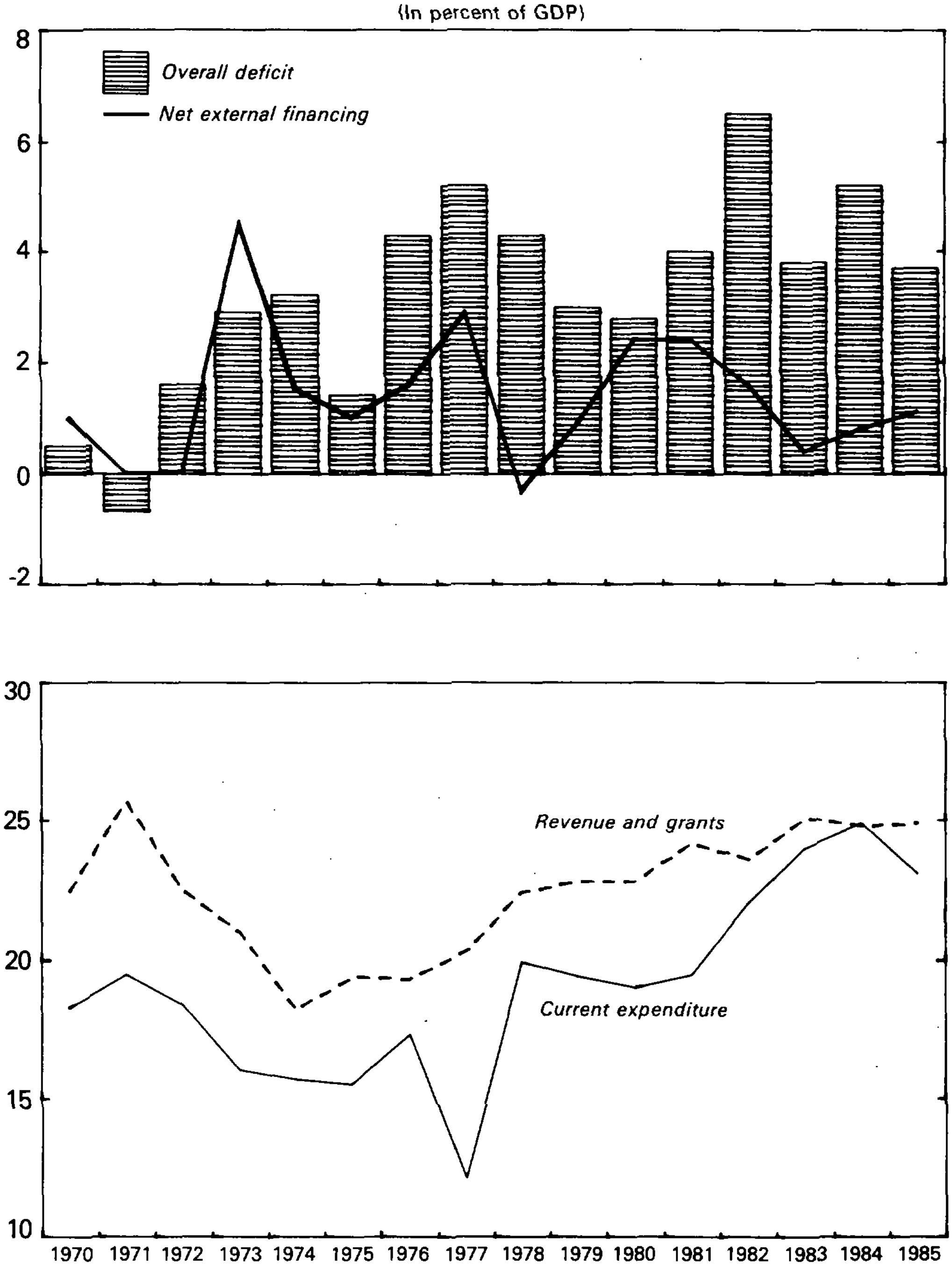
[2]Financial year ending March of subsequent year.

CHART 5

FIJI

GOVERNMENT BUDGET, 1970-85

(In percent of GDP)

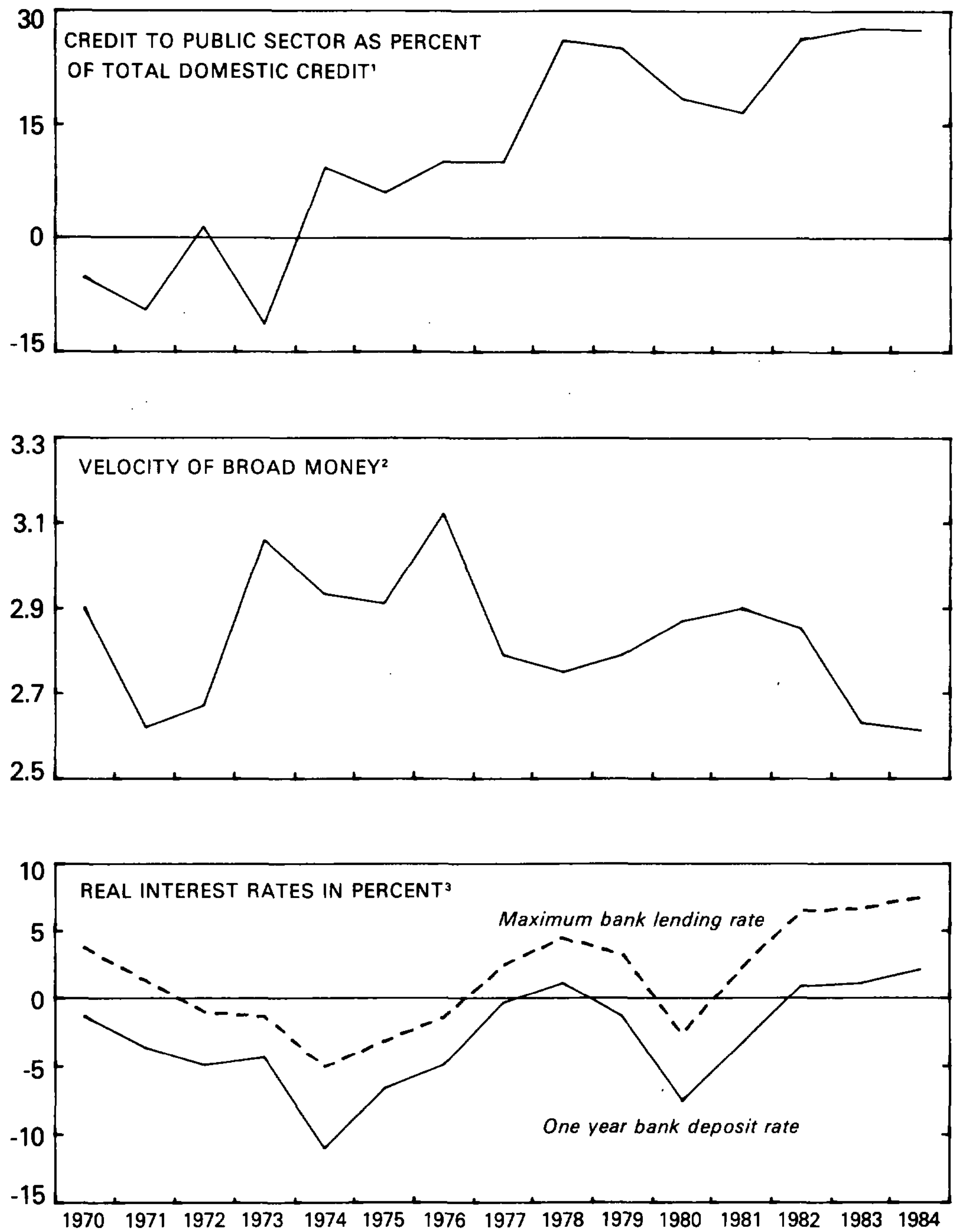


Sources: Data provided by the Fiji authorities and staff estimates.

CHART 6

FIJI

MONEY AND CREDIT, 1970-84

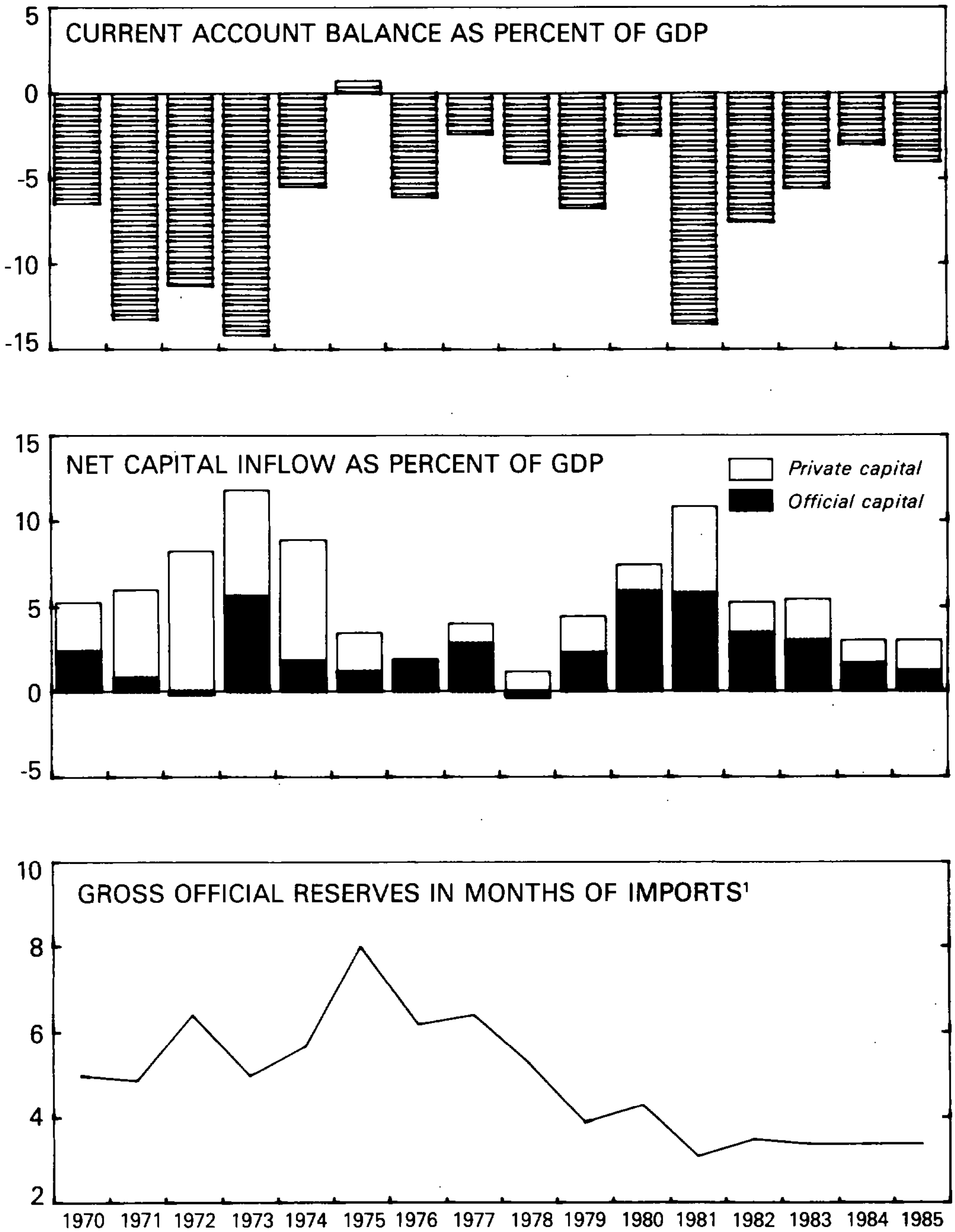


Sources: Data provided by the Fiji authorities and staff estimates.
[1]Amounts outstanding at end of period; net credit to government and gross credit to public enterprises.
[2]Nominal GDP in relation to total liquidity at end of period.
[3]Nominal rates of interest less the rate of increase in consumer prices.

CHART 7

FIJI

BALANCE OF PAYMENTS, 1970-85



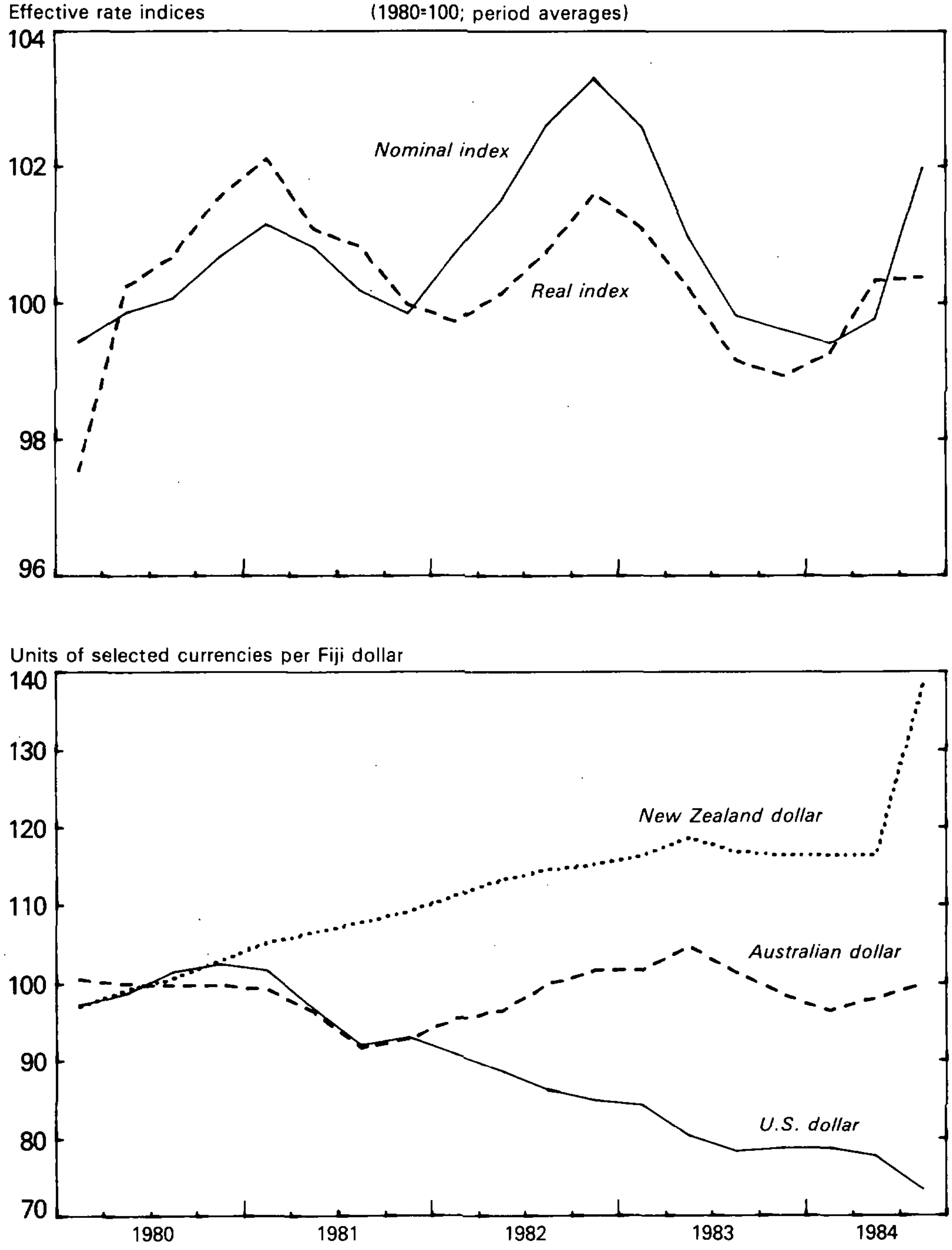
Sources: Data provided by the Fiji authorities and staff estimates.

[1]End-year reserves data.

CHART 8

FIJI

EXCHANGE RATE INDICES, 1980-84



Sources: Data provided by the Fiji authorities and staff estimates.