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December 29, 1983

To: Members of the Executive Board
From: The Acting Secretary
Subject: Fiji - Staff Report for the 1983 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1983 Article IV consultation with Fiji, which has been tentatively scheduled for discussion on Wednesday, February 1, 1984.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Browne, ext. (5)7329 or Mr. Shah, ext. (5)7327.

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INTERNATIONAL MONETARY FUND

FIJI

Staff Report for the 1983 Article IV Consultation

Prepared by the Staff Representatives for the 1983
Consultation with Fiji

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

Approved by Tun Thin and Manuel Guitian

December 29, 1983

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I. Introduction

The 1983 Article IV consultation discussions with Fiji were held in Suva during October 17-28. The Fiji representatives included the Minister of Finance and officials of the Ministry of Finance, the Central Monetary Authority, the Central Planning Office, and other government departments. The staff team comprised Messrs. Browne (Head), Shah, Zavadzil (all ASD), Mansfield (FAD), and Miss Allen (Secretary, ASD).

Fiji has consented to the increase in its quota under the Eighth General Review of Quotas. A summary of Fiji's relations with the Fund is provided in Appendix II and with the World Bank Group in Appendix III.

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 developments in 1970-82

During the decade following independence in 1970, the rate of growth of the Fiji economy was satisfactory, and employment opportunities expanded steadily (Charts 1-3). Major contributors to development were the tourism sector, particularly in the early 1970s when foreign private investment was substantial; the sugar industry in the mid-1970s through an expansion of the area under cultivation; and public investment in the late 1970s, mainly in the hydroelectric and water sectors. Financial policies were broadly successful in maintaining internal balance. The central government budget deficit averaged less than 3 percent of GDP, and the credit needs of the private sector were met without excessive monetary expansion (Charts 4 and 5). Domestic consumer prices increased at about the same rate as the average of Fiji's main trading partners. A stable real effective exchange rate was maintained through small adjustments in the nominal exchange rate. This policy encouraged the expansion of the traded goods sector. The external current account deficit, which had been 11 percent of GDP during the investment boom in 1970-73, was reduced to 4 percent in 1974-80 despite higher oil prices. With sizable external concessional assistance, overall balance of payments surpluses were recorded in most years (Chart 6).

In 1980-82, the pace of economic activity slackened and financial policies became more expansionary. Government expenditure increased markedly, mainly because of a rapidly rising wage and salary bill. Coupled with sluggish revenue performance in 1982, the budget deficit widened to 6 percent of GDP. The financial position of public enterprises weakened; lower world prices reduced the profits of the sugar corporation and rising fuel costs contributed to losses in fishing and airline operations. The public sector made much greater use of bank

credit and, although rises in real interest rates helped to limit private sector credit demand, the rate of growth of domestic credit remained at 20 percent in 1982. With less imported inflation, the rate of price increase slowed to 7 percent. In such a small open economy, the main effect of expansionary fiscal policies is to stimulate import demand and, to that extent, their impact on domestic prices is limited. Between 1980 and 1982, the terms of trade deteriorated by one quarter because of the effects of the international recession on export prices and the rise in petroleum prices. The external current account deficit rose to more than 13 percent of GDP in 1981, only in part because of unusually high imports of capital equipment financed with external concessionary assistance, and remained at 7 percent of GDP in 1982. Large overall balance of payments deficits were recorded in both years.

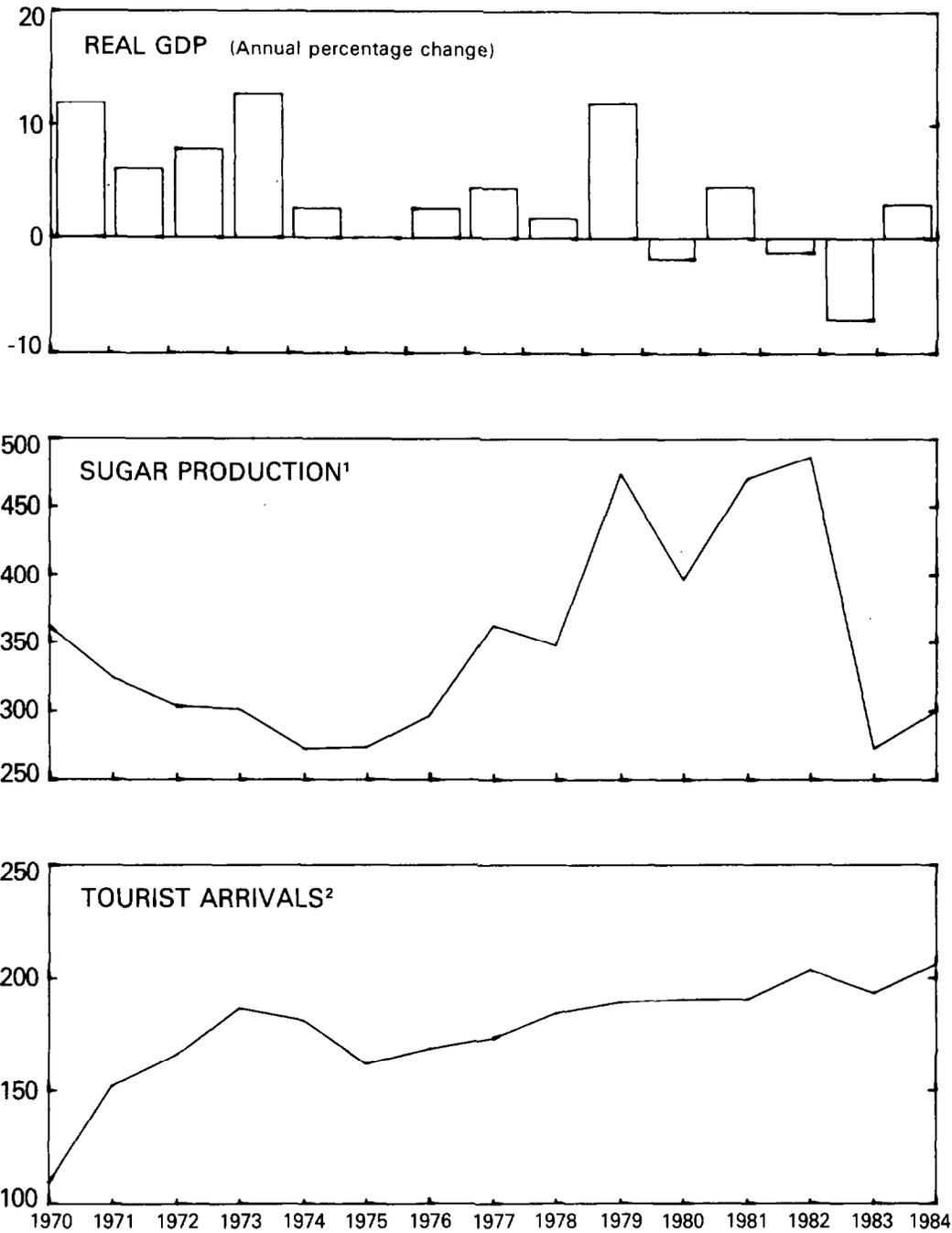
2. The economy in 1983

Economic developments in 1983 were much less favorable than originally projected. Real GDP declined by about 7 percent, primarily because of the impact on agriculture and tourism of severe cyclones in March and a subsequent serious drought. The sugarcane crop fell by 45 percent; its lowest level since 1975. Several leading hotels were damaged by the cyclones and the number of tourist arrivals in March-September was 14 percent lower than in the corresponding period of 1982. However, supplies for the domestic market were not disrupted and the rate of inflation remained below 7 percent.

Despite the adversities, the external current account deficit narrowed to 5 percent of GDP (Table 1). The fall in exports was limited by a drawdown of sugar stocks that had been unusually high at the beginning of the year. ^{1/} For the whole year, the decline in tourist arrivals was estimated at only 5 percent. The rise in retained imports was small because of the decline in the oil bill due to lower prices and the completion of the hydroelectric project. As a result of the cyclones, the settlement of claims against foreign insurance companies and emergency grant assistance resulted in inflows equivalent to 3 percent of GDP. Considerable external concessionary loan assistance was received and the authorities therefore believed that an overall balance of payments deficit would be avoided without external commercial borrowing. The nominal effective exchange rate, which appreciated by about 3 percent in the first quarter of 1983, mainly because of the initial decision not to follow fully the Australian and New Zealand depreciations in early March, was depreciated gradually by 5 percent between mid-March and mid-August 1983. As a result, the slight appreciation of the real effective rate that had occurred in 1981-82 was reversed (Chart 7).

^{1/} Sugar growers are paid for their crop over 12-18 months. Partial payments are made on delivery to the sugar mill and at the end of the crushing season. Full payment is not made until some weeks after export receipts have been received. Thus, growers' incomes were depressed in 1982 when stocks were built up and boosted in 1983 when stocks were drawn down.

CHART 1
FIJI
GDP, SUGAR AND TOURISM, 1970-84



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

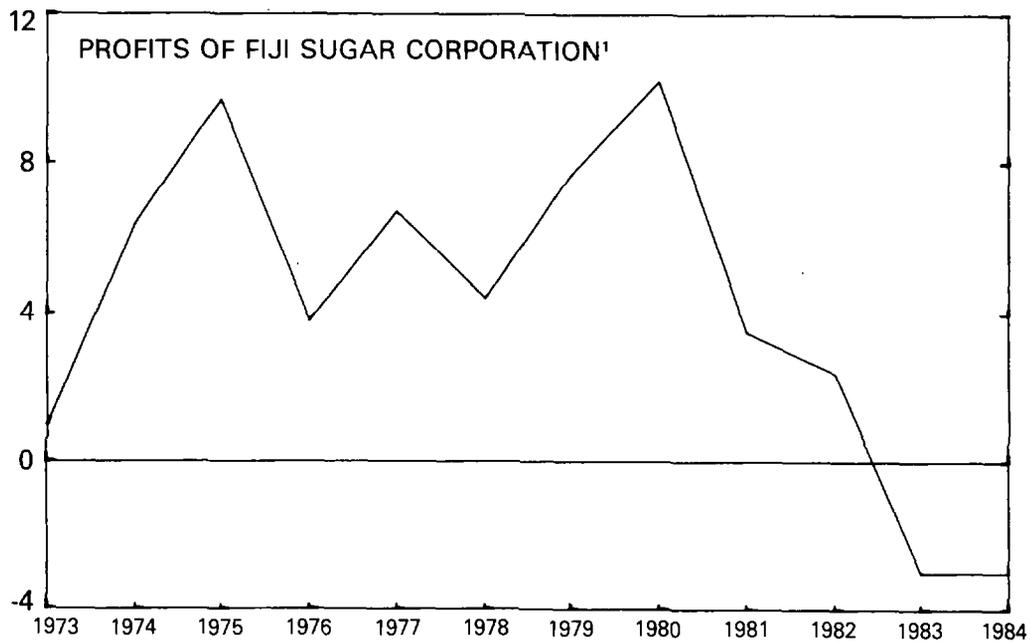
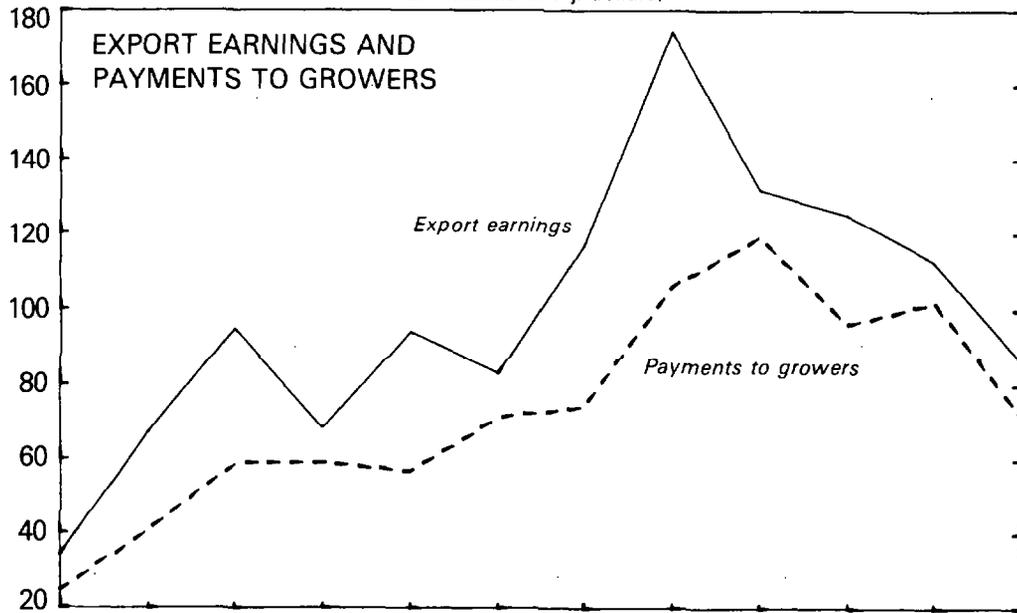
¹Thousands of tons.

²Thousands of visitors.



CHART 2 FIJI SUGAR EARNINGS, 1973-84

(In millions of Fiji dollars)

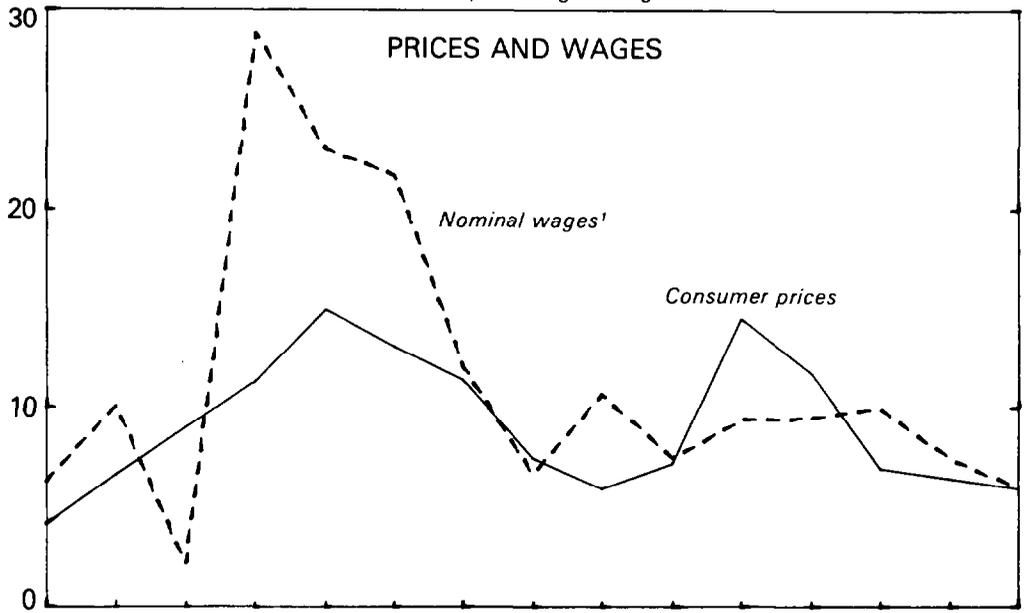


Source. Data provided by the Fiji authorities; and staff estimates.
¹ Financial years ending March of the subsequent year.



CHART 3
FIJI
PRICES, WAGES AND EMPLOYMENT, 1970-84

(Annual percentage change)



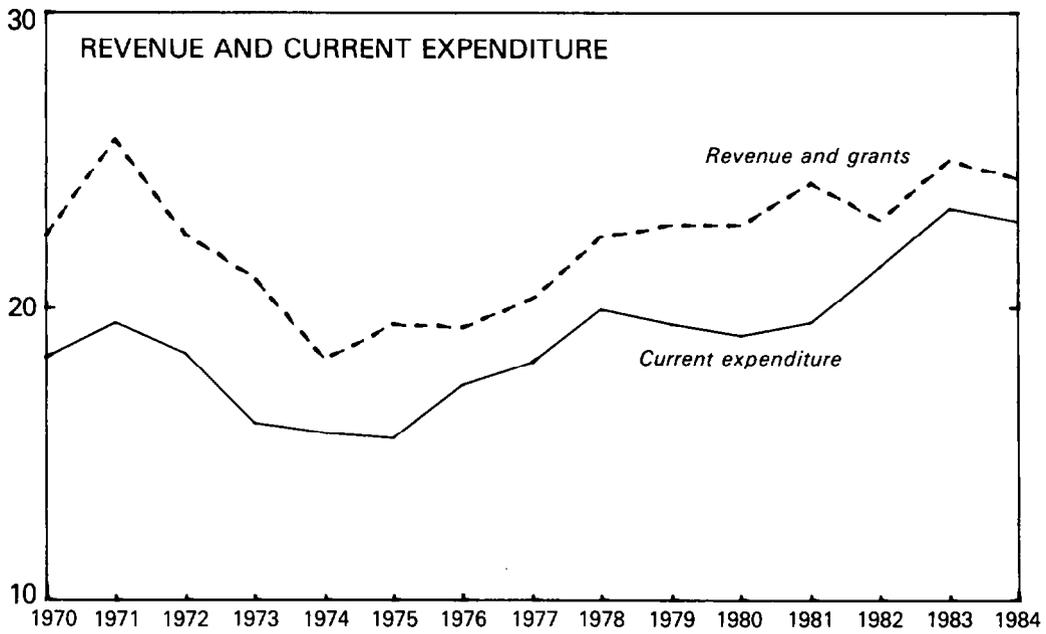
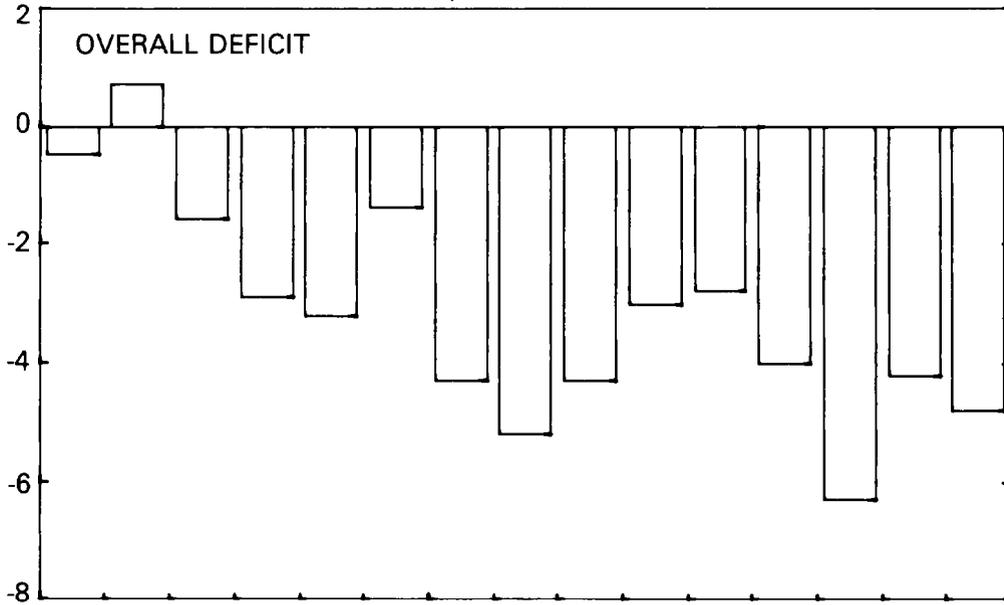
Source: Data provided by the Fiji authorities; and staff estimates.

¹Union and non-union workers in paid employment; excludes most agricultural workers.

²Number of workers in paid employment.



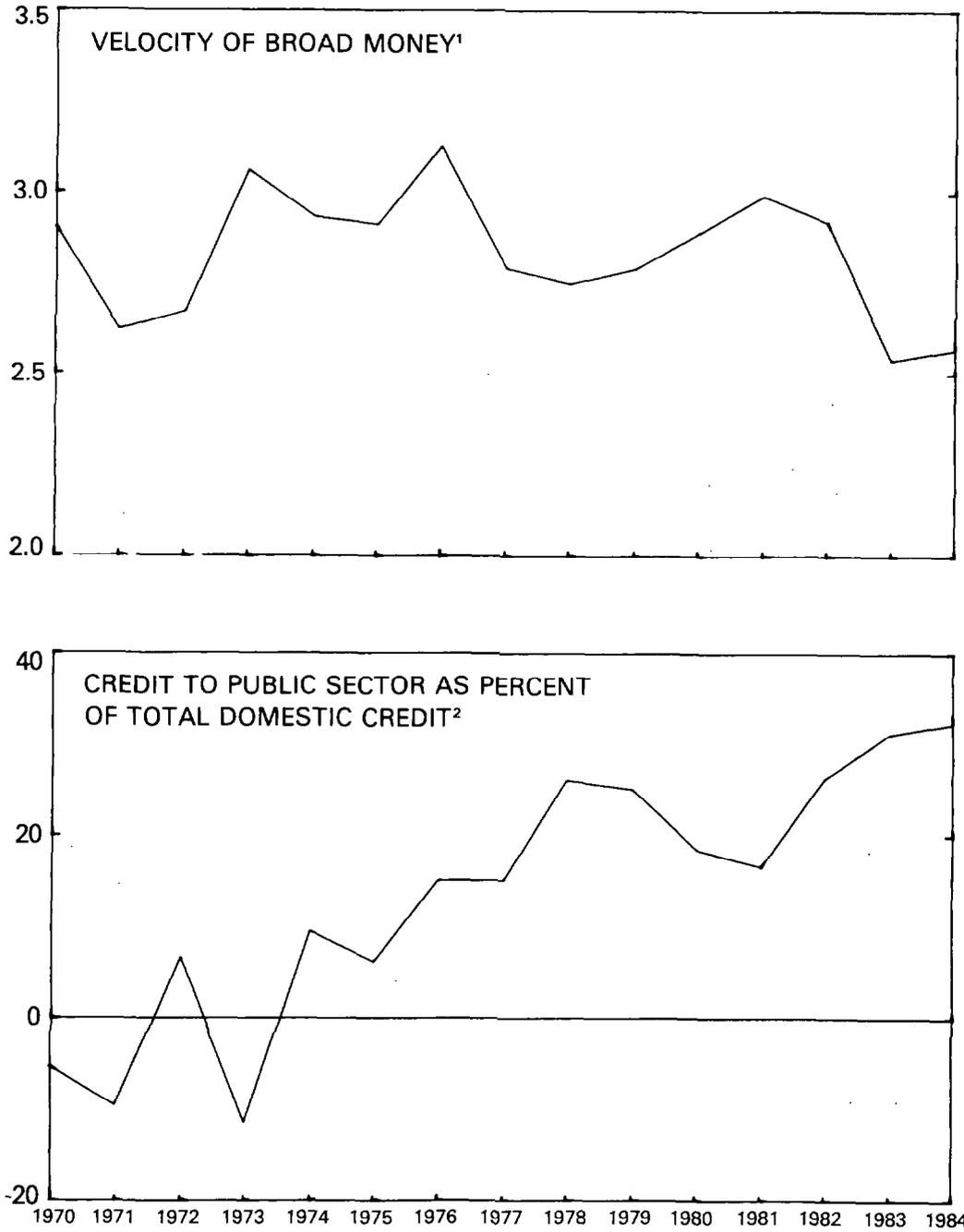
CHART 4
FIJI
GOVERNMENT BUDGET, 1970-84
(In percent of GDP)



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



CHART 5
FIJI
MONEY AND CREDIT, 1970-84



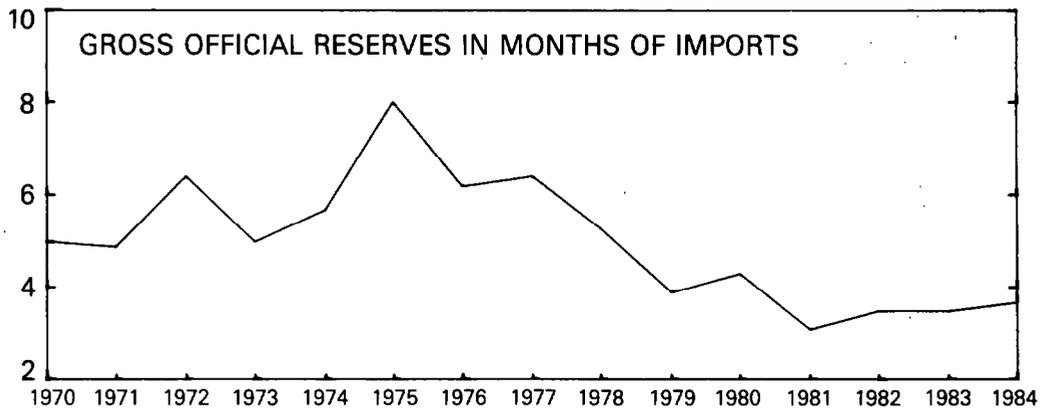
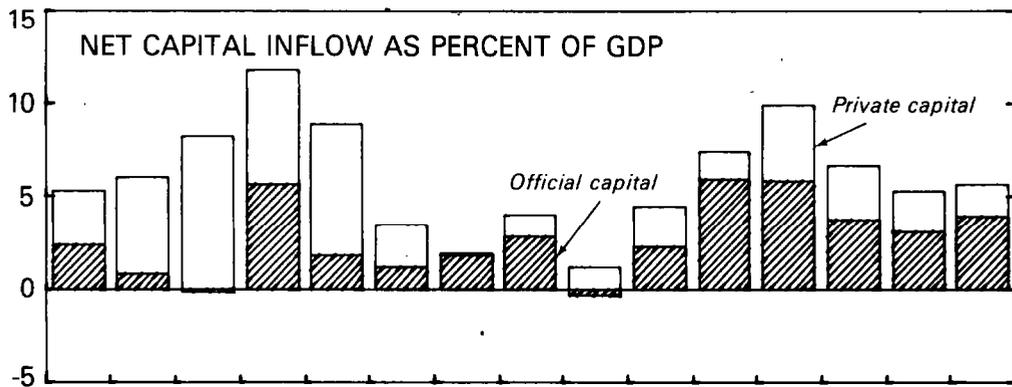
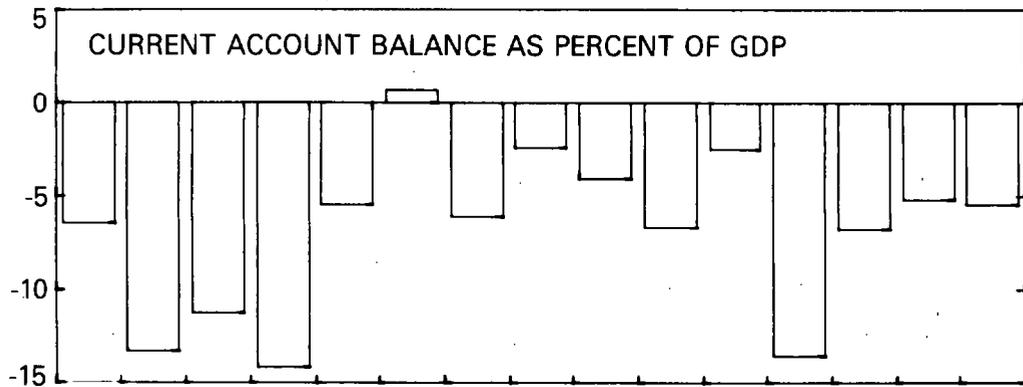
Source: Data provided by the Fiji authorities; and staff estimates.

¹Broad money at end of period in relation to nominal GDP.

²Amounts outstanding at end of period; net credit to Government and gross credit to public enterprises.



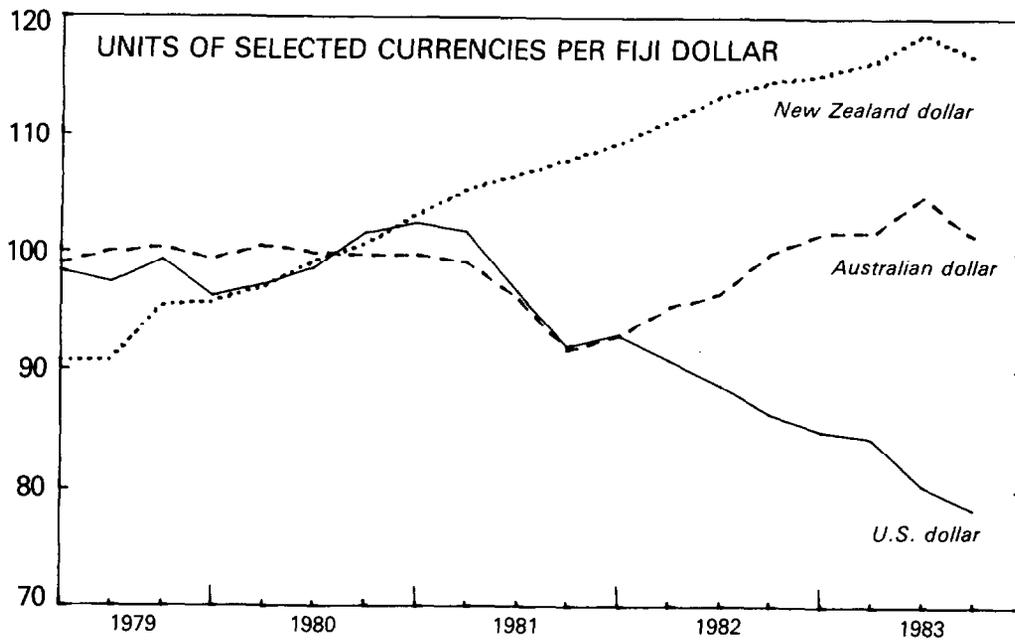
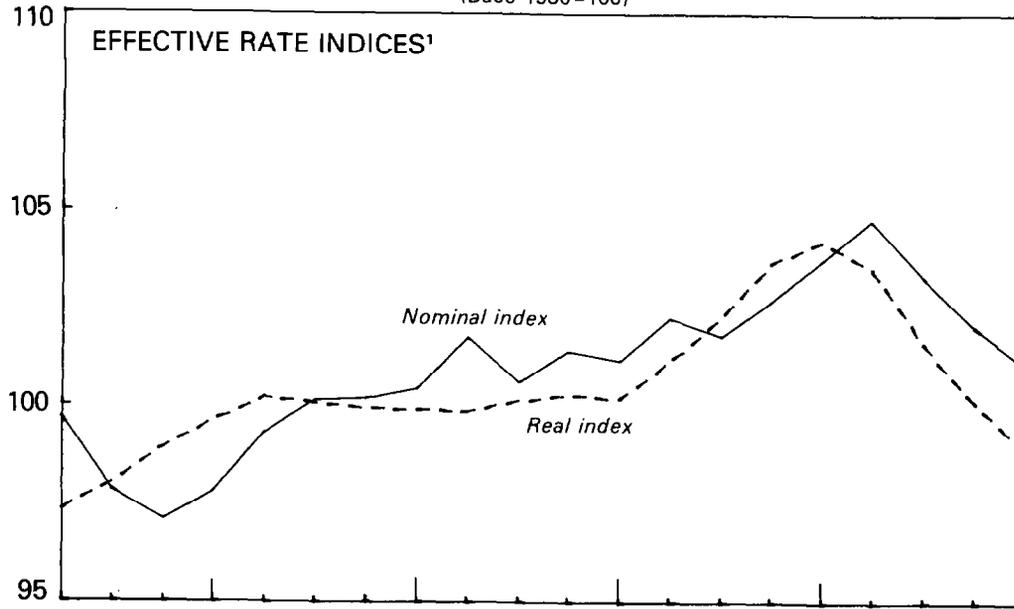
CHART 6
FIJI
BALANCE OF PAYMENTS, 1970-84



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



CHART 7
FIJI
EXCHANGE RATE INDICES, 1979-83
(Base 1980=100)



Source: Data provided by the Fiji authorities.
1982 trade weighted



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Table 1. Fiji: Balance of Payments, 1980-84

(In millions of SDRs)

	1980	1981	1982	1983 Estimate	1984 Projection
Exports	262	239	230	203	195
Sugar	(164)	(131)	(122)	(104)	(86)
Other domestic	(57)	(61)	(54)	(62)	(67)
Re-exports	(41)	(47)	(54)	(37)	(42)
Imports	-369	-463	-400	-390	-380
Oil	(-49)	(-76)	(-70)	(-57)	(-52)
Other retained	(-280)	(-340)	(-276)	(-296)	(-286)
Re-exports	(-41)	(-47)	(-54)	(-37)	(-42)
Trade balance	<u>-107</u>	<u>-224</u>	<u>-170</u>	<u>-187</u>	<u>-185</u>
Services	62	65	72	104	99
Transfers	<u>20</u>	<u>12</u>	<u>22</u>	<u>28</u>	<u>21</u>
Services and transfers	<u>82</u>	<u>77</u>	<u>94</u>	<u>132</u>	<u>120</u>
Current balance	-25	-147	-76	-55	-65
Official capital	54	63	42	33	45
Concessionary	(30)	(43)	(35)	(30)	(11)
Commercial	(24)	(20)	(7)	(3)	(34)
Private capital	<u>14</u>	<u>54</u>	<u>32</u>	<u>22</u>	<u>20</u>
Nonmonetary capital	<u>68</u>	<u>117</u>	<u>74</u>	<u>55</u>	<u>65</u>
Errors and omissions	-13	12	-20	--	--
Allocation of SDRs	2	2	--	--	--
Overall balance	32	-16	-22	--	--
(In percent of GDP)					
<u>Memorandum items:</u>					
Current deficit	2.7	13.6	6.8	5.2	5.5

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

The central government budget deficit decreased to 4 percent of GDP, despite expenditure to repair cyclone damage and assist the agricultural sector (Table 2). Total revenue was higher because of increases in income tax receipts, customs duty collections associated with a change in the composition of imports, and nontax revenue. Total expenditure was unchanged from 1982. Capital spending declined sharply, following the completion of a large water supply project. Current expenditure increased, because of higher wages and salaries, interest payments and subsidies and transfers to public enterprises. External financing of the deficit declined, and notwithstanding continued large borrowing from the National Provident Fund, further use of domestic bank credit was required.

The rate of growth of domestic credit remained high (Table 3). Credit to the public sector increased because of government borrowing and the continued weakening of public enterprise finances, particularly the sugar corporation. Private sector credit demand, which was reduced in the first half of the year by the receipt of insurance money, accelerated during the second half of the year. Broad money grew by 16 percent in the year to October 1983, although nominal GDP did not increase during this period. Part of the increase may be attributed to savings encouraged by higher interest rates since December 1981.

III. Report on the Discussions

The discussions focused on the economic outlook and the stance of policies in 1984. The recovery will be modest, with the increase in real GDP unlikely to exceed 3 percent. The early growth of sugarcane was stunted by the drought and even with normal weather from the end of October 1983, the harvest is expected to be only 10 percent larger than this year. The appropriateness of the proposed demand management policies in response to the loss of export earnings was assessed in the light of the medium-term growth and balance of payments prospects.

1. External policy

An external current account deficit of 5.5 percent of GDP is projected for 1984, somewhat larger than in 1983. The value of exports is estimated to decline further because of the poor sugar crop and the depletion of stocks. Other exports, including fish and timber, are expected to increase because of stronger external demand. Import demand should ease as sugar growers' incomes decline, but only moderately in view of the excess liquidity in the economy. Receipts from tourism should pick up with an expected increase in the number of tourist arrivals, but net receipts from services and transfers are estimated to decline in the absence of the special inflows that occurred in 1983. The projections are based on the assumption underlying the 1984 government budget, namely, that the compensation of public sector employees will not be increased. However, this assumption appears optimistic in view of outstanding wage claims.

Table 2. Fiji: Central Government Budget, 1980-84

(In millions of Fiji dollars)

	1980	1981	1982	1983 Estimate	1984 Budget
Revenue and grants	<u>222</u>	<u>263</u>	<u>265</u>	<u>289</u>	<u>309</u>
Tax revenue	<u>180</u>	<u>214</u>	<u>211</u>	<u>234</u>	<u>249</u>
Income tax	(104)	(113)	(120)	(127)	(132)
Customs and excise <u>1/</u>	(73)	(96)	(86)	(102)	(112)
Other taxes	(3)	(5)	(5)	(5)	(5)
Nontax revenue	34	41	44	46	46
External grants	8	8	10	9	14
Expenditure	<u>250</u>	<u>307</u>	<u>338</u>	<u>338</u>	<u>370</u>
Current	<u>185</u>	<u>212</u>	<u>247</u>	<u>271</u>	<u>290</u>
Wages and salaries	(101)	(116)	(138)	(148)	(151)
Provident Fund	(5)	(5)	(7)	(7)	(7)
Goods and services	(38)	(36)	(39)	(37)	(36)
Interest	(14)	(19)	(26)	(31)	(46)
Subsidies and transfers	(27)	(35)	(38)	(48)	(50)
Capital	65	95	91	67	80
Fixed assets	(46)	(60)	(57)	(35)	(48)
Grants and net lending	(19)	(35)	(34)	(32)	(32)
Overall deficit	<u>-27</u>	<u>-43</u>	<u>-73</u>	<u>-49</u>	<u>-61</u>
Externally financed	23	25	18	5	6
Domestically financed	4	18	55	44	55
Provident Fund	(15)	(20)	(29)	(30)	(45)
Other nonbank	(-2)	(-)	(7)	(2)	(5)
Banking system	(-9)	(-2)	(19)	(12)	(5)

(In percent of GDP)

Memorandum items:

Revenue	22.8	24.2	23.0	25.0	24.4
Tax revenue	(18.4)	(19.8)	(18.3)	(20.2)	(19.7)
Other revenue and grants	(4.4)	(4.4)	(4.7)	(4.8)	(4.7)
Expenditure	25.6	28.2	29.3	29.2	29.2
Current	(19.0)	(19.5)	(21.4)	(23.4)	(22.9)
Capital	(6.6)	(8.7)	(7.9)	(5.8)	(6.3)
Deficit	2.8	4.0	6.3	4.2	4.8

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

1/ Includes license fees and vehicle taxes.

Table 3. Fiji: Monetary Survey, 1980-84
(In millions of Fiji dollars; end of period)

	1980	1981	1982	1983 Estimate	1984 Projection
Net foreign assets	134	120	106	108	108
Domestic credit	<u>232</u>	<u>279</u>	<u>334</u>	<u>392</u>	<u>429</u>
Government	22	20	39	51	56
Public enterprises	21	26	49	71	83
Private sector	189	233	246	270	290
Other items, net	-23	-35	-45	-45	-45
Broad money	343	364	395	455	492
	<u>(Annual percentage change)</u>				
<u>Memorandum items:</u>					
Domestic credit	3.3	20.7	19.4	17.4	9.5
Public sector	-23.8	7.7	91.3	38.6	14.0
Private sector	12.4	23.6	5.6	9.8	7.5
Broad money	12.1	6.3	8.5	15.2	8.0
Velocity of broad money <u>1/</u>	2.89	2.98	2.92	2.54	2.57

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

1/ Broad money at the end of period in relation to nominal GDP.

The net inflow of external concessionary assistance will be much less than in earlier years, following the completion of major public investment projects, delays in finalizing new projects, and higher repayments of existing public sector debt. The authorities intend to prevent a decline in net international reserves by undertaking, if necessary, increased external commercial borrowing. With the proposed budget, borrowing of 4 percent of GDP would probably be needed to avoid an overall balance of payments deficit. If the proposed degree of wage restraint cannot be achieved, additional borrowing will be required in the absence of further adjustment measures. Public sector wage and salary adjustments have important balance of payments implications because it is estimated that about half of any increase would be spent on imports. The staff team stressed the need to strengthen adjustment policies and thereby constrain commercial borrowing in view of the medium-term external prospects.

2. Budgetary policy

The 1984 central government budget, presented to Parliament in November 1983, provides for an increase in the overall deficit to nearly 5 percent of GDP. In view of the difficult external situation, revenue measures equivalent to about 2 percent of GDP have been introduced, including an income tax surcharge, an increase in the hotel turnover tax, a new miscellaneous services turnover tax, and increases in customs and excise duties for a wide range of goods. Several of the recommendations of the Fiscal Affairs tax review mission that visited Fiji in March 1983 have been implemented. Even with the measures, total revenue is expected to fall in relation to GDP, while expenditure is estimated to remain unchanged. Domestic bank financing of the deficit will be kept low, provided that the desired borrowing can be obtained from the National Provident Fund.

Government revenue is estimated at over 24 percent of GDP, lower than the unusually high level of 1983, but 1 percentage point higher than in 1980-82. Income tax collections will increase, despite lower personal incomes and smaller company tax payments because of reduced 1983 profits, on account of the imposition of the temporary 5 percent surcharge. Customs and excise duty collections will increase because of higher duty rates and a further change in the composition of imports away from goods with a lower rate of duty including petroleum and capital equipment. Nontax revenue should be maintained, despite lower profit transfers from the public enterprise sector, mainly because of higher payments for the United Nations peace-keeping force.

Government current expenditure is estimated at less than 23 percent of GDP, thus reversing the recent upward trend in the ratio. Apart from the large increase in interest payments on domestic and external debt, the growth in other categories of expenditure will be 2 percent. The allocation for wages and salaries, which accounts for more than half

of total current expenditure, allows only for small merit and seniority increases. However, as explained in Section 4 below, the potential for increased expenditure on wages and salaries is large.

Government capital expenditure is budgeted to increase by 19 percent. New projects are concentrated in employment creation for drought-affected areas and in tourism, agriculture, fishing, and forestry which offer the best prospects of strengthening the external payments position in the medium term. The composition of capital expenditure has been scrutinized to secure close accord with the Government's development objectives, but the authorities acknowledged that the level of desired spending might prove too ambitious in relation to available resources. Grants and net lending to the public enterprises are greatly increased, including special assistance for the sugar corporation, equity participation in the pine-processing complex, and a rationalization of the fishing corporation (Table 4). Apart from the higher profitability of the electricity authority because of a 5 percent tariff increase and lower generation costs, no improvement in the trading performance of the enterprises is in prospect. A public enterprise unit will be established within the Ministry of Finance in 1984 to help in the future allocation of budgetary resources. If the crop is of normal size, the sugar corporation's profitability would be restored in 1985.

3. Monetary and credit policy

At the beginning of the year, it was considered that growth of broad money of about 8 percent in 1983, about the same as the expected growth in nominal GDP, would be appropriate. In March, to help cyclone reconstruction, commercial banks were permitted to increase loans and advances from 65 percent to 75 percent of deposits. At mid-year, while the liquidity position of the commercial banks was unusually strong, the authorities did not tighten monetary policy because private sector activity remained weak. However, at the time of the discussions, following the sharp acceleration in credit to the private sector in the third quarter, the authorities were considering steps to absorb the excess liquidity in the economy to ease pressures on the balance of payments. In October, commercial banks were asked to limit credit to nonpriority areas and in November, the minimum lending rate of the Central Monetary Authority, which is the rate applied for the rediscounting of securities by commercial banks, was increased by 1 percentage point to 10.5 percent. Most bank lending rates and deposit rates for more than six months' maturity are positive in real terms, except for interest rates on savings and short-term bank deposits, which have risen since late 1981 by less than the deregulated rates on large long-term deposits.

The staff team suggested that the liquidity needs of the economy could be adequately met with a modest increase in broad money in 1984, particularly in view of the reduction in the velocity of circulation that occurred in 1983. The authorities had not drawn up a firm monetary program at the time of the discussions but indicated, as a possible target, an increase in broad money of no more than 8 percent. Achievement

Table 4. Fiji: Major Public Enterprises Finances, 1980-84

(In millions of Fiji dollars)

	1980	1981	1982	1983 Estimate	1984 Projection
Operating profit and loss					
Air Pacific	-4.1	-4.5	-5.0	-5.0	-5.0
Civil Aviation Authority	0.3	0.2	-0.4	0.3	0.3
Fiji Electricity Authority	-0.8	0.6	1.1	1.5	3.8
Fiji Pine Commission	-0.2	-0.3	-0.1	0.1	0.3
Fiji Sugar Corporation <u>1/</u>	10.2	3.5	2.4	-3.0	-3.0
Housing Authority	-0.9	-1.1	-1.2	-1.3	-1.1
Ika Corporation <u>2/</u>	-0.2	-0.2	-0.6	-1.1	-0.9
Ports Authority of Fiji	<u>2.2</u>	<u>1.4</u>	<u>1.2</u>	<u>1.1</u>	<u>0.9</u>
Total	6.5	-0.4	-2.6	-7.4	-4.7
Government grants and transfers					
Air Pacific	--	--	--	2.9	2.0
Civil Aviation Authority	1.3	1.6	1.8	2.0	2.8
Fiji Electricity Authority	8.2	10.1	10.7	6.4	5.1
Fiji Pine Commission	3.8	4.2	4.2	5.6	8.6
Fiji Sugar Corporation	--	--	--	--	2.0
Housing Authority	2.1	1.0	1.0	1.0	1.0
Ika Corporation	0.3	0.2	0.8	0.8	3.0
Ports Authority of Fiji	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>
Total	15.7	17.1	18.5	18.7	22.7

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

1/ Financial years ending March 31 of the subsequent year.

2/ Engaged in fishing; financial years ending June 30.

of this target would depend on a marked deceleration in the rate of growth of domestic credit. The authorities expected that bank financing of the budget would be reduced and that demand for credit from the public enterprises would be lower because of increased budgetary transfers. The authorities indicated that action to limit private sector credit demand would be taken if this appeared necessary in order to discourage imports.

4. Wage policy

Movements in nominal wages in recent years have been closely in line with the annual guidelines issued by the Tripartite Forum, which comprises representatives of the Government, trade unions, and employers. The recommendations are usually applied automatically throughout the unionized sector, which includes all public sector workers and most private sector employees in manufacturing, construction, banking, finance, and insurance. The guidelines are followed by the wages councils which influence rates in much of the nonunionized sector. Although negotiators receive a detailed briefing on the state of the economy, the most important influence on the Forum discussions has always proved to be the rate of increase in consumer prices during the preceding year. As a result, the fast growth in real wages, which characterized the period 1973-76 prior to the establishment of the Forum, has been slowed substantially. However, despite the considerable benefits that have accrued from the present system, real wage increases have been higher than warranted by the underlying economic situation. The Forum has not provided a mechanism for spreading throughout the economy the impact of exogenous factors, including falling export prices, cyclones, and the drought, that have curbed incomes in the export sector. Moreover, wage earners have been persistently compensated for rises in import prices.

In early 1983, at the request of the Government, the Forum examined the possibility of a wage freeze, but trade union support for the proposal did not materialize. The guideline finally agreed upon was an increase of 6 percent, with smaller rises for higher paid employees. The maximum increase was awarded in the private sector to virtually all employees in order to preserve differentials. Increases in the non-unionized sector were generally smaller, reflecting the weakness of the labor market. The guideline was not implemented in the public sector during October as is customary.

The issues of wage and salary adjustments in the public sector are complex. In addition to the application of the Forum recommendation of a 6 percent increase, broader questions on the wage and salary structure have been put to an arbitrator. His award, which is expected soon, could result in additional increases in rates averaging about 10 percent. Furthermore, an understanding had been reached in 1982 between the Government and the unions that the award would be backdated. At the time of the discussions, the authorities believed that a new understanding could be reached with the unions on wage restraint in the public sector. In the event that pressures remained excessive, the Government would consider the imposition of a wage freeze for up to

two years in order to safeguard the fiscal and external payments position. The Minister of Finance possesses the authority, under the 1973 Counter Inflation Act, to issue an order controlling wages throughout the economy for an indefinite period. Without decisive action, cutbacks in public sector employment might become inevitable to preserve appropriate fiscal discipline.

5. Exchange rate policy

The authorities maintain a relatively stable real effective exchange rate by using a trade and tourism-weighted basket of the currencies of Fiji's five main trading partners and taking into account relative consumer price movements. The real effective exchange index has been kept broadly unchanged by making small, discrete adjustments against the basket since 1980. However, because of the weakening of world market prices, the competitiveness of the export sector has come under pressure. The authorities have not attempted to use exchange rate policy to influence the distribution of income between the traded goods and the nontraded goods sectors arising from adverse movements in the external terms of trade and the increase in real wages. The staff team emphasized that, particularly in view of the moderation of inflation in Fiji's trading partners, more flexible use of the exchange rate, combined with a change in institutional arrangements for wage determination so that higher import prices are not reflected in wage increases, could bring about the desired shift of income to the export sector and generate a supply response that would strengthen the balance of payments.

6. Medium-term prospects

The medium-term balance of payments outlook is less promising than during the 1970s. In particular, no further expansion of the sugar industry is planned soon because of the lack of easily cultivated land, and progress in import substitution is hindered by relatively high wage rates and the small domestic market. Although Fiji has access to the international capital market, a cautious posture is needed to keep the debt burden manageable. Outstanding external debt has reached the equivalent of 35 percent of GDP and external debt service is projected to rise to 14 percent of exports of goods and services in 1984. The sharp growth in the ratio from 6 percent in 1979 reflects in part increased interest and amortization payments on commercial borrowing. The authorities recognized that commercial borrowing on the scale envisaged for 1984 could not be prolonged and that, in later years, even though normal weather would result in much larger sugar crops, substantial further adjustment measures will be required. In the second half of the decade, potential exists for export diversification into timber processing and fish products and import substitution of rice and some industrial products. Several promising projects, for which external concessional assistance is available, are expected to commence shortly. Delay in exploiting these opportunities could necessitate the implementation of unduly restrictive demand management policies in order to strengthen the balance of payments and avoid excessive commercial

borrowing. With a successful policy to diversify and increase output of internationally competitive traded goods, the staff believed that the external current account deficit could be restored to a sustainable level of about 3 percent of GDP in 1985-88 consistent with achieving a satisfactory rate of growth of output and employment (Table 5).

IV. Staff Appraisal

Throughout the 1970s, the economy of Fiji experienced satisfactory growth with external balance. Fiscal, monetary, and wage policies were generally conducive to development without endangering internal and external stability. In 1980-82, when the rate of economic growth slackened, financial policies became more expansionary. The central government budget deficit widened because of sluggish revenue growth and increased expenditure, particularly on wages and salaries, and the profitability of public enterprises deteriorated. With the increased financing requirement of the public sector, domestic credit expansion was rapid. Although the rate of price increase slowed, expansionary policies stimulated imports at a time when export receipts declined markedly. The resulting increase in the external current account deficit was financed by commercial borrowing and a drawdown of reserves.

In 1983, economic activity, beset by cyclones and drought, declined sharply. The sugar and tourism sectors, which earn about two thirds of external current receipts, were particularly affected. However, pressures on the balance of payments were moderated because of the large sugar stocks at the end of 1982 and extraordinary inflows of insurance proceeds and emergency external grant assistance during the year. Reduced external borrowing by the Government and a weakening of the finances of the public enterprises contributed to a strong growth in credit to the public sector. An acceleration in credit to the private sector also occurred in the second half of the year.

Recent monetary developments are likely to put pressure on the balance of payments in the coming months. Moreover, although tourism should experience renewed growth, the continuing drought and depletion of stocks will curtail the export of sugar in 1984. Without policy adjustment, the external current account deficit would increase to an unsustainable level.

The 1984 budget contains some adjustment measures in response to the difficult external situation. Revenue measures equivalent to 2 percent of GDP are substantially larger than in any other recent year and the proposed restraint on current expenditure is severe. Nevertheless, the budget deficit is projected to increase in relation to GDP, the ratio of current expenditure to GDP remains high, and the financial position of public enterprises will continue to be difficult. Fiscal policy could become substantially more expansionary because, at present,

Table 5. Fiji: Medium-Term External Debt Profile, 1982-88

(In millions of SDRs)

	1982	1983	1984	1985	1986	1987	1988
External current deficit (As percent of GDP)	76 (6.8)	55 (5.2)	65 (5.5)	40 (3.0)	40 (2.8)	40 (2.7)	40 (2.5)
Gross capital receipts	100	70	92	76	78	78	79
Public	51	49	67	51	53	53	54
Project finance	(44)	(44)	(30)	(40)	(40)	(40)	(40)
Commercial loans ^{1/}	(7)	(5)	(37)	(11)	(13)	(13)	(14)
Private	36	27	25	25	25	25	25
Direct investment	(15)	(15)	(15)	(15)	(15)	(15)	(15)
Loans	(21)	(12)	(10)	(10)	(10)	(10)	(10)
Use of Fund credit	13	--	--	--	--	--	--
Debt service on debt contracted prior to 1984	40	49	58	64	63	54	53
Principal	15	20	27	36	38	33	34
Interest	25	29	31	28	25	21	19
Debt service on debt contracted in 1984 and after	--	--	2	11	14	22	24
Principal	--	--	--	--	--	5	5
Interest	--	--	2	11	14	17	19
Total debt service	40	49	60	75	77	76	77
Principal	15	20	27	36	38	38	39
Interest	25	29	33	39	39	38	38
Exports of goods and services	442	448	436	500	535	572	613
Debt service ratio	9.0	10.9	13.8	15.0	14.4	13.3	12.6

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

^{1/} It is assumed that commercial loans have ten years maturity with a four year grace period. Interest rates, based on LIBOR are assumed to decline gradually from 10.5 percent in 1984 to 8.5 percent in 1988.

the budget assumes an unchanged rate of compensation which is unlikely to be fulfilled. If wage increases are granted, further fiscal restraint will be necessary to prevent an increased budget deficit and added pressure on the balance of payments.

The recent increase in the Central Monetary Authority's minimum lending rate is a welcome step toward a more restrictive monetary policy, but taken alone is not likely to prove sufficient. Most bank lending and time deposit rates are positive in real terms, but rates on savings and short-term time deposits could be increased to encourage small savers. Also, to reduce the growth of domestic credit to a rate consistent with the requirements of the external situation, bank borrowing by the public sector should be more tightly constrained. In addition, restrictive guidelines for commercial bank lending or further increases in interest rates are needed to slow the growth of credit to the private sector.

Restrictive financial policies must be supported by an incomes policy that gives appropriate weight to enhancing the competitiveness of the traded goods sector, and particularly of export production and tourism. The wage guidelines issued in recent years have not taken sufficient account of the loss in national income caused by the deterioration in the terms of trade. The authorities should aim for a reduction in real wages which is needed to promote a resumption of faster growth and improved employment opportunities, if further weakness in the balance of payments is to be avoided. Institutional arrangements for wage determination should be modified to give greater weight to external developments. This step, together with the implementation of a more flexible exchange rate policy, could prove an effective combination to achieve the desired degree of adjustment in costs and relative prices of tradeable and nontradeable goods and thereby contribute to the needed strengthening of the balance of payments.

Fiji has traditionally maintained economic and financial policies that have facilitated growth within an open economic system consistent with domestic and external stability. Although the stock of external debt has risen substantially in relation to GDP, the burden of its servicing has not been excessive. But grounds for concern exist regarding the level of external commercial borrowing envisaged for 1984. The staff believes that adequate and timely adjustments of fiscal, monetary, and incomes policy, together with greater flexibility in exchange rate policy, would enable Fiji to avoid undue dependence on external borrowing.

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

FIJIBasic Data

Area	18,333 square kilometers				
Population (1982)	658,000				
Population growth (1979-82)	1.9 percent per annum				
GDP per capita (1982)	SDR 1,700				
	1980	1981	1982	1983 Est.	1984 Proj.
<u>Demand and supply</u>	<u>(In millions of Fiji dollars)</u>				
GDP at current market prices	989	1,088	1,155	1,155	1,266
GDP at 1977 factor cost	679	710	702	654	674
Real GDP growth rate (in percent)	-1.6	4.6	-1.2	-6.8	3.0
Sugar production (in '000 tonnes)	396	470	487	272	300
Tourist arrivals (in '000)	190	190	203	193	209
<u>Investment and savings</u>	<u>(In percent of GDP)</u>				
Gross investment	31.1	32.2	25.4	23.7	22.5
Gross domestic savings	26.2	18.4	19.6	18.1	17.5
<u>Employment, prices and wages</u>	<u>(Percentage change)</u>				
Paid employment	-0.1	0.9	2.6	-0.6	-1.5
GDP deflator	16.1	5.5	8.2	6.5	6.0
Consumer prices	14.5	11.2	7.0	6.8	6.5
Tripartite Forum wage guideline	9.0	11.0	10.0	6.0	...
Terms of trade	12.8	-18.0	-16.5	2.1	5.0
<u>Central government budget</u>	<u>(In percent of GDP)</u>				
Revenue and grants	22.8	24.2	23.0	25.0	24.4
Expenditure and net lending	25.6	28.2	29.3	29.2	29.2
Overall deficit	2.8	4.0	6.3	4.2	4.8
External financing	2.4	2.3	1.5	0.4	0.5
Domestic financing	0.4	1.7	4.8	3.8	4.3
Of which: Banking system	-0.8	-0.1	1.6	1.0	0.4
<u>Money and credit</u>	<u>(Percentage change)</u>				
Domestic credit	3.3	20.7	19.4	17.4	9.5
Public sector	-23.8	7.7	91.3	38.6	14.0
Private sector	12.4	23.6	5.6	9.8	7.5
Broad money	12.1	6.3	8.5	15.2	8.0

Fund Relations with Fiji

Date of membership:	May 28, 1971
Status:	Article VIII
Quota:	SDR 27 million
Proposed quota:	SDR 36.5 million
Fund holdings of Fiji dollars: (November 30, 1983)	SDR 35.1 million or 130.0 percent of quota. On February 3, 1982 Fiji purchased the equivalent of SDR 13.5 million, or 50 percent of quota, under the CFF in respect of an export shortfall for the 12-month period ending March 1982.
SDR position: (November 30, 1983)	Present holdings are SDR 2.7 million or 38.6 percent of net cumulative allocations of SDR 7.0 million.
Direct distribution of profits from gold sales:	US\$2.1 million
Gold distribution:	11,126 ounces
Exchange rate system:	Representative rate under Rule 0-2(b) is determined by the mid-point between the Central Monetary Authority's buying and selling rates for the U.S. dollar. In late November 1983, the representative rate was F\$1 = US\$0.9647. Since April 1975, the exchange rate has been determined daily on the basis of a weighted basket of currencies of Fiji's major trading partners.
Technical assistance:	CBD has a panel expert as Research Manager of the Central Monetary Authority. FAD completed a review of the tax system in August 1983 and has a panel expert advising on the computerization of income tax collection. LEG is assisting in the redrafting of income tax legislation.
Last Article IV consultation:	January 24, 1983 (EBM/83/31). Staff discussions were held during October 18-29, 1982 (SM/82/242).

Financial Relations of the World Bank
Group with Fiji 1/

(In millions of U.S. dollars)

<u>Sectors</u>	<u>Loans 2/</u>	<u>Of which: Undisbursed</u>
Sugar	12.0	1.0
Power and energy	30.5	12.6
Cyclone reconstruction	18.0	5.1
Other	23.2	--
Total	83.7	6.2
Debt outstanding (including undisbursed)	69.0	
Commitments for FY 1984	--	
Technical assistance:	None	
Recent report:	Issues and Options in the Energy Sector (Number 4462- FIJ), June 1983.	

1/ Fiji is not eligible for the IDA loans.

2/ As of September 30, 1983.

