Fiji in its three decades of independence has experienced two changes in government. The first of these led to the coups of 1987 when the military ousted the Labour government. The second coup of the same year brought into force a racially biased constitution that discriminated against the immigrant population, the bulk of whom were third to fourth generation descendants of Indian indentured labourers brought to Fiji a century ago by the then colonial power, the United Kingdom.

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Given the infrequency of change in governments in Fiji and the ethnic polarisation that takes place at elections, the immediate period of change in government is always tense and requires delicate management. The current regime with the first non-indigenous Prime Minister exposes the country to greater potential political instability. This was particularly so at the point of transfer of power between regimes and the period immediately following. The smooth transition that took place from the old to the new regime is a credit to the maturity of the people of Fiji and their political process. The President, the former Prime Minister and the current Prime Minister all played important roles in ensuring a smooth transition. The Labour party took an important step in the process immediately after realising the win and before taking office by consolidating its power bases. However, this has meant increased budgetary outlays in the immediate term.

This paper considers the policy shifts made by the new government since taking office. The rationale for these shifts in policy and their economic consequences are discussed. Given the several promises made by the incoming government, there seems to be a strong need for the government to deliver on at least a sub-set of these promises. Budgetary constraints will make it extremely difficult for the government to deliver on all of its election promises. The economic success of the government within its five-year term will be crucial to its ability to deliver on several of its election commitments. Success in reviving the economy is necessary though not sufficient to reducing poverty and attaining fiscal balance—economic growth under competitive conditions is required to bring about the ‘trickle-down’ effect.
Success on these two fronts would contribute strongly to the democratic process and racial harmony in the country.

**Policy changes**

**Reversal of airport workers’ retrenchment**

Immediately after realising that they had won the majority of the seats in Parliament, the then Labour party general secretary and now the Prime Minister visited airport workers sacked due to the restructuring by the former government to assure them of their jobs. This was done despite widespread recognition of the inefficiencies in the management of the Fiji’s airports. The gesture by the prospective government of the day was in order to consolidate its power base, the workers of the country. This move was a signal to workers in other statutory bodies and the civil service that their jobs were secure under the incoming administration.

**Debt forgiveness for sugar-cane farmers**

Immediately after taking office, the Prime Minister announced that the debt incurred by sugarcane farmers to rehabilitate their crops devastated by the long droughts of the previous year were forgiven. This gesture, costing around F$30 million, had a high pay-off given the support it drew from farmers. Once again, the Prime Minister drew public accolades for the gesture. The financial outlay made to obtain this support may have been another deciding factor in the acceptance of the new government and a non-indigenous Prime Minister by the indigenous community.

**VAT with new exclusions**

The incoming administration has indicated that it will remove the value-added tax of 10 per cent on all essential items, including outlays on food, health, and education. The revenue impact of this gesture on the budget is yet to be estimated. Newspaper reports quote figures ranging from F$30–100 million in lost revenue. Fiji’s GDP of F$2.5 billion suggests a maximum figure for VAT of F$250 million; with the food and export exemptions, the new figure should be around F$60 million with exports around half of GDP. Besides the loss of revenue, there are several problems associated with the VAT exemption for some categories. Compliance assurance will be a challenge since there will be strong incentives for business and consumers to switch sales into the non-VAT category. A further social cost will be the loss in economic efficiency as a result of the price distortion due to some goods being taxed and others not.

The exclusion of the basic necessities of life from VAT in order to help the poor is laudable but this consideration could have been better delivered through direct subsidies. The current proposal will not only help the poor but all of the population including those who could easily afford to pay the tax. A subsidy to the poor via the social security system could have delivered the benefit to the poor in a much more targeted manner.

**Budget position**

The commitment of the government to increased outlays on social and physical infrastructure is important as these investments are necessary for long-term growth of the country. The challenge will be to finance these outlays. Budget deficits have been high in the recent past and debt levels as a consequence are around 50 per cent of GDP. The reduction in tax receipts from the proposed changes to VAT, unless more than offset by other revenue-raising measures, will have a detrimental impact on the deficit. There is little room for the government to increase the budget deficits. It will, therefore, be a fine balancing act to
deliver on the election promises while maintaining the deficit in check. At some stage the government will need to distinguish between the promises it will deliver on in the near term and those it will have to postpone.

**New minimum wage proposal**

The government has made promises to the effect that a new minimum wages at F$120 per week would be brought in. This is approximately twice the average wage rate in the garment sector. The increased minimum wage has been suggested as a means of reducing poverty in the country. If enforced, this policy is likely to reduce employment and hamper growth of exports. Higher wages have to be underwritten by higher productivity. Improvements in living standards cannot be introduced by legislation.

Poverty reduction is to be pursued via raising employment opportunities. This strategy of increasing employment to reduce poverty has strong merit, but a minimum wage guideline is unlikely to bring about any increase in employment opportunities for workers. In fact, the impact of the minimum wage guideline may be the complete opposite. On the other hand, a flexible wage rate will encourage domestic investment; this, in turn, should create the jobs that the country desperately needs.

The government has made strong gestures towards revoking work permits of expatriates. As of May 1999 there were 4,342 expatriate workers in the country. Of these, 1,275 were engaged in the garment industry. The Fiji Trade Union Congress points out that these workers were employed ahead of local workers because of their willingness to work longer hours and at lower wage rates. The suggestion was that, in the process, local workers missed out on employment opportunities. This may be true, but revoking work permits of expatriate workers in not likely to solve the problem. The unavailability of expatriate workers—especially those with specific skills—will reduce production and skill transfer to the local workforce, and employment opportunities could fall as a consequence. The position taken by the labour unions on this issue is understandable since it would confer rents to their members. However, the government should have the welfare of the nation at large in mind; the majority of people, and the unemployed in particular, do not belong to unions and therefore will pay a price for this policy.

Exporters such as the garment manufacturers face world prices for their products. These prices are not affected by the quantity of local output due to the standard small-country assumption. The unavailability of workers at competitive wage rates will have a detrimental impact on exports and employment. Unless these exporters are making super-normal profits, they will be unable to support the higher labour costs over any extended period. Hence, disallowing expatriate 'cheap' workers from entering the country has the potential to have different consequences from those desired by the government in implementing this policy.

Furthermore, developing economy experience suggests that foreign workers are complementary to local employment, hence a restriction on expatriate workers could well reduce employment. The publicity surrounding the foreign worker issue is a negative signal to investment, particularly by foreign companies. In sum, the decision to restrict foreign workers has strong potential to have adverse consequences on employment, production, poverty reduction, and exports.

The only certain means of raising employment and wages simultaneously is through improvements in labour productivity. Such improvements will raise wages while reducing the effective cost of
labour. This, in turn, will raise employment, output, and exports and, in the process, reduce poverty. There is sufficient literature on ways of raising labour productivity. Some of these means include getting the incentives for productivity improvements right, improving the work culture, raising capital intensity, providing social and physical infrastructure to enable shift work, and raising the human capital of the population.

Workers need to be trained better for the tasks in demand in the labour market. Such training can be undertaken best through a partnership between the public and the private sectors. An improvement in the skill content of locally available labour should allow domestic producers to graduate into higher value-added products. This is a long-term strategy that will enable wages to rise and allow the economy to graduate to the next stage of the value-adding chain in the production process. Keeping wages free of policy-induced distortions should provide the appropriate signals for workers to invest in those skills in demand.

**Interest rates**

The government has instructed the Housing Authority to lower its interest rate from 11.2 per cent to 6 per cent. The interest rate reduction is to be achieved without the provision of a government subsidy. This directive is given with the presumption that it should be possible given similar rates abroad. Should Housing Authority be able to comply with this request, it would be a serious indictment on the performance of the previous managers of this lending institution. Given that average lending rates are around nine per cent, the lower rate of 6 per cent charged by the Housing Authority should create an excess demand for credit from the Authority. Should this be the case, some type of rationing of credit by the Authority would be necessary.

There are strong economic justifications why interest-rate parity does not hold across jurisdictions. It may, therefore, be too optimistic to expect interest rates in Fiji to equal those in industrial countries. The disparity in interest rates between countries is due to a combination of sovereign risk of capital invested in the country and the exchange rate risks of the domestic currency. It would be naïve to assume that these risks are absent in Fiji.

**Public sector reforms**

The government has halted the reforms in the public sector. Fiji Water was given the mandate of fully recovering costs of water supply by the former government. The incoming government has stopped Fiji Water from registering as a corporation. The government has made a commitment that citizens should have access to clean water at affordable costs. This is another questionable gesture; as a consequence, the pressure on the budget would be increased. More importantly, this gesture signals that all other proposed reforms of public enterprises can be reversed. The signal on the possibility of reversal of reforms will induce increased lobby-group pressure against all reforms. The adverse budgetary effects of such a move could be significant.

The government has made these gestures to strengthen its support in the electorate and gain legitimacy for its ‘concern’ for the citizens. Such goodwill should be used to obtain agreement from the other parties on efficiency improvements in all public enterprises. Performance indicators and conditions of no further budgetary support should be agreed to with the management of these enterprises. The managers and workers of public enterprises should also be given the flexibility to improve performance of their enterprises.
Attracting investment for growth

At the core of the challenge to raise economic growth and employment opportunities as a means of resolving several of Fiji’s current problems lies the need to increase investment. The economic environment has to be made much more conducive for investment. The inhibiting factors facing investment include exchange rate risk, insecurity of property rights, lack of adequate physical and social infrastructure, and lack of skills within the workforce. All of these factors cannot be attended to simultaneously and in full due to budgetary constraints. Some thought will have to be given to prioritise among them. Investors can provide the best indicator on where maximal returns exist for the invested public dollar.

Diagnostics and challenges for policymakers

The exchange rate, public debt levels, and the inflation rate will all need to be effectively managed to provide the macroeconomic settings to induce private sector investment and employment creation. Moreover, the private sector should be seen as taking the lead role in economic development while the public sector concentrates on the funding of public infrastructure and attending to social needs. Note, however, that even the social provisions do not have to be provided by the public sector; they may be funded publicly but provided by the private sector. Efficiency considerations should drive decisions on who should engage in the production of specific commodities and services.

Fiji’s GDP is likely to recover this year given the projection for a bumper sugarcane crop due to favourable weather conditions, a pick-up in gold production, and healthy growth in tourist arrivals. The real exchange rate will have to be kept at a competitive level to retain competitiveness of exports. This implies ensuring that domestic inflation does not exceed that of Fiji’s trading partners. A growing economy raises output, employment, and tax receipts; all of these would directly contribute to enabling the government deliver on its election promises.

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foreign investment. In such an environment, minimising sovereign and exchange rate risks can minimise the gap between domestic and foreign interest rates. The exchange rate risk can be eliminated through a currency board arrangement, but in this case interest rates are endogenously determined. The alternative of a flexible exchange rate enables the targeting of interest rates; and exchange rate determination becomes endogenous. The current regime of a pegged exchange rate regime will continue to have an associated exchange rate risk, given the possibility of devaluation. Domestic interest rates are also difficult to manage in such an environment.

Recent speculation about an impending devaluation is a significant risk since such speculation has the potential to become a self-fulfilling prophecy. The recent financial crisis in East Asia has taught us the lesson that no amount of foreign exchange reserves is sufficient to prevent an attack on a pegged currency. The only insurance against such speculative attacks are a transparent exchange rate determination process coupled with responsible fiscal management.

Changes in stocks

National debt at 51.3 per cent of GDP is high by developing country standards. Some 75 per cent of this debt are owed by the national government; statutory authorities owe the remainder. However, the government bears the contingent liability for the repayment on debt of statutory authorities and any associated currency and interest rate risks. The current low interest rate environment has kept the budgetary pressures of servicing this debt manageable. This will not be the case if interest rates increase. Fortunately, around 70 per cent of this debt is owed in local currency; which means the exchange rate risk faced by the state is not large. However, the government has to consider strategies to reduce the high debt burden.

As of 25 June 1999, foreign reserves were F$773 million, sufficient to cover four and one-half months of imports. This quantity of reserves is adequate to finance any short-term shortfalls on the current account, but no amount of reserves can be sufficient insurance against an attack on the fixed exchange rate. The Central Bank has to make credible announcements of the stability of the exchange rate. Instilling some transparency in exchange rate determination will help against such speculation.

The area of land used in agricultural activities and the intensity of use are likely to fall due to recent adverse weather conditions and the insecurity of tenure. Disputes over the renewal of leases will reduce investment in land improvement and improved management practices. There is a need to provide certainty such that land under cultivation is at least preserved if not enhanced in quality and further investments are made in bringing good agricultural land under cultivation. Combined with the above, there needs to be a strategy of diversifying production away from agriculture such that the dependence on land is reduced. Such diversification will ease the pressure on use of marginal land for agricultural purposes as well as reduce tensions between tenants and landowners.

Conclusions

The transition from the old to the new government has been smooth. The President and subsequently the former Prime Minister encouraged the population to accept the verdict of the voters and allow the new administration a chance to govern. This delicate process was exceptionally well managed and credit is due to all involved in the transition process.
The challenges in the medium to long-term are to place the economy on a higher growth path by raising investor confidence and productivity of resources. The two concessions made to airport workers and farmers need to be used to enlist their support for the desperately needed restructuring in both of these industries. This has as yet to happen. Such an initiative has the potential to deliver gains to both the government and to the people as a whole. The right signals would be generated in the process for further and much-needed reforms in the rest of the economy.

All new governments have a honeymoon period; Fiji’s coalition government is no exception. In the medium to long-term and definitely within this election cycle, the new administration will have to achieve faster economic growth. Only then will several of the election promises materialise. The major challenges are to increase output and employment and reduce poverty. This calls for a well thought-out and well articulated strategy. A new budget provides the government with this opportunity.

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