7. Swim or sink: The post-coup economy in limbo

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A snapshot of the economy post-coup

The interim finance minister, Mahendra Chaudhry, in launching the revised budget for 2007, stated that the economy was in a 'sink or swim' situation, but that he was determined to swim out of the turbulence that followed the military coup of December 2006. As of mid-2007, the state of the economy could have been described as being in limbo, and a year later things were hardly better. Fiji's coups have been costly. Each coup has pushed back the economy some three years in terms of per capita income. More importantly, all of the four past coups have contributed to the erosion of governance and thus weighed heavily on the rate of growth of the economy. It is the immobile factors of production – land and unskilled labour – that have borne the brunt of the costs of economic contractions resulting from each of the past coups. Rising poverty is one symptom.

In its review of the economy in February 2007, the Reserve Bank of Fiji (RBF) announced that some 3,000 jobs had been lost since the coup due to the (possibly unrelated) closure of the Vatukoula gold mine, and to the slump in the tourism industry. The RBF's forecasts of contraction in Gross Domestic Product (GDP) became more pessimistic as time passed: First it predicted a contraction of 2.5 per cent; by October 2007 it was saying 3.9 per cent. In the end, GDP shrank by 6.6 per cent during 2007.[1] The effects of the economic contraction were evident in job losses, shrinking foreign exchange reserves, and pressure on the exchange rate. The RBF put in place stringent capital controls to protect reserves. The inflation rate, however, rose to some 6 per cent by mid-2007, nearly double the target rate of 3.5 per cent, and, by March 2008, inflation was running at a ten-year high of 7.5 per cent. Government revenues were put under pressure, although the government held the budget deficit to 1.3 per cent of GDP in 2007 by cutting public servants' salaries and suspending wage increases. When nurses and teachers went on strike in August 2007, Bainimarama reflected on the advantages of being an unelected government: 'We do not have to worry about votes', he said. 'This Government is not going to budge.'[2]

The immediate challenges facing the administration were those of maintaining foreign reserves at adequate levels and containing public debt to manageable levels. There is little escape from the fact that the economy had been hit hard by the coup. Exports are down, investments are on hold, and jobs are being lost.

Tourism holds the best prospects for an economic revival, but this requires the lifting of travel restrictions and a return to normalcy in diplomatic relations between the major source destinations, Australia, New Zealand, and the USA.

Contrary to the claims of the interim minister of finance, the prospects of a complete revival of the sugar industry are poor – and those for garment exports just as rickety. International conditions for both of these exports have worsened, with the price premium earned by local producers from trade preferences in their main markets on the ebb. Total garment export earnings grew in 2007 by a mere 0.3 per cent, and the outlook remains uncertain. Before the coup, garment and sugar producers were already facing severe adjustment costs as a result of the changing international conditions; their main hopes rested with growth in the rest of the economy and adjustment assistance from the donors and the government. The coup has put all of these hopes at risk.

Overall, the economy is declining, and the worsening external and internal imbalances make an economic revival all the more urgent. Such a revival requires the rebuilding of investor confidence and the removal of the many conflicting policies that have been adopted by previous governments. A determined administration could succeed where past governments have failed. Clearly, the coup culture has to be eradicated if prosperity is to have a chance. Will this coup be the 'mother of all coups', eradicating coups from Fiji's landscape forever? Or will it add to the momentum of more coups in future? Only time will tell.

The economic impacts of the coups

Fiji has had four military coups in its 37-year post-independence history. Each coup had its own drivers, but a reason given for the first three was to return political leadership to the indigenous peoples. The two coups of 1987 and that of 2000 displaced governments that were allegedly dominated by ethnic Indians. Thus, the coups were condoned by the chiefs in their role as the representatives of the indigenous population; by the Methodist Church, which has a majority indigenous following; and by the army, which is also predominantly indigenous. In each case, the overthrow of a constitutionally elected government had a deleterious impact on the economy and on private investment in particular. They all signalled that rule by the gun had superiority over rule through the ballot box, and consequently eroded the legitimacy of legislated constructs – such as the constitution and respect for institutions of civil society. The corrosive effects of the coups are visible in the form of deteriorating physical infrastructure and in spurts of violent crime in their immediate aftermath.

The first coup sanctioned income redistribution to the indigenous population; albeit with the policies supporting the redistribution often couched in terms of poverty reduction. However, these redistribution policies have lent themselves to abuse, particularly by the elite. The largest scam in Fiji's history – the National

Bank of Fiji financial disaster, which cost taxpayers some F$220 million – was undertaken under the guise of affirmative action. The beneficiaries of the scam were far from being poor Fijians; rather, the scam was a tax imposed on the poor for the benefit of the rich. Many more scams followed. According to one estimate, losses due to corruption and abuse of office in the decade to 2002 amounted to half a billion Fiji dollars.[3] Moreover, the abuses of office have extended well beyond corruption. Abuses of legal processes, such as the release of prisoners on compulsory supervision orders, have also followed. In sum, good governance has been a major, albeit a silent, victim of past coups.

Since, 2004, the Republic of Fiji Military Forces (RFMF) had been voicing its opposition to what it saw as abuses of office and, in the lead-up to the 2006 election, threatened a 'clean-up' should the elected government continue with the abuses. Dwindling foreign reserves, rising unemployment, and worsening poverty all pointed to a gloomy future. In hindsight, it is clear that something had to give. The coup by the RFMF was a surprise to many only because the commander had so often threatened the overthrow of the government.

At least in rhetoric, the coup of 2006 is significantly different from the previous coups. The interim prime minister, on taking office, committed his administration to:

- upholding the constitution;
- eradicating 'systematic' corruption;
- introducing code of conduct and freedom of information provisions;
- facilitating sustained growth of the economy;
- reducing poverty and levels of destitution in the nation;
- ensuring that a greater share of the benefits from use of natural resources, land included, flowed to the owners; and
- improving relations with the international community.

There was evidence of some improvement in law and order during 2007, not withstanding the disturbing allegations of human rights abuses (which raise questions regarding the commitment to uphold the constitution). In line with the second commitment, an anti-corruption agency was established. This is a marked improvement on past administrations, given that such action was first proposed in 1997 in a report commissioned by the then finance minister and produced by the former head of the Serious Fraud Unit of New Zealand. As of September 2007, there were media reports of raids on offices suspected of being engaged in corrupt dealings and evidence being gathered, but no successful prosecutions had materialized. Bringing such cases to court is a lengthy process, however.

In relation to the third commitment, code of conduct and freedom of information provisions are yet to be produced.

Progress on the final four commitments is difficult to evaluate for several reasons, including the fact that they are inter-twined and that any evidence of their progress is likely to become clear only slowly. As of June 2008, the economy was showing little signs of a rebound, foreign exchange reserves were recovering but still at low levels, poverty was continuing entrenched, and relations with the international community were far from being on the mend.

It is early days to pass judgment on whether the coup of 2006 will be the last or whether the RFMF elevates itself to a position whereby democracy will be allowed only with its blessing. However, the public will soon be in a position to judge progress on each of the developmental and governance commitments made by the interim prime minister. A favourable scenario for Fiji would demonstrate the quality of governance improving rapidly, successful prosecutions with respect to some high profile cases of abuse of office, private investment rebounding, the economy beginning to grow, and the levels of poverty and destitution beginning to recede. Such economic prosperity would encourage and facilitate peace, the rebuilding of institutions of civil society, and a jettisoning of the coup culture. A determined leader, and one who is not required to maintain popular support, could achieve the above. The experiences of Chile, Indonesia, South Korea, and Thailand under military rule demonstrate this. Converse scenarios are too frightening to contemplate as they could include simultaneous economic and political crises.

The macro-economy

According to RBF July 2008 figures, aggregate GDP contracted by 6.6 per cent in 2007 after having grown by 3.6 per cent in 2006.[4] Per capita GDP for the first 35 years after independence grew at an annual average rate of less than 1.4 per cent and contracted substantially in the years of coups – by 7 per cent in 1987 and by 2.7 per cent in 2000. In terms of growth collapses, the 1987 coup set Fiji back, in terms of per capita GDP, by six years. In comparative terms, the 2000 coup was less damaging as it set the country back in terms of per capita GDP by just two years. The 2006 coup was worse for the economy than that of 2000 and almost as destructive as that of 1987.

Assuming a population growth rate of one per cent, the per capita decline of GDP in 2007 will wipe off at least three years of economic progress. Thus, each of the past coups has wiped off, on average, three years of economic growth. The impact of the coups on poverty, however, may have been a lot larger than these average figures suggest. One in eight in the population was in poverty in 1977; this figure had risen to one in four by 1991 and to one in three by 2001.[5]

Poverty has been on the increase in Fiji and this trend is likely to continue. Real wages of unskilled workers fell by some 15 per cent over the decade to 2002.[6] The earnings of those fortunate enough to have work have often been insufficient

to fund the minimal basic needs of their households; they thus comprise the 'working poor'. The pool of the 'working poor' and that of the 'walking poor' has grown after each of the coups.[7] Households most at risk of being in poverty or of falling into poverty include the destitute – comprising single mothers, widows, the disabled, the elderly and the chronically ill, and family members of imprisoned breadwinners; those with casual work, often comprising the unskilled with earnings below the poverty line—agricultural workers, the bottom-rung garment factory employees, and security guards fall into this group; those in rural areas with limited access to basic health, education, and infrastructure services; and, the landless urban settlers.[8] The ranks of all of the above-mentioned categories have been swelling over the past decade.

Abbott notes that urban poverty was the highest amongst households living in settlements and housing authority areas. Furthermore, the population of settlements is expanding at an annual rate of 3.7 per cent; informal (*vakavanua*) settlements are growing at more than 5 per cent; and peri-urban areas in Nadi are reported to be growing at an annual rate of 11.2 per cent, in Savusavu at 12.8 per cent, Sigatoka at 9.1 per cent, and Ba at 8.4 per cent.[9] This trend is likely to continue as leases continue to expire; some 45 per cent of Indo-Fijian arrivals in the settlements since 2000 have been of those whose leases had expired. The concentration of poverty in the burgeoning settlements runs the risk of keeping asset-poor households in permanent poverty. Serious pockets of poverty have already developed amongst households within parts of urban settlements and in rural regions facing sharp declines in agricultural income.

The coups and the ensuing political instability have adversely affected investment. Gross Domestic Investment (GDI) peaked at 34 per cent of GDP in 1981, dropped to 12 per cent in 1988 (after the first two coups), and hovered around 13 per cent in 2000.[10] These falls took place despite the introduction of tax incentives for investments in exporting. Foreign Direct Investment (FDI), the form of investment most sensitive to political uncertainty, was negative in 1999 and 2000. The small turnaround in GDI after 2002 can be attributed to increased public sector investment and to the construction of several ('lumpy') private-sector investments in tourism (hotel) infrastructure. There is anecdotal evidence to suggest that the 2006 coup has stalled several investment projects; if so, the effects will be captured in the data some years down the track. The falls in investment following past coups have been accompanied by an exodus of skilled personnel; thus, the economy has suffered a 'double whammy' – the loss of financial and of human capital. Again, data are not yet available to show if the same thing has happened following the 2006 coup, but the Reserve Bank predicted that investment, having stalled in 2007, would 'remain subdued' in 2008.[11]

Fiscal policy

The interim minister for finance announced the theme of his 2007 'revised' budget as 'securing financial and economic stability'. While the minister did not define what he meant by these two terms, the first is interpreted as achieving fiscal sustainability, while the latter is interpreted as achieving internal and external balance. Priority was given to the former in the budget.

Securing financial stability entails reducing expenditure, raising income, and/or improving productivity of public outlays in order to contain any deterioration in access to public services. The minister warned that failing to contain the deficit would result in a devaluation of the Fiji dollar. While budget deficits and current account deficits have a close association, linking fiscal policy to the value of the Fiji dollar may have been a mistake, particularly when the risk of capital flight following the coup remains significant. The government achieved its deficit target in 2007 but this will be no guarantee against a devaluation of the currency. Ultimately, current account sustainability will hold sway in determining the value of the currency. The decision to devalue the currency will be driven by considerations of ensuring external balance.

Savings in the revised budget were achieved through a salary cut of 5 per cent for public servants. While this salary cut was lower than the 12.5 per cent and 15 per cent pay cuts following the coups of 2000 and 1987, respectively, public servants were also denied the 4 per cent cost of living adjustment previously agreed to with the ousted government. Total savings from this measure were estimated at F$70 million. Amongst the major revenue initiatives was an increase in the airport departure tax from F$25 to F$40; this was anticipated to raise an additional F$7.88 million. VAT was left at 12.5 per cent instead of being raised to the 15 per cent foreshadowed in the original budget brought down by the ousted government in November 2006. Government debt as of 2006 was estimated at 53 per cent of GDP.

While the motivations for containing public expenditure are clear, the impact of these initiatives on public sector productivity could be devastating. Salaries of public servants have barely kept pace with inflation since 1993.[12] Nurses with a diploma entering the public service at the beginning of 2007 earned 22 per cent more (in 1993 dollars) than they did in 1993 – an implied annual growth rate in their real (that is, inflation-adjusted) salary of 1.4 per cent. Nursing salaries, moreover, have hardly kept pace with inflation for the first six years of the new millennium. Compounding the low real income growth has been the high demand for nurses abroad; entry level salaries for registered nurses in Western Australia as of July 2006, for example, were some four times that of their counterparts in Fiji. These situations are expected to hold for the rest of the public service. Salary cuts for public servants, therefore, are likely to

adversely affect productivity – and lower productivity could be a justification for real wage reductions.

Efforts are being made to raise productivity within the public sector. For example, the number of ministries was reduced from 23 to 16, and a taskforce was established to consider strategies for improving efficiency and productivity of the public service.

Monetary policy

The conduct of monetary policy is the responsibility of the RBF. The bank targets price stability whilst attempting to ensure that an adequate supply of foreign exchange is maintained. Interest rates have been used to target the former while the value of the exchange rate and capital controls have been used to ensure that foreign reserves remain at healthy levels. Inflation for 2006 was recorded at 3 per cent, and had hovered around this figure since 2004; thus, on price stability, the RBF has had considerable success. However, its record in terms of maintaining a healthy stock of foreign reserves has not been as favourable. Fiji has traditionally maintained reserves sufficient for 6 months of merchandise import cover, but the level dropped steadily to 5.7 months of import cover in 2004 and to 3.3 months of import cover by December 2006. It had recovered, but only to 4.1 months, by April 2008.

Furthermore, the stock of foreign reserves as of December 2006 (F$823 million) included the proceeds from the bond issue of US$150 million in September 2006. The pressure on foreign exchange reserves was relieved by the ratcheting up of interest rates prior to the coup and the ratcheting up of capital controls since. The RBF has rationalized these interventions as being, 'necessary to ensure that reserves are safeguarded under the current circumstances'.[13] The economic decline following the last coup makes further interest rate tightening impractical.

The pressure on foreign reserves, however, predates the coup – which would only have exacerbated the problems. Both the nominal and the real (that is inflation-adjusted) exchange rates have appreciated since 2003.[14] The nominal exchange rate is a weighted average of five currencies; namely, the Australian, New Zealand, and United States dollars, the Euro, and the Japanese yen. The weights are not disclosed (but can be readily computed from the data), and thus may be altered as an instrument of policy. Since all of the currencies in the basket have appreciated against the US dollar over the recent past, the Fijian dollar has followed suit. This has reduced the competitiveness of exports and encouraged imports, the cumulative effect of which would be reflected in terms of pressure on the current account.[15]

There is some evidence of the Fiji dollar (FJD) being over-valued by at least 12 per cent as of 16 April 2007. This conclusion is gleaned from a simple comparison of the value of an investment in sovereign bonds vis-à-vis holding the same in

FJD at home. Despite this clear evidence of an over-valued FJD, the RBF has been reluctant to devalue the dollar. This reluctance is perhaps due to a fear of destabilizing the currency, particularly when the markets have been anticipating a devaluation. Capital controls are more effective during short bouts of uncertainty, such as following a coup, as demonstrated with earlier coups. On its own, devaluation could have induced a run on the currency, forcing the authorities to devalue the currency yet further, even if this was not necessary prior to the coup. But, these strategies work only in the short term because investors find alternate means of circumventing the capital controls, or consumers go on an import binge in the face of an imminent devaluation. However, the evidence of an over-valued exchange rate existed long before the coup of December 2006.

The RBF has vehemently defended its decision not to devalue the dollar, a decision supported by the interim minister for finance. Exports have not picked up, thus capital controls remain the only option for protecting foreign reserves. The RBF has recently been easing liquidity (whilst tightening capital controls in order to protect foreign reserves) in order to stimulate domestic investment. The RBF has been directing credit to investments and rationing the supply of foreign exchange in the hope of encouraging exports. Success on this front, however, has been less than encouraging. This can be concluded from the repeated warnings by the RBF regarding the falling export income and buoyant imports – and, thus, a widening current account deficit; but the RBF has yet to acknowledge that at least some of the blow-out in the current account may be of its own making.[16]

Employment conditions are likely to remain subdued until investment picks up. In the meanwhile, workers who have lost jobs and those with reduced hours of work are likely to face hardship. There is considerable anecdotal evidence of rising poverty, particularly within the urban informal settlements. In its February 2007 survey, the Fiji Employers Federation noted increased redundancies, reduced hours of work and temporary termination of work, all of which will increase in the absence of an economic rebound. Fiji has, since independence, witnessed an increase in the working-age population, particularly within the urban centres. Unless used, this demographic bonus could be a recipe for further social and economic problems.

Sectoral prospects

Garments

Prior to 1987, Fiji had a small garment sector, but exports took off after 1987.[17] The major drivers of this change were domestic, including the devaluation of the Fiji dollar by some 33 per cent in 1987; the offer of tax concessions and publicly subsidised infrastructure[18]; and, a wage freeze and restraints on labour

unions following the first coup. External conditions were also favourable; they included the preferences afforded via SPARTECA[19] , the introduction in 1991 of the Australian Import Credit Scheme, the high tariffs imposed in Australia on textiles, clothing and footwear (TCF) imports from sources outside the Pacific, and the Multi-fibre Arrangement (MFA) quotas provided to Fiji. What changed in 1987 were the domestic conditions; thus the growth of garment exports in 1987 and later must be attributed to these factors only.

What has changed since? On the domestic front, inflation has picked up, thus diminishing the real value of the dollar; wages, overall, have risen but without any evidence of a commensurate increase in productivity; and, the tax exemptions have expired. The Fiji dollar was devalued by a further 20 per cent in 1998, but without the wage restraints of the earlier era. We have had two more coups since, but without the export incentives offered earlier. Political instability has continued since 2000 and so has the emigration of the skilled workforce. The domestic situation has pushed local investment toward the acquisition of skills and qualifications for emigration, thus penalizing the growth of locally and internationally competitive industries. External conditions have also changed. China has entered the scene with its ability to mass-produce garments at a fraction of the cost of its nearest competitors. The MFA expired at the end of 2004. Australian tariffs on TCF imports have been falling, even though the TCF clauses of SPARTECA have been extended for seven years. Australian tariffs will fall further under its APEC/WTO commitments. This will increase the competitive pressures faced by the local industry. Fiji can do little about stalling these changes. The consequences of the decline in the garment industry have been growth in 'the working poor' and an industry that has been locked into producing a narrow range of cheap-labour-intensive products for a single market.

Sugar

The sugar industry, which includes the growing of sugar cane and the manufacture of sugar for export, has historically had a central place in the economy. The industry still provides the livelihoods of a large part of the population, and remains a major earner of foreign exchange. Sugar cane production peaked at 4.38 million tons in 1996, when it accounted for some 11 per cent of GDP and some 37 per cent of merchandise exports (measured net of re-exports). As of 2005, the most recent period for which published data are available, sugar accounted for 6 per cent of GDP and some 26 per cent of total merchandise exports (again excluding re-exports). Production has been declining over the past decade as leases of land on which the crop has been cultivated have expired. While some landowners have been induced into taking up sugar cane farming by government subsidies, many of the farms from which the tenants were displaced remain fallow. The decline in sugar cane production predates the announcement of price reductions – of 36 per cent to be spread over three

years – by the EU but is coincidental with the uncertainty about the loss of leases.[20]

The interim administration has expressed its commitment to reviving the industry to its former health. As part of a sugar industry reform package, the interim minister for finance announced in the 2007 budget:

- the upgrading of mill facilities, to increase mill capacity and efficiency;
- improvements to the mill transportation system, to reduce costs of carting cane;
- modernizing farming methods, to improve farm productivity; and
- diversification of industry risks into value-adding opportunities such as cogeneration of electricity and ethanol production.

The minister subsequently announced a target of raising sugar cane production by 1.3 million tons within three years. This would mean returning production to its peak of 1996. Mills are to be upgraded, while the Sugar Research Institute has been tasked to 'educate' the farmers in order to improve yields.[21]

Returning the industry to its glory days may be difficult given that both domestic and international conditions for sugar have changed markedly.[22] Leased land, on which the bulk of sugar cane has been grown, continues to be vacated as leases expire. Many of the displaced farmers have been swelling the ranks of squatters around urban centres of the two main islands. While Fiji has an abundance of un-farmed land, mobilising it for development has, to date, had limited success. This is in contrast to the success that Ratu Sir Lala Sukuna had some 70 years ago.[23]

As in the garment industry, external conditions have conspired with deteriorating domestic conditions to weigh down the sugar industry.

Tourism

Tourism is a significant sector of the economy and, unlike sugar, one that has been expanding except for short periods following the coups. Tourist arrivals are extremely sensitive to perceptions of security in the host nation. If past coups are any guide, a rebound in tourism numbers will happen quickly following a return to 'normalcy'. The slow easing of travel warnings by the major source countries – Australia, New Zealand, and the US – appears to be contributing to a continuing decline in visitor arrivals, despite the discounting of hotel rooms (by as much as 40 per cent).

Australia has been the major source of Fiji's tourists, accounting for some 35 per cent of the total arrivals of around 550,000 in 2005; New Zealand came second with a share of 21 per cent; and the USA was third, accounting for a further 13 per cent.[24] Fiji's gross earnings from tourism in 2006 have been provisionally estimated by the Fiji Islands Bureau of Statistics at F$741.7 million. The tourism

industry as of September 2007 was appealing for further budgetary support to market Fiji abroad. Tourist arrivals began to rebound somewhat in 2008 and the Fiji Visitors Bureau thought the year would bring an increase of 5.9 per cent over 2007 arrival levels, but the Bureau remained pessimistic about the state of the industry because tourists were paying less and staying for shorter periods.

The heavy discounting by hotels will hurt profitability of existing operators, many of whom have sunk substantial amounts of capital into immovable assets; but even more importantly, the slump will scare away future investments. This is unfortunate as Fiji has many natural advantages – including being centrally located within the Asia-Pacific region; and having well-developed infrastructure, extremely hospitable people, a pleasant climate and an attractive natural environment – that enable it to excel as a tourist destination for the swelling ranks of the middle class in the region. A significant expansion of the tourism industry would have taken much of the pressure off the Fijian economy with respect to the adverse employment and foreign exchange earnings impacts from the declining garment and sugar sectors.

Information and communication technology (ICT)

There has been some recent growth in the information and communication technology sector. Fiji has locational advantages, as the Southern Cross cable and the international dateline both pass close by. Fiji, furthermore, has an English-speaking and relatively skilled workforce able to support data-processing. An uncompetitive telecommunications sector has been a major drag on the ICT industry, an issue that has been taken up by the interim government.[25] The interim minister for commerce has announced the government's intention to induce increased investments into business process outsourcing and call-centres, software development, and IT training. The specifics, in terms of the inducements to be offered to investors, remain to be detailed, however. The government does not have the resources to provide tax concessions to individual investors; doing so, in any case, is unlikely to attract the scale of investments that is required. Access to a more competitive telecommunications and public infrastructure is likely to be a lot more helpful than policies targeted at development of particular industries or localities.[26]

The way forward

The immediate challenges facing the government involve addressing the growing fiscal pressures and problems of governance, whilst raising the rate of growth of the economy.

Attaining fiscal sustainability has been an immediate priority. Early in 2007 the government announced its intention to contain the budget deficit to 2 per cent of GDP and reduce the level of public debt to 45 per cent of GDP over the medium term. The revised budget brought down in March 2007 projected total revenues

of F$1,471 million, an increase of nearly 6 per cent over the estimate for 2006, but an 8 per cent decline from the projection for the 2007 budget brought down by the ousted regime in November 2006. In fact, total revenues amounted to just F$1,288 million in 2007. However, total expenditure for 2007, anticipated in the revised budget at F$1,572 million, was just F$1,360 million.[27] The revenue estimates in the revised budget were based on an economic contraction of 2.5 per cent of GDP, which in fact turned out to be 6.6 per cent. The declines in both revenue and spending pointed to the sharp downturn in Fiji's economic activity following the coup. So, while the budget deficit was contained to 1.3 per cent in 2007, the change came at considerable cost – and the deficit was expected to increase to 2.0 per cent in 2008.

In terms of governance for growth, the newly established Fiji Independent Commission Against Corruption has much to live up to. The Commission has the powers to investigate corruption and report these directly to the President. Another special unit is to be set up within the interim finance ministry to carry out investigations of all allegations of abuse of public funds. According to the interim minister for finance, this special unit will be equipped with competent and experienced auditors empowered to visit agencies unannounced, conduct spot checks, and prepare timely audit reports. Unless this unit is a simple revamp of the internal audit unit within the ministry, it may entail costs of duplication. While it is often reported that corruption has risen significantly over the past decade, and thus combating its rise is long overdue, the creation of new agencies with parallel responsibilities to existing ones is unlikely to be productive. Arguments for economies of scale in fraud investigation and prosecution would suggest that amalgamation of existing agencies could have been a better alternative.

For the bulk of its post-independence history, Fiji has been governed democratically. Normalcy, therefore, requires a return to constitutional rule; a fact that has been put as a precondition for the complete re-engagement of the donor community. The medium- to long-term challenge for the interim administration is to chart a path to constitutional rule. A rebound in the economy is likely to assist in such a transition – while an economic crisis is just as likely to spill over into political chaos.

Conclusions

In bringing down its 2007 budget, the interim government announced that it was either a 'swim or sink' situation for the country. The interim minister for finance announced his intention of 'belt-tightening', particularly with respect to recurrent outlays. Without a strong rebound in the economy, debt levels are unlikely to return to 45 per cent of GDP over the medium term as targeted in the budget; indeed in 2007 they amounted to 49.1 per cent.

Foreign reserves have been falling since 2002 and are unlikely to rebound soon given prevailing policies. Efforts by the RBF to protect reserves using tightened capital controls, and the introduction of a credit ceiling on commercial banks, will raise the cost of credit, making economic recovery all the more difficult. The RBF, in all likelihood, has got itself tangled up in rationing foreign exchange, while the nominal (and the real) exchange rate(s) have appreciated sharply since September 2006. The loss of foreign reserves, due to the worsening of the trade balance could, therefore, be of its own making. As mentioned above, on one measure, that of the difference in the value of Fiji's sovereign bond with the official exchange rate, the FJD was over-valued by 12 per cent as of 16 April 2007.[28]

Macroeconomic stability requires a return to fiscal sustainability and external balance. In relation to the former, new revenue-raising measures need to be considered; in relation to the latter, the RBF may ultimately be persuaded to devalue the dollar. The longer the RBF holds out against devaluing the dollar, the larger the correction that will be necessary when its hand is forced. The only saviour would be large capital inflows and/or substantially increased exports, which are unlikely without a substantial boost in investor confidence.

For the economy, the position is neither one of sinking nor swimming – it is more akin to floating. Continuing with the water metaphor, the economy had been taking in water well before the December 2006 coup. Total investment as a share of GDP had reached a low of 11.3 per cent by 1996, with each of the coups pushing the economy back by an average of three years in terms of per capita income. The challenge for policy-makers wanting to raise growth is both to improve the immediate conditions for investment and to put in place measures to prevent future coups.

As regards the prospects for an early economic revival, tourism offers the best potential. Gold and garments have both made their retreat in terms of foreign exchange earnings and their contribution to employment generation. The international conditions for sugar are rapidly changing, and hope of revival in Fiji's sugar industry could be misplaced. Furthermore, the problems within the garment and sugar industries are the cumulative effects of long-standing and unattended local problems. The increased pace of liberalization of global trade over the recent past has only exacerbated the pressures for change.

Information and communications technology activities form a small, albeit growing, sector. Its expansion, as for other sectors, will depend on political stability, maintenance of law and order, and the presence of competitive communications and transport infrastructure. The interim administration has committed itself to cleaning up corruption and walking away from race-based politics, while supplying the environment for growth of private enterprise. It has also announced that merit will henceforth be the sole criterion for

appointment to public office. The intentions are laudable and, if actioned, will deliver the 'goods'. Time, however, will be the ultimate judge.

ENDNOTES

[1] Reserve Bank of Fiji, 2008. *Quarterly Review*, March, July, Suva, Fiji.

[2] 'We have no voters to please: Bainimarama', *fijilive*, 3 August 2007..

[3] Grynberg, R., Munro, D. and White, M. 2002. *Crisis: the collapse of the National Bank of Fiji*, Crawford House, Adelaide. Reported by *Fiji Post* 7 February 2002.

[4] Reserve Bank of Fiji, 2008. *Quarterly Review*, July 2008.

[5] United Nations Development Program, 1996. *Fiji Poverty Report*, accessed online at: http://www.undp.org.fj/index.cfm?si=main.resources&cmd=forumview&cbegin=0&uid=publications&cid=117; Abbott, D. F. 2006. 'Fiji analysis of the 2002/03 household income and expenditure surveys: Estimation of basic needs poverty lines and incidence of poverty in Fiji', Draft Final Report, August.

[6] Abbott, D. F. 2006. 'Fiji analysis of the 2002/03 household income and expenditure surveys'.

[7] The under-employed, who roam the streets in search of work, are the 'walking poor'.

[8] United Nations Development Program, 1996. *Fiji Poverty Report*, accessed online at: http://www.undp.org.fj/index.cfm?si=main.resources&cmd=forumview&cbegin=0&uid=publications&cid=117; Barr, K and Naidu, V. 2002. 'Comment on poverty', *Fiji Update*, 12 June, Suva; Asian Development Bank, 2003. Fiji Participatory Assessment of Hardship and Poverty, Manila.

[9] McKinnon, J.,Whitehead, S., Chung, M. and Taylor, L. 2007. 'Fiji Informal Settlement Scoping Mission Report', (unpublished) Wellington.

[10] The figures used here are from the World Bank. The Reserve Bank of Fiji gives slightly different numbers, but qualitatively similar conclusions.

[11] Reserve Bank of Fiji, 2008. *Quarterly Review*, March 2008, Suva, Fiji, p.16.

[12] Chand, S. 2007. 'Sink or swim: the predicament of the Fiji economy', *Pacific Economic Bulletin* 22(2):1–21.

[13] Reserve Bank of Fiji, 2006. *Quarterly Review*, December, Suva, Fiji, p.33.

[14] See, Reserve Bank of Fiji, 2006. *Quarterly Review*, December, Suva, Fiji, p.19.

[15] While Fiji's total merchandise trade with the USA is less than 10%, US dollar-denominated trade still dominates. For example, all mineral fuels imports and the bulk of remaining imports are US dollar-denominated.

[16] The increase in the cost of mineral fuels accounted for just one-third of the 16.9% increase in imports to November 2006 (RBF, 2006: 18).

[17] Storey, D. 2005. 'End of the line? Globalisation and Fiji's garment industry', Paper presented at the conference on Globalisation, Governance, and the Pacific Islands, The Australian National University, 25–27 October.

[18] The Kalabo Tax Free Zone (TFZ), for example, was built with an EU grant of $7.25 million dollars.

[19] SPARTECA is a non-reciprocal trade agreement whereby Australia and New Zealand (ANZ) offer duty free access to all products originating from the developing island member countries of the Forum (FICs). SPARTECA came into effect for most FICs from 1 January, 1981 and the current list of countries includes Cook Islands, the Federated States of Micronesia, Fiji, Kiribati, Marshall Islands, Nauru, Niue, Papua New Guinea, Solomon Islands, Tonga, Tuvalu, Vanuatu and Samoa.

[20] Prasad, B.C. and Narayan, P.K.2004. 'The relationship between Fiji Sugar Corporation's profitability and sugarcane production', *Pacific Economic Bulletin* 19(2):19–32.

[21] Reported in *The Fiji Times* (online version), 3 April 2007.

[22] Chand, S. 2005. 'Globalisation or self-inflicted wounds in the Fiji sugar and garment industries' *Pacific Economic Bulletin* 20(3):124–29.

[23] Ward, R.G. 1995. 'Land, law and custom: Diverging realities in Fiji' in Ward, R.G. and Kingdon, E. (eds). 1995. *Land, Custom and Practice in the South Pacific*, Cambridge University Press, UK.

[24] RBF. 2006. *Quarterly Review* , Table 30.

[25] Duncan, R. 2004. 'Information and Communications Technology in the Pacific Islands: marginalization by monopolization', *Pacific Economic Bulletin*, 19(2):129–31.

[26] See, Duncan, R. 2007. 'A "Clean-Up Campaign" for Fiji's Economy', *Pacific Economic Bulletin* 22(2):119–26.
[27] RBF. 2008. *Quarterly Review,* p. 17.
[28] This assumes that the currency was at par when the bonds were floated.