

## COUNTRY SUMMARIES

### FIJI

**Population:** 810,000 (1999)

**GDP:** US\$ 2,452 million (1999)

**GDP Per Capita:** US\$ 3,027 (1999)

---

#### Background

The May 19, 2000 coup in Fiji has had a devastating impact on the economy, with GDP expected to fall by about 8 percent. This turn of events was especially unfortunate, as prior to the coup, the growth outlook for 2000 was bright. GDP was expected to rise by about 4 percent, on the back of strongly performing sugar, tourism, construction, and gold mining sectors. The coup led to the downfall of the Chaudhury government that took office in mid-1999 after a landmark election that brought to office a Prime Minister of ethnic Indian origin for the first time.

In 1999, the Fiji economy had recovered from one of the worst droughts in its history with a real GDP growth of nearly 8 percent. The 1998 drought came on top of the shocks from the East Asian crisis, a subsequent devaluation, and a financial crisis within the country emanating from problems in the National Bank of Fiji. Despite these unfavorable events, Fiji had maintained a stable macroeconomic environment.

#### Economic Impact of the Coup

- Tourist arrivals are projected to fall by about 35 percent compared with the record level achieved in 1999. Tourism accounts for 20-25 percent of gross foreign exchange earnings, employs 20 percent of the labor force, and gross tourism receipts are equivalent to 15 percent of GDP. Hotel occupancy rates are reported to have come down to only 30 percent.
- Sugar exports have been affected by the initial refusal to harvest by Indo-Fijian cane farmers. Sugar accounts for 11-12 percent of gross foreign exchange earnings and the sector contributes 10-12 percent of GDP. The greatest potential damage would come from the EU suspending or changing Fiji's preferential access under the sugar agreement. Over the last three years EU sugar transfers have averaged \$US59 million per annum. EU prices are currently about 2 times world market prices and cover about 60 percent of total sugar exports.
- The garment industry (13-15 percent of gross foreign exchange earnings) is at risk from sanctions by Australia and New Zealand, both of which provide preferential access to Fiji garment exports. Australian and New Zealand unions had announced bans on the shipment of garments from Fiji.
- 7469 workers have been made redundant since May 19 and about 7000 are working reduced hours. 50 percent of the job losses have been in wholesale, retail, hotels and restaurants sector, followed by 20 percent of job losses in the garments and footwear industry.

Investor confidence (both in terms of foreign direct investment and domestic investment) in Fiji will be significantly undermined. In recent years stagnant private investment rates (at around 11 percent of GDP) have been a major barrier to growth and the creation of the right environment to attract investment had

been the focus of both the Chaudhry and Rabuka Governments – the coup has greatly undermined this major policy goal.

The broader impacts include:

- Fiji had been chosen by the European Union to host the successor of the Lome convention, but was later cancelled. The ‘Suva Convention’, as it was to be called, would have significantly raised Fiji’s (and the broader Region’s) international profile.
- The major bilateral partners in the region (the US, New Zealand and Australia) have taken progressively harder positions and there is a possibility of significant sanctions (diplomatic, trade and aid) being taken against Fiji. Action may also be taken through the Commonwealth.
- A number of countries (Tonga, Solomon Islands and Kiribati) have withdrawn their students studying in Fiji. Investments in tertiary education by the University of Southern Queensland (Australia) and Massey University (NZ) could be jeopardized and Fiji’s emerging role as a regional and extra-regional tertiary education services provider undermined.

The steep decline in economic activity has led to a corresponding sharp decline in government revenue leading to shortfall of about F\$146 million relative to the original 2000 budget. This decline in revenue would lead to a deficit of F\$250 million or 9 percent of GDP (compared with the budgeted level of 1.9 percent) if expenditures remained as budgeted. To bring expenditure down in line with reduced revenues the interim government announced a mini-budget that targets a deficit of 3.5 percent of GDP. The expenditure reductions are to be achieved through: 12.5 percent reduction in wages and salaries, 20 percent reduction in operating grants, 30 percent reduction in operating payments, and 30 percent reduction in capital expenditure. Allocations to key social and economic sectors (health, education, social welfare, law and order and tourism) are to be protected.

On the external front foreign exchange reserves have been protected through tight monetary policy (a credit ceiling) and capital controls. Foreign reserves currently stand at about US\$ 390 million or 6.1 months of imports.

### **Recent Economic Performance (Prior to the Coup)**

Real GDP growth averaged only about 2 percent per year during 1991-98. Underlying this performance has been a steadily falling investment rate from about 25 percent of GDP in the early 1980s to less than 12 percent in recent years. Contributing to the depressed investment climate in the past has been the dominance of current expenditure in the government budget resulting in low public investment, especially for supportive social and economic infrastructure. Private investment, on the other hand, has been dampened by structural factors including poor governance, uncertainty in the regulatory environment and the delay in resolving issues concerning expiring sugar land leases.

In 1998, GDP grew by 1.4 percent. The drought related to the El Niño weather phenomenon drastically reduced agricultural production, with sugarcane production declining by 29 percent. The impact of the East Asian crisis was not as severe as anticipated. Garment exports to niche high-value markets were largely unaffected by increased competitiveness of East Asian manufacturers resulting from their depreciated currencies. While tourists from East Asia to Fiji declined, those from Australia, New Zealand, North America and U.K. rose by a greater amount to keep the overall numbers higher. In 1999, the economy rebounded with a 8 percent increase in GDP. Leading the recovery was a strong expansion in agriculture, particularly sugarcane production. Sugarcane production and sugar manufacturing grew by an estimated 47.5 percent and 47.3 percent respectively in 1999. A growing tourism sector as well as a

strong expansion in garments and gold production also contributed to the improved growth performance. Expansion in garment output was strengthened by the extension of the derogation by the Australian Government under the South Pacific Regional Trade and Economic Agreement. Excluding sugarcane and sugar, real GDP grew by 5 percent in 1999.

Despite strong output growth, inflationary pressures eased in 1999, reflecting low trading partner inflation, excess capacity in the domestic economy, modest wage settlements in recent years, and recent government policy initiatives including a reduction in import duty on some basic food items and lowering of utility rates. Consumer price inflation was estimated at 0.2 percent at end-1999, down sharply from 8.1 percent at end-1998, and was expected to remain low in the coming months following zero-rating of value added tax from some basic food items effective January 2000.

Reflecting favorable developments in the sugar and tourism sectors, as well as improved external conditions during the last quarter of 1999, the external position strengthened considerably in 1999. Gross international reserves rose to US\$421 million (4.8 months of import cover) at end-1999, up from US\$360 million (3.8 months of import cover) in 1997.

On the fiscal front, as total expenditures were projected to increase by 1.2 percent while revenues (excluding receipts from asset sales) decline by 2.7 percent, the overall fiscal deficit for 2000, excluding receipts from asset sales, was projected at 3.9 percent of GDP versus an estimated deficit of 3.1 percent of GDP for 1999. In its 2000 budget, the Chaudhury Government outlined employment generation, poverty alleviation and narrowing of the gender gap as its key goals for the people of Fiji. Attainment of these objectives, the Government stressed, would be dependent on a vibrant economy underpinned by strong investment growth. Accordingly, the Government planned to re-orient expenditures away from less critical areas towards the priority areas of health, education and infrastructure. The Government intended to promote investment through attainment of economic stability, promotion of law and order, security of property, and maintenance of consistent and clear policies, and good governance.

#### FIJI: SELECTED ECONOMIC INDICATORS, 1994-99

	1994	1995	1996	1997	1998	1999 e/
<b>Indicator Levels (US\$ million)</b>						
GDP (at current market prices)	1820.5	1906.8	2026.5	2077.0	2227.1	2452.4
Govt. Revenue & Grants	477.0	491.5	508.3	549.3	780.2	674.4
Govt. Expenditures	549.8	553.1	648.5	739.7	851.5	821.5
Govt. Budget Deficit (-) a/	-72.7	-61.7	-140.2	-190.4	-71.3	-147.1
Exports (fob)	516.0	518.3	660.2	518.9	422.7	534.9
Imports (fob)	747.8	749.1	852.3	763.1	614.8	654.5
Ext. Current Account Balance (after grants)	-65.5	-18.3	63.3	31.6	-6.0	27.8
Gross Reserves	273	349	427	360	385	421
<b>Macro Balances (% GDP)</b>						
Budget Deficit (-) a/	-4.0	-3.2	-6.9	-9.2	-3.2	-6.0
External Current Account Balance (after grants)	-3.5	-0.9	3.0	1.6	-0.4	1.5
Total External Debt	15.0	13.8	11.9	11.6	13.7	14.3
Domestic Debt (Central Govt.)	29.8	28.9	31.8	38.1	32.6	32.5

#### Memo Items (% p.a.)

GDP growth (at constant factor cost)	5.1	2.5	3.1	-0.9	1.4	8.0
Consumer Inflation (end-period)	1.2	2.2	2.4	2.9	8.1	0.2
Reserves (months of imports c/)	2.9	3.7	4.0	3.8	4.8	4.8

a/ including asset sales.

e/ estimated

c/ Goods and non-factor services

*Source: Reserve Bank of Fiji*

Policy makers are keenly aware of the need to diversify the economy, both away from the reliance on the sugar crop within the agricultural sector, and, more generally, away from dependence on agriculture. Within the agricultural sector, the government has encouraged the development of the timber industry. Earnings from exports of timber and its products have increased substantially since 1986 as plantations run by Fiji Pine, the country's main operator in the sector, have come on stream. Outside agriculture, there had been an upsurge of investor interest in Fiji. During the last quarter of 1999, the Fiji Trade and Investment Board (FTIB) approved the establishment of new projects estimated at over F\$350 million with an employment potential of 3,000 jobs. These include two additional hotels in Denarau, the Natadola Four Seasons hotel and the second phase of the Denarau villa residential project.

### **Key Issues**

**Land leases.** The long term prospects for the sugar industry depend on resolution of the Agricultural Landlord and Tenants Act (ALTA). Without an extension of leases, sugar growers face an uncertain future, and are currently unable to get bank loans on leases about to expire.

**The Regulatory Environment for Private Sector Development.** While there has been progress in improving the regulatory environment for the private sector, the degree of official discretion in the regulatory system has remained high, resulting in a high degree of uncertainty and hence the cost of doing business in Fiji. The main sources of discretion relate to tax and custom duty concessions, approval of foreign investment, granting of work permits, and price controls. The complexity and the lack of clarity in the rules, together with weaknesses in enforcement have combined to increase the perceived risk of investment in Fiji.

Further deregulation to establish a secure, predictable business environment will be essential for fostering the recent upsurge of investor interest. In the 2000 budget, the government also announced reforms in foreign exchange regulations aimed at facilitating private investment. These include increasing limits under which various capital account transactions can be made, delegating authority to commercial banks, the Suva Stock Exchange and authorized dealers and lenders for approving various transactions, and by reducing various documentary requirements.

**Policy Changes** In keeping with its election manifesto, the Chaudhury government made policy announcements, some of which reverse those of the former government. These included reinstating airport workers sacked due to restructuring, reversals in SOE privatization policy and programs, debt forgiveness for sugar-cane farmers, a new minimum wage proposal of F\$120 per week (approximately twice the average wage in the garment industry), reduction in housing loan rates from 11 percent to 6 percent, and zero-rating of VAT on basic food and other essential items. It is not clear what the stand of the new government will be on these fronts. However, it is crucial for Government to assess the benefits of these changes in terms of improved welfare of its people against the costs, for instance, in terms of its fiscal position and the overall investment environment.

***Asset Maintenance.*** The lack of funds for infrastructure maintenance is affecting the business community as well as households. Road maintenance gets half the estimated amount for optimum use, while deficiencies in the water distribution system has limited water supply to households. Adequate funding for infrastructure maintenance will be essential as was articulated in the 2000 budget.

***Social Expenditures.*** In the social sector, the key issues relate to (a) adequate funding of basic education (primary and secondary), teacher training for primary and secondary levels, and improved planning in the education system; and (b) better resource allocation to rural and primary health care services, greater role for private sector participation in health care, and better planning of health care systems. The 2000 budget addressed some of these issues.

## FEDERATED STATES OF MICRONESIA

<b>Population:</b>	<b>113,470 (1998)</b>
<b>GDP:</b>	<b>US\$213 million (1998)</b>
<b>GNP Per Capita:</b>	<b>US\$1,800 (1998)</b>

---

### Background

With the progressive reduction of United States grants under the Compact of Free Association<sup>1</sup>, the Government of FSM began to implement a comprehensive adjustment program in 1996 to address large structural imbalances in the public finances and the external accounts. These imbalances have arisen from unsuccessful attempts by Government to expand the productive base of the economy through its direct involvement in economic activities. The reform program focuses in particular on government expenditure reductions and on structural measures aimed to promote private sector activities. Over the period 1986-98 the FSM economy grew at an annual average rate of 2.3 percent. There have been considerable year-to-year fluctuations in growth rates, and growth has been unevenly spread across the four states, with Pohnpei and Yap performing significantly better than Chuuk and Kosrae. A population growth rate of roughly the same magnitude as economic growth has meant that per capita incomes have stagnated over the 1986-98 period.

### Recent Economic Performance

The FSM economy has been dominated by the public sector. On the supply side public administration accounts for over 40 per cent of GDP while on the demand side government expenditure is about 70 per cent of GDP, down from over 100 percent in the early 1990s. The decline in external resources necessitated a downward adjustment in government expenditures. As part of the reform program, the public sector has been downsized as a result of which real GDP growth declined by 2.8 percent on an annual average basis during FY95-98. In FY99, growth is estimated to have turned positive by 0.5 percent as private sector activity picked up. Wholesaling and retailing is the most important private sector activity, accounting for 22 per cent of GDP, followed by fisheries and tourism that contribute 2 per cent each. Subsistence activities are estimated to account for about 16 per cent of GDP.

With the economic slow-down in the late 1990s, consumer price inflation eased to 3 percent per annum from moderate levels attained during the early 1990s.

The external current account deficit (excluding grants) narrowed during FY96-98 and no new commercial loans were incurred during the period. External reserves, as measured by the financial holdings of the state and national governments, stood at the equivalent of 6 months of imports of goods and services at end-1998.

Compact assistance which accounted for about 58 percent of government revenue in FY87 had with progressive reductions declined to about 47 per cent in FY98. Over the same period the share of tax revenues increased from 7 per cent to 14 per cent. FY97 marked the beginning of the second step-down of Compact funding in the amount of US\$15 million per year. Despite declining Compact transfers, small

---

<sup>1</sup> The major element of this assistance provided for annual block grants of US\$60 million during FY87-FY91, US\$51 million during FY92-FY96, and US\$40 million over FY97-FY01. A new assistance package from the US is currently being negotiated.

overall surpluses were recorded in the fiscal accounts during FY1997-98 and a larger surplus was expected for FY99. The above fiscal development was largely achieved through successful implementation of the Public Sector Reform Program, especially reduction of the wage bill, in all four States. Repayment of arrears by Chuuk State during the period also contributed to the improved fiscal performance.

**FSM: SELECTED ECONOMIC INDICATORS, 1993/94-97/98**

	1993/94	1994/95	1995/96	1996/97	1997/98
<b>Indicator Levels (US\$ million)</b>					
GDP (at current market prices)	194.9	205.8	215.5	213.0	212.7
Govt. Revenue & Grants	166.2	172.5	178.3	157.3	161.0
Govt. Expenditures	167.3	169.1	163.5	154.2	160.3
Govt. Budget Deficit (-)	-1.1	3.4	14.8	3.1	0.7
Exports (fob)	66.3	49.0	32.0	33.0	32.0
Imports (fob)	160.0	124.5	91.1	85.0	83.0
Current Account Balance (after grants)	12.7	45.8	61.6	63.8	66.7
<b>Macro Balances (% GDP)</b>					
Budget Deficit (-)	-0.5	1.6	6.9	1.4	0.4
External Current Account Balance	6.5	22.3	28.6	30.0	31.4
<b>Memo Items (% p.a.)</b>					
Real GDP growth	-1.8	1.6	-2.3	-3.9	-0.6
Consumer Price Inflation	4.0	4.0	4.0	3.0	3.0

e/ Estimated.

Source: IMF Staff Reports

**Key Issues:**

- **Progress on Implementing Reform Measures.** The implementation of government policy has met with some success. The freeze on wages, travel and subsidy payments has continued; selected national and state government ministries/agencies have been merged or eliminated, and state services have been contracted out to the private sector. Revenue raising measures implemented include shifting import duty calculations from f.o.b. to c.i.f. basis, reducing tax exemptions and strengthening tax administration. While much progress under the program has been made, further steps to sustain the adjustment effort are needed, particularly in maintaining large fiscal surpluses needed to offset the decline in US financial assistance over the coming year. Other measures planned for implementation include raising state taxes, creating a single federal tax department, and increasing user charges. The government has recently endorsed a proposal to replace the gross revenue tax with a Value Added Tax which would improve the efficiency of the tax system. The government aims to increase tax revenue collections from a currently level of 10 per cent of GDP to 20 per cent over the long term. Revenue sharing between national and state governments is also being addressed. A proposal to increase the states' share of tax revenue from 50 per cent to 70 per cent is under consideration.

- ***Promoting Private Sector Development.*** Private sector development should focus on the key areas of tourism, fisheries and agriculture as the long-run growth potential of the economy is dependent upon these activities. There is the need to reduce costs, improve competitiveness and boost domestic and foreign investor confidence in these sectors. Achieving these objectives call for addressing a wide range of structural measures including streamlining investment approval processes, facilitating use of land as collateral or for leasing and curbing public sector wage growth in order to narrow the differential between public and private sector wages. The adoption of a new Foreign Investment Act effective October, 1998 would help improve the foreign investment regulatory environment. Increased private sector activity should also assist in generating adequate employment for a rapidly expanding labor force. A number of other reform measures are also being considered as part of a proposed Private Sector Development Loan by the ADB.
- ***Public Enterprise Reform.*** FSM has met with some success in commercializing the operations of most national and state public enterprises. Plans for the restructuring and privatization of the remaining loss-making state-owned fishing and agriculture ventures are well advanced. Government needs move quickly to finalize privatization efforts.
- ***Achieving Participatory Development.*** Good progress has been made by Government towards achieving participatory development. A second Economic Summit on FSM held recently in Pohnpei brought together a number of development partners including traditional leaders, the private sector, non-government organizations, churches, women's and youth groups, government officials and representatives of foreign governments. The summit helped strengthen the ongoing dialogue among government officials, the business community and community leaders to ensure that economic policies, consistent with the goals and aspirations of the people, are supportive of participatory development. This dialogue needs to be carried out on a frequent and systematic basis.
- The termination of secure Compact related funding at the end of 2001 has discouraged both domestic and foreign investment. In its negotiations with the US on a new assistance package, FSM has proposed that the uncertainty created by the "terminal date" effect be tackled through the creation of a trust fund. This trust fund would be mainly funded through official transfers and concessional lending and would enable investors to lengthen their planning horizons.

## KIRIBATI

**Population:** 86,000 (1998)

**GDP:** US\$45 million (1998)<sup>2</sup>

**GNP Per Capita:** US\$1180 (1998)

---

### Background

Kiribati continues to maintain its solid record of financial stability and fiscal prudence. Yet it remains one of the least developed Pacific Islands economies with low growth in per capita real incomes. While social indicators have improved, life expectancy remains low (at 59 years) and infant mortality high (at 64 per thousand live births). Economic growth has been constrained by a number of structural impediments, including a large and inefficient public sector that crowds out the private sector; an inefficient tax system; limited access to land; price controls; government subsidies; and cumbersome procedures for direct foreign investment.

For many years, economic strategy had been based on two pillars: a cautious fiscal policy and state-led development. This strategy maintained macroeconomic stability and built up the country's external trust fund (the Revenue Equalization Reserve Fund) but resulted in stagnant per capita incomes. In 1995, a new government adopted an expansionary fiscal policy by raising expenditure sharply in order to revitalize economic activity. While this approach gave a temporary boost to growth, it was financed by large drawdowns from the RERF.

### Recent Economic Performance

Real GDP growth accelerated to 6 percent in 1998, up from 3 percent the year before. Real GNP growth, which is highly volatile and influenced largely by fishing license fees, recorded 21 percent in 1998 building upon a high of 29 percent in 1997. Although fishing license revenue (27 per cent of GNP in 1998) is generally the largest item in net factor income from abroad, the smallest item, remittances from about 1300 seamen (7.4 per cent of GNP in 1998), is most important in terms of impact on private consumption as a large number of people are affected. Underlying strong economic performance in 1998 was higher public investment related to construction activity at the major sea port (Betio) and construction of junior secondary schools. A strong recovery in copra output in 1998, more than double the level in 1997, as well as increased output in government administration (which accounts for over 30 percent of GDP) also contributed to the improved growth performance in that year. Consumer inflation remained low at 2 percent in 1997 but rose sharply to nearly 5 percent in 1998 as imports were constrained owing to the handling problems at the Betio port, and the depreciation of the Australian dollar, the national currency. For 1999, however, economic growth is estimated at around 2 percent with low inflation. The recent completion of the US\$ 22 million Betio Port improvement project, funded through a grant from Japan, is expected to boost Kiribati's economy through increased exports of copra and other local produce, increased foreign trade, and the creation of new jobs.

The fiscal and external positions strengthened during the late 1990s mainly due to favorable developments in agriculture, particularly the fishing industry. The El Nino weather phenomenon boosted fish catch in Kiribati waters in 1998, increasing considerably fishing license fees in that year to nearly 60 percent of GDP, about twice normal levels. Consequently, the overall fiscal balance (excluding income

---

<sup>2</sup> In recent years Kiribati's GNP has been about 1.5 to 2 times the GDP, reflecting sizable income from fishing license fees, external assets, and seamen's remittances.

from the Revenue Equalization Reserve Fund) reached a substantial surplus, the equivalent of 24 percent of GDP in 1998, compared to a deficit of over 35 percent of GDP two years before. Current expenditure fell slightly in 1998 as a share of GDP, but remained high at over 70 percent of GDP. No drawdowns from the RERF were needed in 1998.

**KIRIBATI: SELECTED ECONOMIC INDICATORS, 1994-99**

	1994	1995	1996	1997	1998	1999	e/
<b>Indicator Levels (US\$ million)</b>							
GDP (at current market prices)	39.6	46.0	50.3	48.7	45.2	48.5	
Govt. Revenue & Grants	36.0	43.1	37.8	59.8	61.9	45.0	
Govt. Expenditures	36.7	47.8	55.7	56.7	51.1	60.7	
Govt. Budget Deficit (-)	-0.7	-4.7	-17.9	3.1	10.8	-15.7	
Exports (fob)	5.2	7.4	5.3	6.3	5.9	5.9	
Imports (fob)	26.4	35.2	38.0	39.1	36.8	41.8	
Ext. Current Account Balance (after grants)	4.2	0.7	-13.7	3.6	11.6	-9.9	
Official External Assets	260	287	302	318	372	380	
o/w RERF	247	274	296	306	350	364	
<b>Macro Balances (% GDP)</b>							
Budget Deficit (-)	-1.7	-10.1	-35.6	6.3	24.0	-32.4	
External Current Account Balance (after grants)	10.5	1.6	-27.2	7.3	25.8	-20.4	
External Debt	17.3	15.0	19.5	19.0	17.2	26.6	
<b>Memo Items (% p.a.)</b>							
GDP growth	7.2	6.5	2.6	3.3	6.1	2.5	
GNP Growth	6.1	7.9	-11.5	30.0	15.6	-16.1	
Consumer Inflation (annual average)	5.3	4.1	-1.5	2.2	4.7	2.0	
Official External Assets (yr. Imports)	4.5	4.8	4.3	5.0	5.6	5.1	

e/ estimated.

1/ Imports of goods and services.

Source: IMF Staff Reports (06/99)

On the external front, increasing revenue from fishing license fees as well as increased fish exports caused the current account deficit (excluding grants) to narrow significantly to under 4 percent of GDP in 1998, down from an average of over 30 percent of GDP during the previous two years. The improvement in the current account deficit together with strong inflows of external grants led to a sizable overall surplus and a rise in external assets. At end-1998, official external assets stood at US\$372 million (A\$606 million), equivalent to about 5.6 months of imports of goods and services. Valuation gains in the RERF (from the rise in world bond and equity prices as well as the depreciation of the Australian dollar), also contributed to the improved reserve position. Public external debt remained low on highly concessional terms.

### **Key Issues:**

- ***Implementing the Medium-term Strategy.*** A Medium-term Strategy that aims to re-orient the economy toward private sector-led growth was adopted in late 1997. The strategy identifies three key issues: (i) limited growth in per capita GDP since independence in 1979; (ii) the need to find employment for the 60 percent increase in the workforce expected over the next 15 years; and (iii) Government's ability to sustain growth in public services. There is the need to accelerate the implementation of this strategy as small size of the private sector is unlikely to generate sufficient employment for the rapidly expanding labor force in the medium-term. Strategies to address these issues should include reducing the size of the central government, reforming public enterprises, and facilitating private sector development, including encouraging foreign investment.
- ***Public Enterprise Reform.*** Although public enterprises dominate economic activity, the performance has been poor. They have incurred large losses, provided poor services and have crowded out the private sector by operating on a non-commercial basis. Since the continuing performance of many public enterprises constrains growth and places a burden on the budget, there is the need to move quickly with the commercialization and privatization of these enterprises.
- ***Fiscal Policy.*** Over the medium term, to reduce tax burden and support private sector growth, there is the need to curb the rapid growth in current expenditure that has occurred over the past five years. This could be done by reducing support for public enterprises and right-sizing the civil service.

### **Government's Development Strategy**

In response to a history of stagnant per capita incomes, together with concerns that the fiscal expansion in the mid-1990s was unsustainable, the government adopted a medium-term strategy in 1997 to generate sustainable growth. The strategy aims to encourage private sector-led growth by (i) reducing the relative size of the public sector through containing the level and improving the quality of government expenditure, including through medium-term output-based budgeting, voluntary redundancy schemes for civil servants, and a freeze on new recruitment; (ii) reforming public enterprises, through commercialization or privatization; and (iii) providing a sound physical and regulatory infrastructure, including by improving basic education and health services; preserving the environment; liberalizing trade and investment; removing monopoly privileges, promoting a foreign investment friendly environment; and clarifying land titles.

## REPUBLIC OF THE MARSHALL ISLANDS

**Population:** 63,000 (1998)

**GDP:** US\$96 million (1998)

**GNP Per Capita:** US\$1,540 (1998)

---

### Background

A key challenge facing the Marshall Islands economy is to adjust to the progressive reduction of United States grants under the Compact of Free Association. Given that, until recently, compact assistance provided on average about 70 per cent of government revenue, the brunt of the adjustment would be borne by the public sector. In response, the Government of Marshall Islands began to implement a comprehensive adjustment program in 1996 to address large structural imbalances in the public finances and the external accounts. The reform program focuses in particular on government expenditure reductions and on structural measures aimed to promote private sector activities.

### Recent Developments.

Following three years of contraction GDP grew by an estimated 0.5 per cent in 1999. During 1996-98, GDP declined by a cumulative 25 per cent. The steep recession was caused chiefly by cuts in government expenditure and employment under the public sector reform program. In addition, agriculture and fisheries production fell by about 20 per cent during 1996-97 due to a drought related to the El Nino weather phenomenon. Economic activity picked up in 1999 as aid-funded road works employing 300 people got underway. Private construction activity was also boosted with the building of a tuna processing factory. The agricultural sector began to recover from a drought, and public sector downsizing was forestalled.

Consumer price inflation which had reached a high of nearly 10 per cent in 1996, eased to average of about 4 per cent during 1997-98, and further to about 1 per cent in 1999. With the US dollar as its domestic currency and US being the largest source of imports, the inflation rate tends to track that of the US.

The external current account deficit (excluding grants) narrowed to 28 percent of GDP in 1998 from a high of 50 percent of GDP in 1996 as imports declined in response to the economic downturn. Including grants the current account recorded a surplus of over 20 per cent in 1998. Between 1995-98 merchandise imports fell nearly 24 per cent in value terms while exports declined by 6 per cent. Government financial holdings stood at US\$4 million at end-1998, equivalent to less than one month of imports of goods and services.

A large budget surplus of 20 percent of GDP was recorded in 1996, when capital outlays dropped sharply after completion of several large public investment projects in the previous year. The budget remained in surplus in 1997 and 1998 but declined sharply to about 4 per cent of GDP. Tax receipts fell as the economy contracted, but a reduction in import duty exemptions and improved administration raised the receipts from this source. Compact grants declined reflecting the planned step-down for the final five-year period of disbursements. On the expenditure side compensation payments to retrenched civil servants raised outlays, but capital expenditure declined. A deficit of nearly 9 per cent of GDP is estimated for 1999.

**MARSHALL ISLANDS: SELECTED ECONOMIC INDICATORS, 1993/94-97/98**

	1993/94	1994/95	1995/96	1996/97	1997/98
<b>Indicator Levels (US\$ million)</b>					
GDP (at current market prices)	94.6	105.2	97.7	97.0	95.8
Govt. Revenue & Grants	70.9	80.0	80.5	64.8	63.7
Govt. Expenditures	83.4	94.8	60.6	61.0	59.7
Govt. Budget Deficit (-)	-12.5	-14.8	19.9	3.8	4.0
Exports (fob)	18.6	22.9	20.1	25.8	21.6
Imports (cif)	68.1	73.9	73.2	61.6	55.9
Ext. Current Account Balance (after grants)	4.8	1.6	3.5	16.4	21.3
Government Financial Holdings (end per.)	40.4	8.9	8.0	6.8	3.7
<b>Macro Balances (% GDP)</b>					
Budget Deficit (-)	-13.2	-14.1	20.3	3.9	4.2
External Current Account Balance (after grants)	5.1	1.5	3.6	16.9	22.2
<b>Memo Items (% p.a.)</b>					
Real GDP growth	2.8	2.7	-15.2	-5.3	-5.0
Consumer Price Inflation	5.6	8.3	9.6	4.8	4.0
Financial Holdings (months of imports, cif)	7.1	1.4	1.3	1.3	0.8

e/ Estimated.

**Source: IMF Staff Reports, 06/98****Key Issues:**

- ***Sustaining the Reform Effort.*** As Compact assistance terminates in 2001, sustained implementation of fiscal and structural measures to promote private sector export growth would allow the Marshall Islands to meet its objectives of reducing dependence on external assistance, achieving fiscal stability and attaining a sustainable external current account deficit over the medium-term. A strong commitment to reform will greatly support the government's position in negotiations over a new assistance program following the termination of the current Compact.
- ***Implementing Reform Measures.*** Good progress has been made under the Policy Reform Program. Measures undertaken include rationalization of several ministries, a 33 percent reduction in civil service staff between late 1995 and March 1999, elimination or reduction in subsidies to some public enterprises and a rationalization of the tariff system. A freeze on wage increases remains in effect since late 1995 and efforts to strengthen tax and customs administration are also continuing. However, public service employment has yet to be reduced to its targeted level, and action is required on a number of revenue raising measures. A further commitment to reforming public enterprises and creating an environment for private sector development is also needed. As a strong track record in

the implementation of the reform program is essential in mobilizing financial support from international financial sources, there is the need for Government to stay the course of reform.

- ***Promoting Private Sector Growth.*** While Government dominance of economic activity has been reduced, the private sector remains very small. Structural measures to promote private sector growth must be implemented vigorously, in particular actions to ease investment, facilitate the use of land, and stimulate competition. Parliament approved legislation on investment approval and business licensing procedures in 1998 but it is yet to be implemented.

## REPUBLIC OF PALAU

**Population:** 18,110 (1998)

**GDP:** US\$129 million (1998)

**GDP Per Capita:** US\$7,137 (1998)

---

### Background

Under the Compact of Free Association with the United States which took effect in October 1994, the Republic of Palau has been heavily dependent on grants from the United States to finance growing and unsustainable fiscal deficits. As these grants are scheduled to be phased out over the next decade, fundamental reforms are needed, particularly in the area of fiscal policy, to achieve long-term economic sustainability. Other reforms, structural in nature, are also necessary to promote a dynamic private sector and improve medium-term growth prospects. These would include streamlining of investment approval processes, relaxation of regulations concerning foreign direct investment as well as clarification of land ownership and lease rights which has prevented the effective use of real estate as collateral.

### Recent Economic Performance.

Economic conditions deteriorated considerably during 1997-98 as the Asian financial crisis adversely affected the tourism industry, the main private sector activity. Real GDP growth was flat in 1997 and was estimated to have deteriorated further in the subsequent year with little improvement estimated for 1999. However, economic activity is expected to pick up considerably in 2000, as the regional economy rebounds and the construction phase of several large public and private investment projects are initiated. Notable among these are a 53-mile highway project and a new airport terminal, both on the main island of Babeldaob as well as a proposed 5-star 450-room hotel.

The external accounts has in recent years been characterized by large trade deficits on account of a limited merchandise export base and growing dependence on imports. These deficits have, however, been more than offset by sizable surpluses on the services account and grants. The trade deficit shrank from 47 percent of GDP in 1995/96-1996/97 to 40 percent of GDP in the subsequent two years as imports declined in the wake of the economic downturn. With growing tourist receipts, the current account deficit (excluding grants) fell sharply to 6 percent of GDP in 1996/97 from 15 percent of GDP in 1995/96, but deteriorated subsequently with the Asian financial crisis. The current account after grants remained in surplus, albeit declining.

On the fiscal front, the need for corrective action has been made more urgent by a sharp worsening of the fiscal position in 1998/99. The overall fiscal balance (including grants) is estimated to have recorded a deficit equivalent to 12 percent of GDP in 1998/99, compared with surpluses in the previous two years when windfall gains, including earnings from investing Compact funds, temporarily boosted current receipts. Excluding these one-off gains, the fiscal deficit would have been around 4 percent of GDP for these two years. Contributing to the weak fiscal performance was also a weak revenue position resulting from a weakening economy, a step-down in U.S. grants (about 4.5 percent of GDP) and an increase in current expenditure, including a sizable contribution to the heavily underfunded Civil Service Pension Fund.

---

**REPUBLIC OF PALAU: KEY MACRO INDICATORS, 1993/94-98/99**


---

	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99 e/
<b>Indicator Levels (US\$ million)</b>						
GDP (at current market prices)	84.6	105.2	124.3	131.1	129.3	129.3
Govt. Revenue & Grants	49.6	166.2	66.0	72.3	73.4	56.4
Govt. Expenditures	50.4	65.3	75.1	76.5	64.6	71.6
Govt. Budget Deficit (-) a/	0.4	100.8	-9.2	0.3	7.7	-15.2
Exports (fob)	12.6	13.9	13.9	11.8	11.1	11.0
Imports (fob)	44.2	60.4	72.4	72.9	63.2	63.3
Current Account Balance (after grants)	8.2	68.3	12.6	21.7	17.2	8.0
<b>Macro Balances (% GDP)</b>						
Budget Deficit (-)	0.4	95.8	-7.4	0.2	6.0	-11.8
External Current Account Balance	9.7	64.9	10.2	16.5	13.3	6.2
<b>Memo Items (% p.a.)</b>						
Nominal GDP growth	11.5	24.3	18.2	5.5	-1.4	0.1

---

a/ Includes errors and omissions.

e/ Estimated.

Source: IMF Staff Report, 09/99

### Key Issues:

**Fiscal Adjustment.** In light of declining compact grants, there is the need for a gradual fiscal adjustment over the coming years. This could be achieved partly through the introduction of output budgeting and outsourcing of selected government services. Although expenditure reduction remains a priority, it needs to be done with adequate safeguards on health, education and maintenance expenditures. Public expenditures should be made more efficient and effective regardless of whether they are current or capital in nature.

**Promoting Private Sector Development.** There is the need to implement structural measures to attract foreign direct investment and promote private sector activity. Recommended measures should include streamlining of investment approval processes and facilitating use of land as collateral or for leasing.

**Strengthening Implementation Capacity.** A progressive strengthening of implementation capacity of the authorities in Palau would be necessary in carrying out a wide range of reforms that the country will embark upon in the coming years in its adjustment efforts.

**Expanding the Productive Base.** There is the need to expand the productive base of the economy, other than tourism, to include other activities, primarily agriculture which has the potential to add to the country's economic vitality. To the extent possible, commercial ranching on the island of Babeldaob to

produce beef and other livestock products for domestic consumption as well as exports, needs to be explored.

### **Development Strategy**

In anticipation of the cessation of US Compact assistance by 2009, the Government approved, in 1996, a National Master Plan which sets forth the framework and policies for the pursuit of sustained economic and social development over a 25-year period. The main long-term development objectives of the Master Plan are summarized as follows: (i) a substantial shift in economic activity from the public sector to the private sector aimed at increasing productivity and efficiency of resource use; (ii) strengthening of government institutions to improve coordination of decision making processes while, at the same time, reducing the relative size of government; and (iii) identification of financing strategies, including tax reform, to offset the decline in US assistance over time.

## SAMOA

<b>Population:</b>	<b>168,027 (1998)</b>
<b>GDP:</b>	<b>US\$220 million (1998)</b>
<b>GDP Per Capita:</b>	<b>US\$1,310 (1998)</b>

---

### Background

The Samoan government's first Statement of Economic Strategy in 1995 laid the foundation for a partnership between the government and the private sector. The government's role in this partnership was to establish the enabling environment within which the private sector could profitably operate. To date, the government's track record in doing so has been encouraging. Good progress has been achieved on a strongly owned reform program under which tariffs, excise and income taxes have been reduced; the tax base has been widened through a VAT, financial sector has been liberalized, prudential supervision and regulatory framework has been strengthened, the central bank has moved to indirect control instruments, state owned enterprises have been privatized, and efforts have been made to streamline investment guidelines. There are, however, areas where progress has been slow and would need further work in order to harness the full benefit of the reform program, for example, the privatization and corporatization of public enterprises.

In the early 1990s, the economy suffered from adverse economic shocks, emanating from two cyclones and a taro leaf blight. The agricultural sector is yet to recover from the long-term damage caused by the taro leaf blight of 1993. Appropriate macroeconomic policies were put in place to support recovery and growth rebounded to pre-cyclone levels in the mid-1990s.

### Recent Economic Performance

In the mid-1990s, a sharp increase in public investment and expenditure related to reconstruction activity in the aftermath of the devastating cyclones led to a rebound in the economy. GDP growth averaged 6.9 percent per year during 1995-96. During 1997-98, growth slowed to an average of 2.2 percent per year due to the completion of cyclone reconstruction activity, a drought, and a downsizing of operations at Yazaki, the Japanese-owned automotive wiring assembly plant. Growth exceeded expectations in 1999 as GDP rose an estimated 5.5 percent compared with a budgetary forecast of 2 percent. Notable growth was witnessed in the hotels and restaurants sector, and the commerce, transport and communications sector, as a result of increased tourism activity at end-1999 related to the year 2000 celebrations. A key contribution came from the fisheries sector which expanded by over 40 percent. During the last three years the fisheries sector has grown strongly with increased exports to a canning factory in American Samoa and to Japan. As a result the share of fisheries in GDP has risen from about 4 percent in 1996 to about 6.2 percent in 1999.

Consumer price inflation decelerated to low levels in recent years registering 0.3 per cent at end-1999, 2.2 percent in 1998, down from nearly 7 percent in 1997. This performance reflected lower prices for domestically produced goods as food production recovered from an earlier drought, low inflation in trading partners, chiefly Australia and New Zealand, and reduced tariff rates.

**SAMOA: SELECTED ECONOMIC INDICATORS, 1994-99**

	1994	1995	1996	1997	1998	1999 e/
<b>Indicator Levels (US\$ million)</b>						
GDP (at current prices)	189.1	193.2	218.1	235.3	220.2	237.7
Govt. Revenue & Grants e/	78.3	95.3	100.1	91.7	85.0	85.8
Govt. Expenditures e/	92.7	100.8	95.7	86.5	82.5	86.3
Govt. Budget Deficit (-) e/	-14.4	-5.5	4.4	5.2	2.5	-0.5
Exports (fob)	6.5	8.8	10.1	14.6	18.8	18.1
Imports (cif)	104.4	92.1	99.5	100.6	96.7	115.3
Ext. Current Account Balance (after grants)	8.4	12.2	13.2	20.5	16.3	7.87
Total External Debt	173.1	177.4	168.3	166.9	161.0	147.3
Gross Reserves	42.3	46.2	53.5	61.6	61.9	60.5
<b>Macro Balances (% GDP)</b>						
Budget Deficit (-) e/	-7.6	-2.8	2.0	2.2	1.2	-0.2
External Current Account Balance	-9.5	-7.1	-5.1	-3.6	-3.4	-8.1
Total External Debt	91.5	91.8	77.1	70.9	73.1	62.0
<b>Memo Items (% p.a.)</b>						
GDP growth	-0.1	6.4	7.3	1.0	3.4	5.5
Consumer Inflation (%)	18.4	1.0	5.4	6.9	2.2	0.3
Reserves (months of imports) a/	6.3	5.9	6.3	7.2	7.2	6.3

a/ Imports of goods and services.

e/ Estimated.

Source: Government of Samoa

The external position continued to improve after the mid-1990s supported by strong expansion in exports, particularly fishing and tourism and increasing inflows of private and official transfers. Fish exports grew nearly eleven-fold between 1996 and 1998, to increase their share of merchandise exports from about 9 percent to 46 percent. Taro provided an average of 45 percent of export earnings during 1991-93, but since the taro leaf blight exports have been negligible. Gross receipts from tourism, the key foreign exchange earner, averaged about 17 percent of GDP over 1996-98. Private transfers also averaged 17 percent of GDP over the same period. By end-1998, despite the Asian crisis which impacted Yazaki exports, gross official reserves had reached US\$62 million (about 6 months of import cover), up from US\$54 million (about 6 months of import cover) in 1996. Sound monetary and fiscal policies in recent years also contributed to the improved external position.

To stimulate growth, the Government had planned to increase capital expenditure by about 2 percent of GDP which would have led to a shift from a fiscal surplus in 1997/98 to a planned deficit in 1998/99. However, with expenditure being lower than projected, a fiscal surplus of 0.2 percent of GDP was achieved. Although the government has attempted to target additional spending to high priority areas such as education, health, and maintenance of infrastructure, the 1998/99 budget also included lower priority items such as support to public enterprises estimated at 4 percent of GDP.

The overall fiscal balance (including grants) recorded small surpluses in the late 1990s , allowing government deposits at the central bank to rise significantly. As the central bank has no claims on the central government, this situation has enabled the central bank to accommodate strong growth in private sector credit while moderating the pace of broad money growth, and restraining inflation.

A key issue for the Samoan government is to improve the quality of public expenditure by (a) increasing expenditures for basic education and health; (b) spending less on supporting public enterprises by accelerating the privatization program; and (c) downsizing the public service. This would allow a further increase of government deposits and permit increased private sector credit to support growth.

The government's Statement of Economic Strategy 2000-01 reaffirms its commitment to furthering economic reform and emphasizes that reforms must benefit the community as a whole. If the government is able to maintain a stable macroeconomic environment and sustain its reform efforts, over the medium term, barring external shocks, it is possible for the economy to grow at 3-4 percent.

## SOLOMON ISLANDS

<b>Population:</b>	<b>416,200</b>
<b>GDP:</b>	<b>US\$342 million</b>
<b>GDP Per Capita:</b>	<b>US\$820</b>

---

### Background

The ethnic crisis that erupted in mid-1999, led a coup that resulted in the removal of a democratically elected Prime Minister in June 2000. The hostilities involve two armed groups, the Isatabu Freedom Movement (IFM) belonging to the island of Guadalcanal and the Malaitan Eagle Forces (MEF) belonging to the island of Malaita. Tensions between the Guadalcanalese and the Malaitans are not new, but it is only now that it has taken the deadly form of armed conflict.

### Economic Impact of the Ethnic Crisis

*Closure of the main palm oil plantation has already had a large negative impact.* In June 1999, the ethnic crisis forced the closure of the state owned Solomon Islands Palm Limited, as the largely Malaitan labor force fled from Guadalcanal. Earnings from palm oil exports, which provided nearly 14 percent of export earnings in 1998, fell by 33 percent in 1999. No production or export is envisaged in 2000. Given the production cycle, palm oil will be produced only after a minimum of 24 months from the time when operations restart.

*Closure of the gold mine will be a major setback to the economy.* The Isatabu Freedom Movement rebels raided the Australian owned gold mine in June 2000 bringing its operations to a halt. The gold mine which had its first full year of operation in 1999 employed 520 people including about 85 expatriates. In 1999 gold exports provided nearly 25 percent of total export earnings and accounted for about 6 percent of GDP. Excluding gold mining operations Solomon Island's GDP would have fallen by a cumulative 6 percent rather than remaining flat over the last two years. It will take about 6 months for production to restart.

**With the crisis spreading to the western provinces logging and fishing operations are threatened. Logging is the key export activity accounting for about 31 percent of exports in 1999, down from a pre-crisis level of 60 percent in 1996. It contributes about 5-7 percent of GDP and about 25 percent of total tax revenues. Logging in the mid 1990s was however done at a rate that is 2-3 times the sustainable rate and has thus been environmentally damaging. The current rate though lower is still excessive.**

Fish exports provide about a quarter of total export earnings and about 6-7 percent of GDP. Canned tuna which is about 10 percent of total fish exports is sold under preferential trading arrangement to the EU. The key exporter Solomon Taiyo Limited has suspended operations.

*Tourist arrivals fell about 20 percent in 1999 and are headed for a sharper fall in 2000.* While tourism is not as important to the Solomon Islands' economy as in some other Pacific Islands, social unrest has clearly dampened any plans for developing the tourism sector, at least in the medium run.

*Reflecting the widespread disruption of economic activity real GDP is estimated to decline by over 20 percent in 2000, following a contraction of 0.5 percent in 1999.*

*The fiscal impact has been significant* Additional government expenditure in dealing with the crisis, principally the additional costs of the police force and relief measures for the refugees, is estimated at nearly US\$10 million or 3 percent of GDP in 1999. The fiscal deficit for 1999 was about 2.5 percent of GDP. In 2000, with revenues having collapsed but with rising expenditures on security forces, and peace and reconciliation activities the deficit could well be in double digits. The government has announced a mini-budget to bring expenditure down in line with diminished revenues.

*External reserves have been falling since mid-1999.* From a high of US\$61 million in July 1999, they have reached \$39 million in August 2000, providing about 2 months of import cover. Further declines are expected.

*Investor confidence has been badly hit.* Many major investment plans have been cancelled. This is also reflected in the 14 percent decline in imports the bulk of which were investment goods. This is perhaps the most damaging long-term impact of the crisis, as extremely sluggish private investment, both foreign and domestic has been a major constraint on the Solomon Island's economy.

### **Recent Economic Performance (Prior to the Crisis)**

The Solomon Islands experienced an economic crisis in 1997-98. The cumulative effects of many years of poor economic management and weak fiscal discipline (budget deficit averaged about 4.5 percent of GDP during 1995-98) were exacerbated by the East Asian financial crisis. The logging boom of the mid-1990s, boosted export receipts and government revenues, but concealed structural weaknesses in the economy and was environmentally damaging. Prior to the crisis timber exports accounted for about 60 percent of export receipts and provided 25 percent of tax revenues. Consequently, the collapse of the log markets in Japan and Korea following the Asian crisis was a major setback to the economy, with logging activity falling by over 30 percent. Due to financing of large budget deficits, the financial sector had become seriously over-exposed to the government which was unable to service its debt: external and domestic debt arrears mounted (reaching about 12 percent of GDP in 1997) threatening the financial stability of the country. During the crisis while government and financial sector activity was greatly impacted, the impact on GDP was cushioned by a pick up in fish exports, and the construction and ultimate commencement of the operations by the gold mine.

Against this backdrop, a new Government elected in August 1997, embarked on implementing a comprehensive Policy and Structural Reform Program, supported by a World Bank SAC, aimed at (1) restoring and maintaining a sound macroeconomic environment; (2) reform of public finances, including the wider public sector; and (3) review and reform of the public service. The new Government's committed and promising start on its reform agenda was disrupted by the crisis.

Economic activity is estimated to have declined by about -0.5 percent in 1999. Impacting economic growth in 1999 was the downturn in agricultural activity as the ethnic crisis disrupted operations at SIPL, a major state-owned oil palm plantation, causing palm oil and palm kernel output to plummet significantly. Production and exports of copra and cocoa declined, in part due to the ethnic crisis. Fish catch improved, but international fish prices weakened. Recovery in logging activity, albeit at prices below those reached in 1997, was insufficient to offset the unfavorable developments in the other agricultural sub-sectors. Some economic improvement is expected in 2000 as the reform efforts are deepened and government revenues show signs of buoyancy, but success will be conditioned upon progress made on resolving the ethnic crisis.

Inflationary pressures eased in the course of 1999, mainly on account of tight monetary and fiscal policies. Although some price pressures emerged during the third quarter of 1999 as the Honiara main

market experienced food shortages, end-year consumer inflation registered 8 percent, down from 10 percent at end-1998 as import prices declined.

Despite the pursuit of tight financial policies in 1999 and increased current receipts in that year, the overall fiscal deficit worsened. Customs receipts and inland revenues for 1999 exceeded budgetary targets by over 10 percent as the capacity of these revenue-collecting institutions was strengthened through bilateral technical assistance. However, the incurrence of additional security-related expenditures on account of the ethnic crisis, caused the budget deficit to deteriorate to 2.5 percent of GDP from 0.5 percent in 1998.

Turning to the external accounts, total export receipts remained flat in 1999, but a surplus was recorded on the trade account owing to a contraction in imports. By end-1999, the external position had strengthened considerably. Gross official reserves (excluding Stabex funds) reached SI\$251 million, the equivalent of 3.9 months of import cover, as disbursement of the first tranche of the World Bank's Structural Adjustment Credit boosted reserves.

On the structural front, good progress had been made, since formulation of the PSRP, in arresting and reversing the deterioration in government revenue. Measures taken since November 1997 include revocation of all discretionary remissions from customs duties, increase in domestic tax rates, imposition of an import surcharge in 1998 and a strengthening of the coverage and operating procedures of the Customs Division.

Public service wages were frozen at the 1997 level through 1999, and the Government reduced its payroll cost (excluding redundancy payments) by at least 15 percent in real terms in 1999. Part of this reduction resulted from the restructuring of the Government to focus on core functions and enable it to improve service delivery in these areas.

#### SOLOMON ISLANDS: SELECTED ECONOMIC INDICATORS, 1995-98

	1995	1996	1997	1998
<b>Indicator Levels (US\$ million)</b>				
Govt. Revenue & Grants	130.9	140.8	126.5	127.7
Govt. Expenditures	148.5	156.7	144.6	133.5
Govt. Budget Deficit (-)	-17.6	-15.8	-18.1	-5.8
Exports (fob)	168.1	162.4	173.9	140.8
Imports (cif)	154.3	151.2	209.4	146.9
Current Account Balance (after grants)	13.4	12.0	-37.9	16.4
Gross Reserves	15.1	32.2	31.7	47.9
External Debt	95.6	104.2	106.4	118.1
<b>Memo Items (% p.a.)</b>				
Consumer Inflation (period average)	10.7	9.6	10.4	10.3
Terms of Trade (% change)	-11.3	5.1	24.8	-15.5
Reserves (months of imports) a/	0.8	1.6	1.3	2.8

a/ Imports of goods and non factor services

Source: IMF Reports (05/99), Central Bank of Solomon Islands and World Bank DRS.

Notwithstanding the ethnic crisis and resulting setbacks, the policy reform program remained largely on track. Progress was made in implementing key actions such as arrears reduction program on domestic and external debt, the public service reforms, and the enactment of new forestry legislation. The proceeds from the privatization of Solomon Telekom in the amount SBD 48.9 million were largely used to clear arrears, repay Government domestic debt and meet the costs of people displaced by the ethnic crisis. On public service reform, the Government's accounting and budget framework had been improved with time frames established for reconciliation between program ministry and treasury payment records. The efficiency of government expenditure had also been improved with increased budgetary allocations to key areas including operations and maintenance.

## TONGA

**Population: 98,700 (1998)**

**GDP: US\$ 173 million (1998)**

**GNP Per Capita: US\$1,690 (1998)**

---

### **Background**

Over the past decade, Tonga's economy was characterized by low economic growth with real GDP increasing at only 1 percent on an annual average basis. A limited number of primary products, namely squash, vanilla and fish, dominate commercial production and exports, making the economy vulnerable to changes in export market and supply conditions. Manufacturing output is limited and has been shrinking. The economy has a large public sector with state enterprises involved in key commercial activities. Efforts to improve the economy's growth potential through increased private sector and foreign investment activities have met with limited success.

### **Recent Economic Performance.**

Economic growth was negative over the 1995/96-1997/98 period, reflecting, mainly, poor performance of agriculture, particularly root crops, squash and vanilla. Squash and vanilla were impacted by some loss in Tonga's niche market position. The completion phase of large aid-financed projects together with stagnant activity in the tourism sector also contributed to the downturn in economic activity over the period. Attempts to boost economic growth through expansionary macroeconomic policies met with little success, fuelling inflation and eroding reserves. While domestic prices rose by 8 percent in 1997/98, decline in import prices kept overall consumer inflation at 3 percent. Economic activity is estimated to have picked up at a little over 2 percent in 1999, as several public investment projects got under way and *kava* manufacturing and the services sector expanded. Agricultural output, however, continued to be depressed from adverse effects of a natural disaster in December, 1998. Consumer price inflation registered a little over 4 percent in 1999, reflecting the effects of drought on domestic food prices as well as devaluation of the local currency.

The external current account deficit widened to 11 percent of GDP in 1997/98, up from an average of about 3 percent of GDP during the previous two years. This development reflected a contraction in exports and strong growth in imports during the construction phase of large public investment projects. With the completion of these projects, the current account deficit is estimated to have narrowed considerably in 1998/99 to about 4 percent of GDP. By end-1997/98, gross official reserves had declined to US\$16 million (2.3 months of imports), down from a high of US\$24 million (3.8 months of imports) three years earlier as monetary policy remained expansionary. The reserve position is estimated to have strengthened to around 4 months of import cover at end-1998/99 as the current account deficit narrowed in the face of an increasing capital account surplus.

On the fiscal front, an increasing wage bill led to a deteriorating current balance resulting in an overall deficit equivalent to over 4 percent of GDP in 1997/98. In 1998/99, however, some moderation in current spending caused the overall deficit to narrow considerably to an estimated 2 percent of GDP in that year.

**TONGA: SELECTED ECONOMIC INDICATORS, 1994/95-98/99**

	1994/95	1995/96	1996/97	1997/98	1998/99	e/
<b>Indicator Levels (US\$ million)</b>						
GDP (at current prices)	167.3	181.4	182.7	172.8	176.2	
Govt. Revenues	73.4	65.3	73.4	66.3	84.3	
Govt. Expenditures	79.3	63.8	75.5	73.9	87.3	
Govt. Budget Deficit (-)	-5.9	1.5	-2.1	-7.6	-3.0	
Exports (fob)	17.1	12.7	13.2	11.9	11.9	
Imports (fob)	73.8	66.5	59.9	78.9	61.6	
Ext. Current Account	-22.1	-10.7	-1.5	-19.3	-6.9	
Balance (after grants)						
Gross Reserves	23.5	23.7	26.8	15.8	18.0	
Total External Debt	70.1	69.6	61.2	64.7	..	
<b>Macro Balances (% GDP)</b>						
Budget Deficit (-)	-3.5	0.8	-1.2	-4.4	-1.8	
External Current Account	-13.2	-5.9	-0.8	-11.2	-3.9	
Balance						
Total External Debt	41.9	38.4	33.5	37.4	..	
<b>Memo Items (% p.a.)</b>						
GDP growth	4.8	-1.4	-4.4	-1.5	2.2	
Consumer Inflation (%)	0.3	2.8	1.8	2.8	4.4	
Reserves (mo. imports, fob)	3.8	4.3	5.4	2.3	3.5	

Source: IMF Staff Report (09/98), ADB and World Bank.

**Key Issues:**

- **Employment Generation/Private Sector Development.** A fundamental challenge facing Tonga is to generate employment for a growing labor force through private sector development in view of the likely slowdown in emigration options in the future. An equally important challenge is to boost production for exports. Tonga met this challenge successfully in the past when copra and banana export markets were lost and replaced with squash. However, structural deficiencies in the economy are such that there is an urgent need to rationalize the public sector and allow the private sector to grow. To sustain growth over the medium-term, measures are needed to reduce the size of the public sector and create a business environment more conducive to diversified growth led by the private sector. Measures to address the large public sector should include (i) privatization of public enterprises engaged in commercial activities, and (ii) reduction in the size and role of the civil service. Substantial fiscal savings could also be achieved by converting the noncontributory pension scheme for public servants to a pension system that depends on contributions.
- **Public Enterprise Reform/Privatization.** Major reforms to enhance the efficiency of Tonga's large and diverse public enterprise sector will also be necessary. While most state-owned enterprises are not a drain on the budget, they do not generate taxes or dividends of any consequence. Government has been preparing a time-bound action plan to commercialize, corporatize and privatize remaining public enterprises. Progress has also been made towards divesting a public sector fishery company

and rationalizing the Ministry of Marine and Ports. Government needs to move quickly to finalize this effort.

- ***Other Structural Reforms.*** To stimulate private sector growth and provide a more reliable revenue flow, there is the need to remove distortions in the current tax and tariff structures. Dependence on taxation levied on trade needs to be lowered by reducing import tariffs, eliminating port and services tax, and introducing a tax system that is based on sales. The government also needs to reform the cumbersome system of granting business, trade and development licenses and to introduce a simple company registration system. The establishment of a neutral, transparent and nondiscriminatory policy toward foreign direct investment would also improve the country's access to urgently needed capital, technology and management skills.

## VANUATU

<b>Population:</b>	<b>193,200 (1999)</b>
<b>GDP:</b>	<b>US\$214 million (1999)</b>
<b>GDP Per Capita:</b>	<b>US\$1,106 (1999)</b>

---

### Background

Economic performance deteriorated in the mid-to-late 1990s, characterized by declining economic activity and dwindling reserves as political instability and weak governance eroded investor confidence, resulting in sluggish investment and increased private capital outflows. A new Government<sup>3</sup>, which took office in early 1998, sought to arrest deteriorating economic conditions through restoration of credible monetary and exchange rate policies. Since 1997, the Government embarked on a Comprehensive Development Program aimed at improving governance, public sector reform and strengthening growth prospects. The reform program also includes rehabilitation of state-owned financial institutions and introduction of proper supervision of banking institutions. While significant progress has been achieved, much of the program needs to be completed.

### Recent Economic Performance

GDP is estimated to have declined by 2.5% in 1999 following a strong 6% growth in 1998. The 1999 decline came about as unfavorable weather events impacted agricultural output which forms about 25% of GDP. Industrial expansion of over 7% was unable to prevent the downturn in GDP. This was in contrast to 1998 when agricultural production, especially copra and kava, grew by nearly 7%, while industrial activity declined by a similar magnitude. Contributing to the negative growth in 1999 was a decline in public investment due to delays in implementation of major infrastructure projects. Visitor arrivals stagnated as an Air Vanuatu aircraft was damaged and grounded for more than 6 weeks and competition from neighboring islands increased.

Over the 1995-99 period inflationary pressures remained moderate. In 1999 growth in consumer prices slowed to 2.8% from 3.3% in 1998.

After three consecutive years of surplus, the current account recorded a deficit of almost 5% of GDP in 1999 as exports of agricultural commodities and tourism receipts declined. Partially offsetting this decline was an increase in foreign investment in the coconut sector and a drawdown of net foreign assets by commercial banks. The external reserve position deteriorated to US\$ 42.7 million (equivalent of 6.6 months of import cover) at end-1999, down from US\$ 44.3 million at end-1998. The foreign exchange markets have come under pressure in the last two years. Policy miscalculations in early 1998 following riots in Port Vila, as well as exchange rate depreciations in neighboring countries, including Fiji and Solomon Islands, had a negative impact on investor confidence, leading to a loss of reserves. The policy miscalculation related primarily to Government's decision to allow unconditional withdrawal of retirement savings by members of the Vanuatu National Provident Fund following the riots caused by allegations of corruption on the part of prominent government ministers and officials. Political uncertainty has also contributed to exchange market pressures.

---

<sup>3</sup> Since then there has been another change in Government in late-1999 – early-2000.

The fiscal deficit in 1999 was 1.4% of GDP relative to a budgeted level of nearly 6% of GDP. This happened despite a shortfall in budgeted revenues. The chief cause was delay in implementation of infrastructure projects which led to development expenditure being only 40% of the budgeted level. In contrast in 1998, the fiscal deficit widened considerably to about 11 percent of GDP, from less than 1 percent of GDP in 1997, a reflection of increased expenditures on education, health and infrastructure investment as well as several one-off items relating to public sector restructuring, including severance pay and retraining costs for retrenched workers.

**VANUATU: SELECTED ECONOMIC INDICATORS, 1996-99**

	1996	1997	1998	1999
<b>Indicator Levels (US\$ million)</b>				
GDP (at current prices)	191.6	195.8	212.2	213.7
Govt. Revenues (incl. Grants)	51.3	52.7	54.8	56.4
Govt. Expenditures	55.4	54.2	78.3	59.2
Govt. Budget Deficit (-)	-4.0	-1.6	-23.8	-3.0
Exports (fob)	30.2	35.3	33.9	25.3
Imports (fob)	83.8	80.9	76.4	77.2
Current Account Balance (after grants)	8.7	2.2	26.9	-10.5
Gross Reserves	44.0	37.0	44.3	42.7
External Debt	36.0	38.2	53.9	63.9
<b>Macro Balances (% GDP)</b>				
Budget Deficit (-)	-2.1	-0.8	-11.2	-1.4
External Current Account Balance	3.9	1.0	12.5	-4.9
<b>Memo Items (% p.a.)</b>				
GDP growth	0.4	0.6	6.0	-2.5
Consumer Inflation (%)	0.9	2.8	3.3	2.8
Reserves (mo. imports, fob)	6.3	5.5	7.0	6.6
Long-term External Debt	18.8	19.5	25.4	29.9

Source: IMF Staff Reports and World Bank.

Activity in the offshore financial center remained weak in 1999. Much of this weakness may have followed allegations of money laundering levied against some offshore institutions, which led several major international banks to ban U.S. dollar transactions with Vanuatu. Some of these banks have since resumed U.S. dollar transactions with certain institutions. In July 2000 the Reserve Bank issued a notice requiring banks to tighten their internal procedures against money laundering.

Since 1997, the government has been implementing a wide ranging economic reform program with the support of the Asian Development Bank (ADB) and bilateral donors. This Comprehensive Reform Program (CRP) seeks to provide much needed institutional strengthening, accountability, and transparency to the public sector. While significant progress has been achieved, much more needs to be done under the program. However, implementation has slowed since mid-1999, and the release of the second tranche of the ADB loan supporting the CRP has been held up due to delay in meeting some of the conditionalities of the loan.