RESERVE BANK OF FIJI

"Leading Fiji to Economic Success"

PRESENTATION TO FIJI INSTITUTE OF ACCOUNTANTS

THE FUTURE FOR FIJI'S ECONOMY

BY SADA S REDDY
GOVERNOR
RESERVE BANK OF FIJI

Venue: Shangri-La Fijian Resort
Date: 11th June, 2010

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The President of the Fiji Institute of Accountants,

Distinguished Guests,

Ladies & Gentlemen

Good Morning

Thank you for inviting me to speak to you on the **Future for Fiji's economy**.

It goes without saying, ladies and gentlemen, that this is a daunting task for the Governor of a central bank to speak on given that a central bank has a much narrower role in the economy. The role of a central bank first and foremost is to maintain price stability. This in itself is a very challenging role. On top of this, in Fiji's case, we also have an equally important task of ensuring that our balance of payment is sustainable. In other words, we have to ensure that our foreign reserves are kept at adequate levels. I am sure most of you in the audience have been closely following the developments in this regard in Fiji over a number of years but more importantly, over the last three years, with the onset of the global economic and financial crisis.

Ladies and gentlemen, herein lies the reason for me to muster the courage to talk to you today about Fiji’s economy and how I see its future. In some respects, my speech will be a “HARDTALK ON FIJI’S ECONOMY”.

To get a better idea of our future, it is important to look to the past, learn from the lessons and chart a way forward for our country. In doing this, we must also understand how domestic and external factors impact our economy.

Ladies and gentlemen, I will first look at the performance of **the global economy**, particularly at the performance of our trading partner countries.

I will then discuss **the domestic economy**, where I will touch on Fiji’s **macroeconomic performance and challenges**, and what we must do to ensure that we secure a better future for all.

1. Global Economic Conditions and Outlook

Let me begin by summarizing the conditions in the global economy.

According to the International Monetary Fund (IMF), the **global** economy is expected to grow by 4.2 percent this year, following a contraction of 0.6% in 2009. Further growth of 4.3 percent is expected in 2011. The contraction of last year is regarded as the worst since the Great Depression of the 1930s. However, that is now well behind us.

Ladies and gentlemen, except for Australia, all our trading partner economies contracted last year as a result of the global financial crisis. This significantly affected our exports and tourism last year. However, all of these countries are expected to post a modest growth this year and continue this into 2011. This is good news for Fiji, as demand for our exports and tourism should increase. In fact, we are already seeing the effects of these, especially in the tourism industry, where we see a strong recovery in visitor arrivals.

Overall, the global economy has performed better than expected. Among advanced countries, the US economy is doing better than Europe and Japan, while for emerging and developing economies, Asia is driving the recovery.

China and India recorded high growth rates in 2009 and are expected to record similar growth in 2010. China's growth quickened to around 12 percent in the first quarter of this year, the fastest pace in almost three years, driven by stimulus spending and a credit boom.

Having said that, we are also witnessing some countries, especially in the Euro area, experiencing great economic difficulties due to debt service problems arising from running several years of large fiscal deficits. And this was compounded by the global crisis. For this reason, growth in the Euro area will be very uncertain. And these uncertainties are causing significant risks to the international capital markets as well as prospects for growth worldwide. Once again this demonstrates the great risks out there for a sustained global growth.

2. Macroeconomic Performance and Challenges

Ladies and gentlemen, let me now share with you my views on the Fiji economy. This is not going to be an easy task. Why? This is because the current state of our economy is a result not only of recent global and domestic developments but it is due to some very long-term fundamental problems in the economy, going back ten, twenty years. These issues have been compounded by various governance issues both at the national and at organizational and/or industry levels.

For now, let me begin by saying that Fiji has huge potential. I do not think anyone in this audience will disagree with me. We have huge potential in tourism, agriculture, forestry, fishing, sports, ITC etc. Fiji is endowed with rich natural resources such as land, a huge marine environment, and minerals such as gold, copper and other minerals. Fiji's tropical climate and pristine environment is a huge advantage which attracts thousands of tourists to our shores. Fiji's relatively more developed status places it as the financial and trade hub of the South Pacific. Our people are well educated and are a great asset for the progress and development of this nation.

However, despite its richness in resources and huge potential, Fiji's economic situation over the past two decades has been characterised by low economic growth, low investments, and deteriorating balance of payments (BOP).

Why has our growth been so low in the past?

On the one hand, we have been prone to factors out of our control which include natural disasters, adverse global developments such as the recent financial crisis, and the erosion of preferential market access. On the other hand, but within our control, our sluggish growth over the past years has been largely due to our slow progress on economic and structural reforms and declining terms of trade, which are essential to support a balanced economic growth path. As a result of this slow growth, unemployment levels have risen.

Let me now talk about the **performance and challenges** in Fiji’s major sectors, beginning with the overall economy.

Over the past 10 years (2000 – 2009), Fiji’s economy has grown, on average, by just 0.7 percent per year. Looking at past trends, growth rates have been anything but stable during the last decade. Furthermore, economic growth has not been able to match the population growth rate, which means that per capita income growth in Fiji has been slowing over the last two decades.

Our economy has been contracting over the last 3 years. Last year our economy declined by 2.2 percent. However, we expect to see a slight growth of 1.8 percent this year. We expect similar growth rates in 2011 and 2012 of around 1.5 – 2.0 percent.

Ladies and gentlemen, a number of factors have contributed to this 3-year contraction in the economy. Of course, you know the significant impact the global crisis has had on our economy. In addition to that, we had several natural disasters that we had to contend with. We also saw during this period, some of our large projects getting into financial difficulties not because of any domestic issues but because of the difficulties foreign developers had with their financiers offshore. And a number of construction projects were affected in this way which had significant negative effects on the economy.

For this year, we are expecting all sectors to show positive growth except for agriculture & forestry and health & social work sectors, which have projected declines. The agriculture sector was badly hit by Cyclone Tomas, resulting in a downward revision of the overall growth rate for this year.

Next year, growth is also expected to be broad-based, apart from an expected decline in the building and construction sector. The tourism industry is expected to lead the growth assisted by some growth in agriculture.

Let me now move to the performance and challenges of major sectors. I begin with sugar.

Sugar has traditionally been the backbone of Fiji's economy. Apart from its direct benefits, the industry has also had significant benefits to the economy. However, the sugar industry has been plagued with on-going problems for a number of years which we were unable to solve decisively and now these problems are threatening the viability of the industry.

The cane and sugar industry's contribution to real Gross Domestic Product (GDP) has fallen over the years. This industry now contributes only around 3.0 percent to real GDP, a significant fall in contribution when compared to around 11-12 percent contribution 10-15 years ago. Following a peak of around 500,000 tonnes of sugar produced in 1994, production has steadily declined. Last year, sugarcane output was the lowest since 1961. The total sugar output last season was 168,000 tonnes. The significant fall in sugar output last year was due largely to the inefficiency of the sugar mills, which affected sugar production. The sugar industry today faces major challenges. These challenges have to be addressed urgently. Areas of reforms needed in the sugar industry are:

- The FSC's financial problems have to be quickly fixed. Its cashflow situation is dire to say the least.

- Factory problems must be fixed as soon as possible. The mill-upgrade programme under way for the last few years has not delivered to expectations and resulted in huge losses to the millers, farmers and the country as a whole. The FSC had to go into huge debt because of the mill upgrade programme. The substandard work done by the contractors resulted in huge losses last year. It was a disaster to say the least. However, the Board and Management of the FSC are now confident that this year's crushing season should go well;

- The industry needs to put in strategies to increase cane production to two or three times the current production in the next 24 months.

For this they need land and financial support. They have to re-habilitate large number of cane farms which are producing well below industry norms due to neglect of farms and long ratooning rather than planting new cane every three to four years. Productivity must be improved through farm rationalization plus good farm husbandry practices; and

- Large scale commercial cane farming must be explored and developed.

The **garment** industry is another sector where output has fallen over the years. The garment industry in Fiji began in 1988, following the introduction of the tax free schemes in 1987. Over the past ten years, the garment industry contributed on average, 3.4 percent to Fiji's real GDP with garment production peaking in 2001 with production valued at around $188 million.

However, the expiry of trade agreements and strong competition from Asian economies has seen production dwindle. In 2004, the Government withdrew the tax free factory status given to exporters to comply with the WTO requirements (World Trade Organisation). In addition, since 2005, the industry suffered the loss of a quota system for garment exports to the United States, which saw the closure of a major garment manufacturer, which generated approximately 50% of total garment production. Moreover, the implementation of the minimum wage regulation effective from July 2009, has increased the cost of producing garments. On average, the industry contracted by 6.5 percent from 2006 to 2009. These developments have further weakened garment production. Strategies are needed to revive the garment industry as we have seen that Fiji's garment industry is able to produce high quality garments.

What about the **forestry** sector? Over the last 15 years, timber production has fallen notably. In 1995, timber output reached a total of 600,000 cubic meters. To reach similar levels now, we would need to increase output by 150,000 cubic meters per year.

Support for implementing the necessary infrastructure and value-adding must be considered. There is a need to explore and develop strategic partners and work to enhance the capacity of resource owners. Improving road access to indigenous timber resources is also necessary. Certification of our timber is imperative for us to market Fiji timber for premium prices in the world market. In light of these changes, the recent move by the Government to restructure the mahogany industry is very encouraging.

With the promulgation of the Mahogany Industry Development Decree 2010, in March this year, we are hopeful that the opening of access to mahogany timber will generate much needed export earnings for Fiji in time to come. The Decree seeks to ensure that the mahogany industry is able to provide suitable and sustainable returns for the betterment of the economy and the people of Fiji and creating a distinct brand for Fijian Mahogany. It will facilitate a sustainable harvesting and reforestation program with the view to create a liberalised mahogany industry with maximum returns to Fiji.

In addition, with the encouragement from the Government, the Kadavu Provincial Council has allowed the Fiji Pine Limited (FPL) to harvest pine plantations on the island of Kadavu. Kadavu has close to 92,000 cubic metres of pine ready for harvest. The FPL has agreed to harvest, weigh and pay resource owners the value of the trees straight after harvest. The FPL mentioned that for every tree harvested, the Company would re-plant three more. This form of sustainable operations will not only boost foreign income in the short term but will provide a platform for long term gains. We need more of such initiatives in maritime areas which have the right soil and climate for pine and mahogany forests.

Sandalwood also, I believe, has great potential. There should be special efforts made to plant more of these forests.

Let me now turn to the **fishing** industry. Fishing industry output has fallen from potential levels of around 30,000 tonnes reached in 2005 to around 13,000 tonnes in 2009. This can be done if all the stakeholders come together to develop a well articulated plan for the fishing industry to drive growth and increase value of our exports.

How about the **mining** sector? The re-start of the Emperor Gold Mine is very encouraging and the mine is gradually increasing production. We need to raise gold production from the current levels of around 35,000 ounces to our potential of 150,000 ounces per annum. We had achieved these levels in the past. We must explore the possibility of new gold mines and other metals and minerals. Recent information on the Wainivesi gold project in Tailevu shows that mining commenced in quarter three of 2009, but has not progressed well due to power and milling problems. In addition, a bauxite mining project in Nawailevu, Bua is expected to start soon and may bring in much needed foreign exchange. Moreover, copper exploration in Namosi and gold prospecting in Tuvatu are progressing well. The ongoing review of the mining legislation, expected to be completed by end of June this year, is encouraging.

Ladies and gentlemen, **agriculture** holds a great promise for this country. At the recent Agriculture Symposium sponsored by the Government, a number of very good initiatives were agreed to by the various stakeholders who attended the Symposium. We hope these initiatives will be taken on board and timely progress is made.

We are very encouraged by the energy and vigour we have seen recently in the Ministry of Agriculture. In June this year, the first batch of potato seedlings was planted at Navai in Nadarivatu. We have been told that the Flour Mills of Fiji (FMF) will work closely with the farmers that have been earmarked for potato cultivation this year. I understand the FMF currently buys 400,000 kilograms of potatoes annually for producing potato chips and with this new venture, the FMF will be able to lessen the import bill for potatoes. We would like this type of activity for other agricultural and livestock products which we consume in large amounts, but are not self-sufficient in. These include rice, dairy, lamb and beef to name a few.

Our **export** sector has performed below potential over the years. This is attributed to our narrow export base and other structural impediments hindering growth of key potential sectors as I mentioned before.

The average growth of exports over the last 15 years was 4 percent. In 2009, exports fell by around 16.4 percent driven by re-exports, sugar, mineral water, timber garments and coconut oil. However increases in earnings were noted for molasses, sweet biscuits, gold and fish. In 2010 total exports are projected to grow by 9.5 percent. Further growth is envisaged for 2011 and 2012. Some export commodities have shown a consistent growth trend, such as mineral water which has performed exceptionally well over the past decade. This trend needs to be maintained and improved.

Ladies and gentlemen, for us to lift our GDP growth from the current low levels to around 5 percent, we need nearly F$500 to F$600m, additional foreign exchange receipts every year. If not the bop constraint we are facing now will not be solved and our policies cannot be relaxed to allow for easier business conditions.

Why is it that we have this bop constraint? This is because our exports are not keeping pace with our imports.

Imports have continued to escalate. **Fuel imports** are around one third of our total import bill, which is very high for a country of our size. Total imports grew at an average rate of over 6 percent over the past 15 years.

In the next 3 years, we must reduce our fuel imports by $300 million and we need to put strategies in place for that to happen immediately. Some initiatives in place include renewable energy projects as well as encouraging energy conservation practices. Government is offering attractive incentives for renewable energy producers. These include tax-holidays, tax rebates, and lower duties. The Fiji Electricity Authority has a renewable energy development program which aims to provide 90 percent of energy through renewable sources by 2011. Currently, around 60 to 70 percent of FEA's annual electricity output is generated by renewable energy sources. The ongoing Nadarivatu hydro project, when completed, should add 41.7 mega watts of power to the national power grid and produce around 100 million units of electricity on a yearly basis.

On its part, the RBF has recently introduced an Import Substitution Facility to try to assist large scale commercial agricultural businesses to obtain credit at concessional rates of interest. The RBF has also offered a scholarship for Chef Training in Malaysia which should encourage the use of local foods in preparation of hotel menus. This is targeted at reducing our import bill and improving our balance of payments position, as well as encouraging local value adding.

I wish to repeat my message once again to the hotel industry. Please do everything in your power to reduce your consumption of imports. This will go a long way in assisting our bop. I wish to congratulate those hotels which have taken the effort to start growing their own fruits and vegetables. This is very encouraging indeed.

As a result of the trend of declining exports and rising imports, the country has been faced with a deteriorating **trade deficit** and an associated current account deficit which reached a new high recently. The **current account deficit** is estimated at around 9 percent of GDP in

2009. A 9 percent current account deficit is unsustainable. Therefore, we have to do everything in our power to increase export earnings and reduce imports.

Tourism has picked up well following the global downturn. In my view, under the current circumstances, tourism holds the greatest potential to lift Fiji's growth rate.

The Tourism Development Plan has set a target of 1 million visitors by 2016. We should aim to raise visitor arrivals threefold in the next three years. The industry and the Government should develop clear strategies to make this happen.

It is very encouraging to see three new airlines have started operations to Fiji since December 2009, with our own Air Pacific adding Hong Kong to its list of destinations. This has linked Fiji to new markets and should boost future visitor arrivals.

Let me now touch briefly on Government finances. Fiji has experienced chronic **budget deficits** over the past two decades. The proportion of capital expenditure to total Government expenditure has been low. On the other hand, operating expenditure has continued to balloon over the years. In 2009, the proportion of operating expenditure to total Government expenditure was 80 percent. The major driver of rising operating expenditure has been personnel costs. Personnel cost as a percent of operating expenditure had been quite high at 43.5 percent in the 1990-1999 period before rising to 49.5 percent in 2000-2009 period. It is encouraging to see that the Government is taking a number of initiatives to reduce the size of civil service and thus reduce Government's operating expenditure.

As a result of continuous fiscal deficits, **Government debt** has risen over the last two decades. Currently, it stands at around 52 percent of GDP. For Fiji it is estimated that a more sustainable level should be around 45 percent of GDP.

Ladies and gentlemen, fiscal discipline is very critical for sustainable economic growth. If Government continues to run large deficits then not only the debt levels increase, it crowds out the private sector and statutory bodies from borrowing in the domestic market thus putting pressure on interest rates. Chronic fiscal deficits also tend to seriously undermine the bop as has been the case in Fiji for last two decades or so. It is therefore very important that the Government budget deficit is kept in check and reigned in to well below 3 percent in the medium term.

I would suggest that for the future the Government should consider legislating a Fiscal Responsibility Act so that future Governments do not squander Government finances and run irresponsible fiscal policies.

We are pleased to see that despite the enormous pressures on Government revenue in recent years, due to the contracting economy, the Government has kept a reasonably tight reign on Government expenditure. This discipline must continue and more should be done to reign in non-essential expenditures.

Ladies and gentlemen, I wish to highlight the importance of keeping the contingent liabilities of the Government under control. The Government's contingent liabilities have grown substantially over the past several years. Total contingent liabilities of the Government in 2009 were around $1.7 billion, equivalent to about 26.5 percent of GDP. This level of contingent liabilities is extremely high given the weak revenue base of the Government.

This trend must be stopped because what it does is that without the Government really knowing what is really going on in the institutions whose debts Government has guaranteed, suddenly Government is faced with those contingent liabilities coming on to the Government's books and thus, seriously compromising Government's finances.

There were a number of instances in the past where the Government had to step in to bail out because of the guarantees. One very well known case is the National Bank of Fiji (NBF). The collapse of NBF cost the taxpayers of this country around $372 million in total. In more recent times, Government had to convert nearly $40 million of Housing Authority debt to equity because Housing Authority was in no position to meet the debt commitments. There are signs that few other institutions whose debt Government has guaranteed may not be in a position to meet their obligations. This situation must not be allowed to continue.

Government must carry out proper due diligence on statutory corporations which seek Government guarantees. If such organisations are not properly managed and run, Government must put conditions to any guarantees it gives in future so that proper reforms are done to make these institutions financially viable so that they borrow on their own strength in the market.

There is a huge moral hazard problem here. The Boards and Management of these statutory bodies take it for granted that the Government is there to bail them out if they get into difficulties. So, they fail to take timely corrective actions to reform the institutions they are in charge of.

Ladies and gentlemen, a number of people have commented on the US$150 million bond that was issued by the Government in September 2006 due for repayment in September 2011. Their concern, rightly so, is whether we have the capability to repay this loan. I would like to reassure you that the Government and the RBF are actively exploring all possibilities to meet this repayment and Fiji as usual will meet all its foreign obligations whatever it takes.

Ladies and gentlemen, against the economic challenges we face, **what can we do to raise growth?**

Basically, we need to raise investment and exports, improve business conditions, accelerate reforms, raise productivity and diversify the economy.

We need to raise **investment** in Fiji to over 25 percent of GDP from its current level of 13 percent. While we have some local investment, it is not sufficient. Hence we need to attract foreign investment to our shores which entails improving the investor environment. We need to implement policies that will improve the state of our infrastructure, improve productivity levels and lower the cost of business in Fiji.

Improving infrastructure is extremely important to facilitate economic growth. Fiji's infrastructure has suffered from neglect and investment in the past. Government is now taking steps to address infrastructure issues.

Recently, Government successfully secured the Exim Bank (Malaysia) loan of over $40 million for its road upgrading project. In addition, Government has allocated around $60 million for water and sewerage schemes in various districts of which the Suva/Nausori water and sewerage scheme is worth over $30 million alone. Another $9.5 million has been set aside for maintenance of Government properties/buildings, including hospitals, police stations and Government quarters. Government is also actively working with the Chinese Government for loans for improving roads and other infrastructure projects. The loan to Housing Authority by the Chinese Government is very timely to provide much needed low cost housing.

Ladies and gentlemen, reliance on preferential access is now a thing of the past, and we must stand on our own feet. We live in a world of competition where many countries have low cost structures and high productivity. Therefore, unless we raise our productivity and do business in a smarter way, we will not be able to compete successfully against the rest of the world. The main test for our industries will be to improve their productivity and compete on the global scene – there will be no easy way out for them.

In this regard, let me touch on important **reforms** that are critically needed to unlock the growth potential of Fiji. For one reason or the other, these much needed reforms have not been successfully implemented in the past. Government has recently announced a major reform agenda, known as the Economic Reform Programme 2010-2014. These reforms include:

- Good Governance (Constitutional, Parliamentary and Electoral Reforms)
- Civil Service
- Public Sector (FSC, FEA, FHCL, LTA, Govt Shipping, National Road Safety Council, etc.)
- Financial Sector (FNPF)
- Availability and Utilisation of Land
- Price Controls

I am confident that a successful completion of these reforms will create efficiencies, improve productivity and competitiveness and improve business and investor confidence in Fiji. Hopefully with these various reforms, the cost and ease of doing business will greatly improve.

Also, structural reforms are critical to ensuring fiscal sustainability, which will stimulate growth and help reduce poverty levels. Specifically, the Government's plan for right-sizing as well as corporatizing, privatizing or outsourcing non-core service areas is vital to this end. Price liberalization is also critical in ensuring right price signals are given, which will support the process of structural adjustment.

3. Summary

In summary, current economic conditions show a recovering global economy, although at uneven rates amongst advanced economies. Strong growth of the Asian economies will drive the global growth. Against this background, the domestic economy is expected to pick up, albeit weakly.

While foreign reserves are stable and inflation has peaked, concerns and risks remain. On the external front, high oil prices would place downside risks to the inflation outlook and the balance of payments.

Ensuring macroeconomic stability is vital for achieving a sustainable growth target of 5 percent. A consistent set of policies is needed to ensure that the stage is set for the economy to grow sustainably into the future. Essentially, we need supportive fiscal and monetary policies to ensure a stable macroeconomic environment, in which structural adjustment can be successful.

As you are aware, the Reserve Bank continues to implement policy changes to ensure that there is sufficient liquidity in the banking system at all times, and that our foreign reserves and inflation targets are not threatened. This has entailed recent changes in interest rates and the implementation of a new monetary policy framework. However, considering the limited scope that monetary policy has, it is extremely critical that fiscal policy is at the forefront of meeting the challenges I have outlined.

The Government has shown great commitment towards fiscal consolidation; however, it needs to speed up the progress on structural reforms, specifically on key sectors that drive economic growth. With these measures, ladies and gentlemen, I believe we will set in place a framework that would allow the economy to grow on a sustainable basis in the future.

Thank you very much.

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