15 February 2018

By Fax

Dr Jim Yong Kim
President
World Bank
Washington DC 20433 USA

Dear President Kim

Fiscal Sustainability and Climate Resilience Development Policy Loan (P165276)

1. Fiji faces important fiscal and economic challenges arising from frequent natural disasters. Tropical Cyclone Winston, which hit Fiji in 2016, was the most powerful cyclone on record in the Southern Hemisphere, causing damage and losses amounting to F$2.9 billion, nearly a third of GDP. Although Fiji’s main tourism, industrial and commercial centres escaped the worst, growth nevertheless slowed to 0.4 per cent in 2016 compared to a pre-cyclone forecast of close to 5 per cent. In fiscal year 2016/17, as the Government responded to the disaster, the planned deficit expanded to 4.7 per cent of GDP. The reconstruction effort, however, was hampered by more adverse weather, difficulties delivering materials to maritime and remote areas, and a shortage of building materials and skilled tradespersons. As a result, the actual fiscal deficit was around 2.2 per cent of GDP. This year, we are implementing the second and the final year of the post-Winston reconstruction budget, and allocated F$206 billion, or about 2 per cent of GDP, to completing the reconstruction program. At the same time, we are continuing to invest in education, health and infrastructure to enhance productive capacity, and we are increasing spending on social protection, scholarships and student loans to promote equitable and inclusive growth.

2. The Government recognises the need to rebuild fiscal space in order to effectively respond to future shocks. Fiscal space has been squeezed because of recurrent climate-related events. Although Winston was the biggest, smaller events, which may not hit international headlines, nevertheless cost the economy significantly, floods being the most frequent. According to a recently completed Climate Vulnerability Assessment, Fiji loses 5 to 6 per cent of GDP in assets every year due to floods. Although this year’s Budget is rightly focused on completing the post-Winston reconstruction, we are committed to fiscal consolidation to rebuild fiscal buffers.
3. On the revenue side, we are strengthening domestic revenue mobilisation. We have already made significant progress, with the ratio of tax revenue to GDP reaching 27 per cent in the last three years, which is higher than the average for middle-income countries in East Asia. We have achieved this in part by simplifying the tax system to encourage compliance and promoting investment and job creation. In the 2012 Budget, we lowered the corporate tax rate from 28 to 20 per cent and the income tax rate from 31 to 20 per cent; in 2016, we lowered the VAT rate from 15 to 9 per cent while eliminating exemptions from the VAT. At the same time, we introduced an environmental levy on tourism (now known as the environment and climate adaptation levy), raised taxes on alcohol and tobacco and introduced taxes on carbonated and sugary drinks that contribute to non-communicable diseases.

4. On the expenditure side, we are committed to exercising stronger control, while still protecting expenditure that increases potential growth. Specifically, we plan to normalise capital spending from the high levels seen in the last two post-Winston budgets (14 to 16 per cent of the capital spending in these budgets was for reconstruction), impose stronger prioritisation of capital spending, and pursue more opportunities for public-private partnerships. Furthermore, we are committed to not increasing recurrent spending in real terms in the medium term by keeping the growth of its main components, such as wages, salaries, subsidies and transfers, within the rate of inflation. With the combination of these measures, we expect to achieve significant fiscal consolidation, as shown in our published medium term fiscal framework and in the fiscal projections of the IMF and the World Bank. In partnership with the World Bank, we are also embarking on our first Public Expenditure Review, to identify additional opportunities for growth-friendly fiscal consolidation.

5. Achieving fiscal sustainability also requires prudent management of contingent liabilities. One source of such liabilities is our portfolio of state-owned enterprises (SOEs). We have been pursuing SOE reform including through institutional reforms, corporatisation, and selective privatisations, to improve services and reduce costs, as well as to help reduce contingent liabilities. In addition, we are adopting a new framework for monitoring fiscal risks arising from SOEs, which has been developed with technical assistance from PFTAC, the IMF’s technical assistance arm in the Pacific.

6. As elaborated in our recently launched National Development Plan, promoting private sector growth remains a key policy priority. Because we are small, remote from our trading partners and dispersed across many islands, this is a challenge. We remain committed, however, to expanding the opportunities for the private sector, building on the successes of recent reforms. Specifically, recognising that foreign direct investment could play a greater role in diversifying the economy and expanding knowledge-intensive industries, we are making investing across borders easier by modernising our investment law to align it with international conventions and established good practice. Specifically, with technical assistance from the United Nations Commission on International Trade Law (UNCITRAL), we are adopting a version of the UNCITRAL model law on arbitration, which will result in the recognition and enforcement of overseas arbitration awards by Fijian courts. The law also adopts key elements of "best practice" from the laws of other leading pro-arbitration jurisdictions, including Australia, Hong Kong and Singapore. We are also pursuing multi-year reforms to improve the business environment, focusing on
reducing the costs of obtaining building permits, starting a business, paying taxes and trading across borders. This will help encourage local businesses – especially small businesses – to take root, expand and create jobs for our young and well-educated population.

7. As the preceding makes clear, we are committed to ensuring that Fiji’s post-Winston reconstruction is successfully completed, and we are pursuing an ambitious set of reforms to rebuild fiscal space, reduce vulnerability to shocks, and encourage sustainable, private sector-led growth. We welcome the World Bank’s involvement in many of these important reforms and seek your favourable consideration of our request for a development policy loan of US$15 million.

Thank you.

Yours sincerely

[Signature]

Aiyaz Sayed-Khaiyum
Attorney-General and Minister for Economy

cc: Permanent Secretary for Economy